

Chapter 6. Access to Markets, Contracts and Corporate Performance and Responsibilities

Since the 1970s there has been a broad-based and often rapid transformation toward large-scale, vertically integrated systems in U.S. livestock agriculture. The transformation has largely occurred in the poultry industry, is well along in beef cattle feeding and pork production, and is gaining steam in the dairy industry. Worldwide, the International Food and Policy Institute projects that 37 percent of livestock worldwide are now raised using large-scale, industrial husbandry systems (IFPRI, 1999).

The transformation in the U.S. is not an explicit or implicit goal of policy, nor does it respond to any clear-cut expression of social preferences. Yet it is remarkably ubiquitous and seemingly unstoppable. Why?

“One man can take care of two thousand pigs in one barn. Twenty pigs to a stall. A hundred stalls. I can pay him \$25,000 and take home at least 20% on my investment, which is hovering at around \$650,000, including the pigs. **Multiply those barns and you multiply your money. Factory farms are here to stay.**”
Jerry Sorokowski (“McFarms go hog wild,” Dollars and Sense, July-August 1998)

The evolution of animal agriculture on the farm has been driven by opportunities to increase profit margins and income by expanding the scale of operations, cutting or avoiding costs, and through strategies that bypass middlemen and market forces. These changes have typically been accompanied, if not triggered by, new contractual relationships with large, vertically integrated companies that both supply some or all inputs and purchase most or all of a farm’s output.

Vertical integration in the livestock and poultry industries entails ownership or control by a corporation of livestock, feed sources, farm operations, meatpacking plants and retail brands. “Often this involves a contract operation in which the corporation helps a farmer build large ‘confinement feeding’ barns on his property and provides breeding livestock and feed, while the contract farmer provides labor. The farmer is paid a set fee per hog or steer,” according to Dr. Neil Harl, an agricultural economist at Iowa State University. Harl claims, “these practices close family farms and undermine food prices in the face of increasing global competition and lead to ever-larger livestock and poultry factories that endanger the environment.”

Concerns over the loss of competitive markets and the ways that power can corrupt have been expressed for many decades. One of the first and most eloquent statements came in a Presidential letter in 1864 –

“We may congratulate ourselves that this cruel war is nearing its end. It has cost a vast amount of treasure and blood....It has indeed been a trying hour for the Republic; but I see in the near future a crisis approaching that unnerves me and

causes me to tremble for the safety of my country. As a result of the war, corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavor to prolong its reign by working upon the prejudices of the people until all wealth is aggregated in a few hands and the Republic is destroyed. I feel at this moment more anxiety for the safety of my country than ever before, even in the midst of war.”

Abraham Lincoln, letter to William F. Elkins, Nov. 21, 1864. Archer H. Shaw, ed., *The Lincoln Encyclopedia 40* (1950) (Quoted from the Cattlemen’s Legal Fund, < <http://www.nobull.net/legal/>>)

A. Who is Making Money in the Agricultural Sector?

Size, control over markets, and vertical integration has made it possible for companies to dictate product specifications, genetics, feed rations, prices, disease management programs, and when supplies will be purchased. These new tools have dramatically shifted economic clout and the relative performance within animal agriculture industries and their full impact has yet to be realized.

1. Agribusiness Enjoys Solid, in Some Cases, Exceptional Profits

Annual rates of return to shareholder equity among the major integrators and leading food companies almost always exceed 10 percent and often are well above 20 percent. In the *Wall Street Journal’s* recent “Shareholder Scoreboard,” the food products industry group comprised of the 19 leading agribusiness food manufactures delivered a respectable 12.2 percent 10-year average return, and a 20 percent average return in the last year (*Wall Street Journal*, February 26, 2001). Six individual companies – IBP, Quaker Oats, Keebler Foods, Hershey Foods, and ADM – delivered one-year returns between 32 and 50 percent in year 2000.

According to the January 2001 Forbes ranking of America’s 400 best big companies, Coca Cola has delivered a 40.7 percent average return on equity over the last five years, while embattled Campbell Soups has achieved a 34.2 percent return. Fourteen food companies made the list, with average five-year returns to equity averaging close to 20 percent.

Compared to several other industry groups, including for example pharmaceuticals, secondary oil companies, casualty insurance providers, and security brokers, the food industry group’s return to shareholder equity has been modest. But compared to the production agriculture sector, upstream food industry profits are dazzling.

USDA’s “Agricultural Income and Finance” series of annual reports shows that the return on equity for U.S. farmers has averaged just 2.1 percent in the last five years (1995-1999).

Farm household income from farming operations has averaged only 11.2 percent of nonfarm family income, and most farm families earn the majority of their income off the farm. Net farm income per farm operator household has averaged under \$6,000 in the 1990s, while off-farm income has averaged over \$40,000. (Table 31, *Agricultural Outlook*, January-February 2001).

2. Farm-to-Retail Price Spreads Continue to Expand

Consumers spent \$846 billion on food in 1999 (Table 2, *Agricultural Outlook*, January-February 2001). **Contrary to popular mythology, food is not getting less expensive in the United States. Per capita food expenditures in constant 1988 prices (i.e., corrected for inflation) rose from \$1,550 in 1953 to \$2,111 in 1999 – a 36 percent increase.** Most of the growth has occurred since 1967. In 1999 about half of consumer food dollars were spent for food served at home and half for food away from home. In 1953, the split was two-thirds and one-third respectively. American's are spending less of their disposable income on food not because food is getting cheaper, but because average disposable income is rising.

Gross crop and animal farm product income was about \$188 billion that year, and net farm income (profits, including government payments) was \$45 billion. Hence about \$658 billion of the total \$846 billion spent on food did not go to farmers. Studies of the “farm-to-retail price spread” documents what consumers bought with this other 78 percent of their food dollar.

The U.S. food system consists of six basic, increasingly intertwined sectors: farm inputs, farm production, food processing, wholesaling, retailing and food service. Profits have been shifting up the food chain for decades, although the rate of change clearly accelerated in the 1990s. The best profits in recent years have typically been earned by those companies that have gained the most control through vertical integration, mergers and contractual agreements covering the cost of their raw materials and the prices they charge their customers.

Since 1984, the real price of a USDA market basket of food has increased 2.8 percent while the farm value of that food has fallen 35.7 percent, according to the Department's farm-to-market statistics. The USDA publishes remarkably comprehensive data on changes in the farm-to-market retail price spreads and what the consumer food dollar pays for (see references for access to these intriguing USDA statistics).

Data series currently on the USDA-ERS website cover 1999 back through the 1950s and some go back to the 1920s. The retail and farm value of a standard “market basket” of food, and percent share of the retail value paid to farmers, is reported in aggregate and broken into food groups. It shows the farm share of the market basket has declined from 47 percent in 1952 to 21 percent in 1999. For the “Meat products” group, the decline has been from 56 percent in 1967 to 29 percent in 1999. The poultry farmers' share has declined less since 1967, from 49 to 40 percent, reflecting the already significant degree of concentration and consolidation in the industry in the late 1960s.

Even in a food sector with minimal processing – fresh fruit – the share of the retail dollar going to farmers has declined by almost half, falling from 31 percent in 1967 to 17 percent in 1999. Curiously, the farmers' share fell the least in the processed fruits and vegetables sector, falling just from 18 to 17 percent.

Between 1990 and 1999, marketing costs rose 14 percent and accounted for most of the 37 percent increase in consumer food expenditures. The farm value of food purchased dropped 11 percent during this period. ERS breaks this data out by food groups and by several common foods within each food group, like one pound of a broiler chicken, 10 pounds of potatoes, or one pound of lemons.

Detailed USDA reports also break down the marketing bill into its component parts (“Elitzak, et al., “Food Cost Review, 1950-1997,” Agricultural Economic Report No. 780, June 1999). Of the average \$0.79 cents out of the food dollar spent on marketing in 1997 –

- Labor accounted for \$0.38, or about 49 percent of the total marketing bill.
- Packaging cost 8.5 cents, or just under 11 percent.
- Transportation cost 4 cents, or 5 percent.
- Energy, profits (3.5 cents on each dollar), advertising, depreciation, rent, interest, repairs, taxes and other costs accounted for progressively smaller shares.

These data translate into major changes in the relative profitability and economic clout of progressive stages in the food system. What has happened in the beef industry is representative of other sectors. Mike Callicrate, a Kansas beef producer, began 10 years ago a farmer-led movement seeking fuller price discovery in beef markets and more competition (see < <http://www.nobull.net> >). He has a degree in animal science and owns two moderate-size commercial feeding operations in northwest Kansas. According to Callicrate --

“Disadvantaged and increasingly impoverished family farmers and ranchers are shouldering more of the investment and risk while earning less of the profit through the strategic efforts of big corporations....Never before has there been so much money in the food system with so little going to the producer.”

“Today, on every 1200 lb. slaughter steer, the retailer gets \$722; the packer \$160; and the producer \$779. The retailer and packer handle the product for a few days; cattlemen raise the animal, supply the labor and the high-capital inputs like land and breeding stock, and invest 2 or 3 years in each animal. Is this a fair distribution of income? If we look closer, income and expense analysis show retailers are making nearly \$400 per head profit. Even if we figure a less-than-generous break-even price, cattlemen who retain ownership of their cattle through slaughter are losing \$100/head or more.” (<http://www.nobull.net>).

B. The Status of Vertical Integration, Contracting and Concentration

The scope and remarkable pace of corporate merger activity in the agricultural and food industry sector makes it impossible to accurately discuss industry concentration ratios for more than a few weeks. At any one time several mega-mergers are in play, as well as dozens of smaller ones. Accordingly it's a safe bet that already most of the information in this (or any) report on agribusiness concentration is already obsolete and understated.

ConAgra bought 11 different companies or product lines in 1998-1999. The nation's largest meat packer, IBP, bought five companies or food lines in 1999 and in 2000 became a target itself, and will likely be owned by Tyson Foods by the end of 2001.

The trend toward consolidation is "irrefutable and irreversible," according to *Feedstuffs* editor Mr. Rod Smith (*Fedgazette*, January 2000). Smith says the driving force behind consolidation is the need to "become more like the companies you sell to." Once a company reaches a certain size, "You don't 'buy' something from a processor. You tell him what to bring you at a price you're willing to pay." This dynamic then forces consolidation down the food chain from packers and other food manufactures to feedlots to family farms, each trying to attain efficiencies through scale to "keep up with the [next-level] processor, who's trying to keep up with the retailer," according to Smith.

1. Brief Overview of Agribusiness Concentration by Sector

In general, economists expect competition to begin suffering when the top four firms in an industry control 40 percent of the market (referred to as a CR-4, or four-firm concentration ratio). It's hard to find any sector in the agricultural inputs and meat and poultry processing industries in which CR-4 ratios do not exceed 40 percent by a wide margin. Several specific markets – meatpacking, corn and soybean herbicides, for example – have four-firm concentration ratios over 80 percent. A brief overview of the degree of concentration in several industries follows.

Farming

Three-quarters of the nation's farms collectively receive less than 7 percent of the market value of agricultural products sold.

Seven percent of farms receive nearly 75 percent of the value of products sold.

Animal Production

Twenty beef feedlots produce about half of the cattle in the U.S., virtually all of which are either owned by meat packers or are under contract to them (Heffernan, 1999).

Beef feedlots with over 32,000 animals controlled almost 36 percent of cattle feeding in 2000 and their share is growing about 2 percent every year. Lots feeding less

than 1,000 head accounted for 17.9 percent of total beef on feed in 2000, down from 24.3 percent in 1995. ("Changes in the U.S. Feedlot Industry: 1994-1999," NAHMS, APHIS, August 2000).

The 50 largest swine operations market on the order of two-thirds of the nation's pork production. Several major mergers have recently been completed or are in process; within a few years the top 10 operations could control two-thirds of the hogs produced.

Ninety percent of all commercially produced turkeys worldwide come from three breeding flocks (Heffernan, 1999).

Poultry and Meat Packing

The top four integrators in each industry now control over 80 percent of American beef packing, about 75 percent of hog and sheep slaughter, and half of all chicken production. The purchase of IBP by Tyson Foods, if completed, will raise further the beef and pork percentages.

Captive beef supplies in November 2000 reached 100 percent of animals moving through lots in Kansas and Texas, according to the Cattlemen's Legal Fund.

Breakfast Cereals

Four companies control 89 percent of the market. The average annual return to equity from 1993 to 1997 for these companies was about 25 percent.

Food Retail

In 1997 the five leading grocery retailers held a combined 24 percent national market share. By 2000, mergers had increased the share to 42 percent.

The degree of market concentration in major metropolitan markets is far higher, since most chains specialize in certain regions. Average metropolitan area CR-4s are now on the order of 75 percent, giving retailers remarkable clout both in dealing with food manufacturers and consumers.

The biggest merger was the purchase of the Fred Meyer chain by the industry leader, Kroger Co. In the last three years Kroger Co. has bought five other chains, including two Fred Meyer acquisitions just before the Kroger Co. merger.

One in \$10.00 consumer food dollars for groceries is now spent in a Kroger owned store.

Wal-Mart, the number two grocery retailer in the nation, was not even in the business in 1993 but is soon expected to become the nation's leading grocery retailer. Wal-Mart's success depends to a large degree on novel business relationships with

suppliers that establish, especially in the meat case, the retail industry's most direct route from farm to consumers for low-cost, higher-volume purchases.

Seeds

Four large firms control about 70 percent of the seed corn market and about half the soybean seed market. The public sector role and capacity in seed breeding and distribution is rapidly eroding in the U.S. and intellectual property rights, coupled with biotechnology, are underwriting a profound transformation in the economics of the seed industry.

The world's largest vegetable seed producer controls over 40 percent of the global market.

Pesticides

Six global firms account for over 70 percent of pesticide sales and another half-dozen are major players. One of the dominant firms – Aventis – has announced its plans to sell its agricultural chemicals and seed division. The company that buys or merges with it will almost certainly be among the top three industry leaders.

In many distinct markets – pesticides marketed to control a given class of pests on a given crop in a given region – two-firm concentration ratios exceed 80 percent.

2. Food Chain Clusters

In early 1999 the term “food chain clusters” was placed on the policy radar screen by a widely read report commissioned by the National Farmers Union (NFU). Dr. William Heffernan's report is entitled “Consolidation in the Food and Agriculture System.” In January 2001, Heffernan and three colleagues completed a second NFU white paper, this time on consolidation in the food retailing and dairy sectors.

Mega-mergers have played a decisive role in creating the hub of some of the first food chain clusters and will continue to create ever-bigger hubs. In 1998, Continental Grain and Premium Standard Farms merged. The combined company became the third largest hog producer in the nation – Continental Grain is already the largest beef feedlot operator and ranks second in grain trading. Then Cargill purchased Continental Grain in 1999, greatly expanding the reach of the “Cargill/Monsanto” cluster described in Heffernan's 1999 paper.

A private equity fund controlled by Donaldson, Lufkin & Jenrette Inc. was trying to buy IBP in mid-2000, the number one meat packer, for \$2.4 billion. One of the players, ADM, would have doubled its stake in IBP to 22 percent, greatly increasing its leverage in accessing captive beef and pork supplies. In January of 2001, Tyson Foods Inc. tendered 74 percent of IBP's stock, or 78.3 million shares (*Feedstuffs*, January 2001), in a

merger attempt that remains ongoing. If this deal is completed, Tyson Foods will emerge as the dominant company in the meat industry's major food chain cluster.

The emergence of agribusiness industry clusters has taken control over supplies and prices to a new level and is marginalizing the role for open markets and competition. In the process food chain clusters are squeezing out independent producers and smaller food processing companies. According to Heffernan's 1999 report –

“Within this emerging [food chain cluster] system, there will be no markets and thus no ‘price discovery’ from the gene, fertilizer processing and chemical production to the supermarket shelf. The only time the public will ever know the ‘price’ of animal protein is when it arrives in the meat case.”

“In a food chain cluster, the food product is passed along from stage to stage, but ownership never changes and neither does the location of decision-making.”

A “food chain cluster” is a set of companies, many themselves vertically integrated, that have established multiple alliances and joint ventures that span the farm inputs industries, feed manufacturing, farm production, meat and poultry processing, food manufacturing, and the sale of consumer food products in stores or via restaurants and food service businesses. Heffernan predicts that four or five clusters will emerge as dominant and account for the majority of food sales in the U.S.

The number of industry clusters that will emerge will be heavily influenced by the number of firms that have control over intellectual property rights (IPRs), especially seeds, genes, and methods of genetic improvement (whether based upon routine methods of varietal and animal improvement or biotechnologies). Clusters that control IPRs will, in turn, govern which companies and farms will be given access to proprietary inputs and identity-preserved market outlets on the most favorable terms.

Others envision perhaps six transnational clusters emerging with a share of the global market for food roughly equal to the share controlled by the top four clusters in any given country. Even if these predictions prove overstated, the economic implications of even today's levels of concentration are profound and national and international laws, treaties, and institutions are ill prepared to deal with them.

Food chain clusters and the strongest companies within them benefit from many new opportunities to cut and move costs, risks and liability, profits, and tax obligations around the system. They have or are often granted preferential access to credit and necessary infrastructure (roads, water supplies), and innumerable opportunities to access labor, raw materials, and energy cheaper than smaller, independent producers and companies. No wonder the bottom line results for integrators and agribusiness have been stellar while the consequences for farmers bordered on disastrous.

Heffernan points out that it is increasingly difficult for scientists and policy-makers to collect data on agreements, mergers, and other deals because trade journals

have come under pressure to not publish some of this information and government agencies often say that to reveal the proportion of a market controlled by a single firm in such a concentrated market would be revealing proprietary information. In the next section we review some of the information that has emerged. While far from a complete accounting, the information conveys the basic strategies the integrators exploit and the magnitude of the resulting economic advantages they now owe their success to.

C. Vertical Integration Rewrites the Economics of Animal Production

In general, integrators and food chain clusters have thrived because they have found ways to move profits and returns to equity upstream from the farm, while pushing environmental and capital costs and risks down the system to farmers, contractors, rural neighbors and communities, or to the public at large.

These shifts, and hence the shifting profitability of large versus moderate-scale livestock and poultry enterprises, have been enabled by a host of programs and policies. Here we identify the major enabling policies and reforms that would help level the economic playing field.

1. Contracting

Over 95 percent of broilers are now raised under contracts issued by fewer than 40 firms. Perhaps two-thirds of beef moving through feedlots do so under contract. The percentage of pigs sold under contract is rising rapidly and may catch up to the beef and even poultry industries in the absence of public policy interventions.

In general, contracts negotiated among equals, or parties with choices, are more likely to be fair and equitable. This is clearly not the case when integrators negotiate contracts with most independent farmers. This is also why integrators seek out regions on the margins of the agricultural economy, where many people have enough land to support a confinement operation, but not a viable farm. Counties also well-removed from other economic options and sparsely populated are even more inviting since they tend to have an ample supply of people living at or near poverty levels, fewer regulations, and local governments eager for any kind of new economic activity to shore up local tax bases.

Contracts typically specify all aspects of management and typically set a fixed price for each bird or animal raised. Inputs are provided, as are detailed animal husbandry system, disease prevention, and product specifications. The farm operator provides space, water, labor, and is responsible for storing and managing manure.

The contract producer gets paid only for birds or animals delivered at proper weight and which meet the contractor's quality specifications. Contract producers are docked when animal health management performance standards are not met or when carcass quality or uniformity slips below standards set forth in the contract. Bonuses are

often linked to exceeding contract specifications and for delivery of animals quicker, with less feed and death loss, than expected.

Carefully worded language is typically inserted to insulate the contractor/integrator from liability for environmental problems, occupational health hazards, and health risks to family members and nearby neighbors. While the language comes in many forms, it typically shields the contractor by vesting responsibility for adverse consequences on the contract producer when he or she fails to follow required protocols and safety precautions.

There is, of course, a convenient and consequential catch-22 built into such language. The fine print states the contractor is responsible for adhering to all required environmental and human health precautions necessary to avoid violation of environmental permit requirements or harm to the contractor, his or her family, or neighbors. Such contract language asserts, in one way or another, that “required precautions” are any and all that prove to be necessary, under whatever circumstances that arise.

Such contract provisions rest upon a highly questionable assumption – that the safety precautions and contractor responsibilities spelled out in contracts are adequate and effective in avoiding dangerous exposures and circumstances. In court, contractors can and do point to the absence of problems on many other similar operations and assert that the problems alleged to have arisen on a given farm must therefore find their origin in some failing on the part of the contractor, not in the design of the system or as a result of some unforeseen disease or environmental problem beyond the control of the contract producer. Proving otherwise imposes a significant legal burden which few contract producers have tried to overcome and fewer still have accomplished.

2. Product Pricing

The ability of integrators to dictate pricing outside open, competitive markets is widely regarded as one of their major advantages. *Hogs Today* magazine has reported an example. In 1993 North Carolina packing facilities were paying \$51.00 per hundredweight for corporate owned hogs compared to \$39.00 to independent producers (*Dollars and Sense*, July-August 1998). Cattle producers have also alleged differential pricing and cite the loss of buyers as a major cause for slipping average prices.

Nonetheless, a senior economist with the USDA’s Economic Research Service is quoted in the January 2000 *Fedgazette* as saying “To the extent people are blaming low prices on concentration, they’re looking for a bogeyman.” While the ERS may have found no clear evidence of an overall, ubiquitous downward bias in prices, government economists, like farmers, lack access to data on what market prices would be if competition were still the norm among many willing buyers and sellers.

And if integrators are in fact responsive to market signals and conditions, why did pork product prices in the supermarket not decline with the collapse of farm-level hog prices in 1998-1999?

3. Control over Farm Management Decision-making

Integrators do not have to advertise or invest in marketing infrastructure to sell their inputs. Their market is locked in by contract specifications.

They lower costs of production by delivering all inputs in volume and as needed, and in ways that maximize the chances that feed ingredients, animal drugs and supplements, and other inputs will be used at the proper time and most effectively. And since contract producers must sell to the integrator at an agreed upon price, they lose the chance to take advantage of more lucrative marketing outlets or higher prices.

4. Risk and Liability

Integrators are able to shield themselves from several sources of liability through their relationship and reliance on contract producers. Who pays for the costs of cleaning up large-scale manure spills, as well as common problems stemming from manure management, has emerged as a major issue in many States, the EPA's "Concentrated Animal Farming Operation" (CAFO) rule, and recently in Congress.

Several States have passed laws or promulgated regulations making integrators jointly liable for pollution at their contract grower sites. Significantly, Texas has not yet done so and environmental regulation of CAFO's lags behind other CAFO-intensive states.

New CAFO rules would require both the parent corporation and the contract producer to sign the facility permits. This would impose an obligation on the corporation to provide financial assistance to its contract farmers for installation of pollution-control technology, and would also make the integrator at least partially liable for cleanup costs and other problems. Integrators have strongly opposed this change, especially those in the poultry industry, arguing that manure management has traditionally been the obligation of contract producers and fully under their control.

These inherent advantages enjoyed by integrators have led Neil Hamilton, Director of the Agriculture Law Center at Drake University, to warn farmers that they should be wary of the lure of contracting. Reasons why are outlined in his 1994 book, *Why Own the Farm When You Can Own the Farmer (and the Crop)?* Hamilton stresses that contracts are never written for the benefit of contract producers and farmers. "The bottom line is that farmers bear all the risks and corporations reap most of the benefits."

D. Leveling the Playing Field

The crash of hog prices in 1998-1999 drove thousands of family hog producers out of the business and served as a wake-up call throughout the farm sector. Throughout 1999 and 2000, a populist movement gained momentum, culminating in the “Rally for Rural America” in Washington, D.C. – the largest farm demonstration in 20 years (*Successful Farming*, May-June 2000).

The rally urged Congress and the Clinton Administration to move on three fronts – rewriting the 1996 farm bill, enforcing antitrust law, and ensuring fair and competitive livestock markets. The day before the rally, the Secretary of Agriculture, Dan Glickman told many of the rally organizers “The biggest problem in American agriculture today is the declining share of the food dollar received by farmers.” In his remaining months in office, Secretary Glickman made very little progress on these issues, earning considerable criticism, especially from livestock organizations working on pricing issues.

In her confirmation hearing, newly designated Secretary of Agriculture Ann Veneman told the Senate Committee on Agriculture that during her visits with lawmakers prior to the hearing –

“Probably no other issue came up so consistently. I know its on people’s minds....We need to help our farmers market up the food chain so they get more value from what they grow.”

Iowa State University agricultural economist Neil Harl has spoken out often and forcefully for the need to stop the erosion in open markets and competition in agriculture. His suggestions for change focus on three areas (*Successful Farming*, Mid-February 2000) –

- Move enforcement of the Packer’s and Stockyard Act out of USDA to a newly created bureau in the Justice Department, Bureau of Competition in Agriculture and Agribusiness, and expand the P&S Act to all farm products, not just livestock.
- Spend more money on public seed research and germplasm preservation at land-grant universities to assure that adequate germplasm remains in public control so that farmers will have options other than those offered by transnational seed-biotech-pesticide companies.
- Farmers need to form strong co-ops or alliances to bargain for higher prices for products and lower prices for inputs.

Many initiatives and actions will be necessary to just slow the trend toward consolidation and vertical integration. It will take a near-revolution in policy to reverse it. Some of the essential ingredients of change are outlined below, including what must happen to build the political will to act.

1. Restoring Competitive Markets

In 1919 five meatpackers controlled 60 percent of the market, leading Congress to pass the Packers and Stockyard Act of 1921. This landmark legislation mandated that all sellers be treated equally and fairly. It provided protection against price discrimination and stipulated, “all prices shall be recorded on a daily basis, including true ownership of business.”

In 1998 Congress passed legislation requiring mandatory price reporting in animal product industries, a major victory for those working to restore competition in the livestock industry. But when the implementing regulations were released by USDA in 2000, they included a “3-60” rule. This provision would prohibit USDA from reporting pricing data in any geographic region that does not have at least three companies bidding and no company buying more than 60 percent of the animals in a particular species. According to the Organization for Competitive Markets, the “3-60” rule “guts Mandatory Price Reporting” because only a handful of states meet the “3-60” rule (OCM Newsletter, February 2001).

The “3-60” rule was proposed by USDA to protect the proprietary business information of meatpackers and processors. It reflects a deep-set bias across many federal laws in favor of the rights of corporations, which aggressively try to keep “confidential business information” (CBI) out of the public’s hands. Sales, prices, and profits, especially by product or product line, are among the most religiously guarded CBI.

Keeping sale, price and profit data secret obviously thwarts public involvement in debates over concentration and predatory pricing behavior. It also undermines many agency programs and laws and can cripple the public’s opportunity to contribute to enforcement efforts. **At times CBI is granted constitutional rights beyond those granted to people. Protecting it whenever industry asks places the interests of corporations above those of its customers and the public at large.** The willingness in USDA to keep information from the public’s eye also often undermines the ability of scientists and policy analysts to sort out how corporate behavior impacts the public good. By controlling access to information corporations control what questions can be answered, and in this way contain public debate and make it easier to contradict “anecdotal” evidence of harm.

The sole purpose of the legislation calling for Mandatory Price Reporting was to bring pricing data – always regarded as CBI – into the public arena. The “3-60” rule undermines the very purpose of the legislation and is a good example of an executive branch agency undermining Congress by crafting implementing rules that seem to ignore the clear intent of the Congress. Whether Congress will do anything about this exercise of Executive discretion remains to be seen.

In January 2001, Senator Tom Daschle introduced S. 20, the “Securing a Future for Independent Agriculture Act of 2001.” Its core provisions read much like the original

Packers and Stockyard Act. It tries to tighten up several parts of the Packers and Stockyard Act in an attempt to assure open markets, fair pricing, and a lack of intimidation in the marketplace. Senator Daschle's comprehensive bill also attempts to bring animals under all sorts of contracting arrangements under the same basic provisions. It imposes several new reporting requirements and greatly increases penalties and the likelihood of meaningful enforcement – a major problem with current law. A major effort will no doubt be made to include its major provisions in the next farm bill, but the effort will face strong and well-financed opposition.

While Senator Daschle and allies might not gain passage of comprehensive legislation, they can direct the USDA's Office of Inspector General and the General Accounting Office to carry out studies – several are underway. It can direct USDA to make available all pricing data collected to various study commissions and analysts. Additional public funding can be appropriated to the Federal Trade Commission to augment its staff and databases across the food and fiber industry.

These efforts will incrementally shed light on market structure and performance. If current trends continue, even if only for a few years, the degree of disparity in profitability across the food system, and the despair in rural America in the wake of these trends, may pass a threshold and reach critical mass. But those wanting to reverse these trends face a practical problem -- as companies get bigger and more profitable, they can afford to spend more and more to influence public opinion and control the policy reform process.

2. Fairness in Contracting

Sen. Tim Johnson (D-SD) has introduced legislation to ban packer ownership of livestock. The "Farmers and Ranchers Fair Competition Act of 2000" called for much greater scrutiny of mergers and their effect on small independent producers and would impose stiff fines for a variety of "anti-competitive" practices. Many of its provisions were similar, but more aggressive, than those in pro-competition bills by Senators Grassley and Daschle.

The lack of action at the federal level to bring a greater measure of fairness to contracting has created a vacuum some states have begun to fill. Several states now have anti-corporate farming laws. A 1998 referendum in South Dakota endorsed a law preventing corporate agribusiness from owning land or livestock in the state. The meatpackers trade association, the American Meat Institute (AMI), is challenging the law. AMI is also fighting a law passed in Missouri in 1999 that prohibits "discriminatory" pricing, preventing meat packers from giving preferential contracts to large producers over small ones. More states are bound to follow Missouri's lead if integrators continue to abuse their market power.

Again, information is likely to prove the essential ingredient to overcome agribusiness opposition for serious reforms. A coalition of Senators should assure that the FY 2002 agricultural appropriations bill includes a provision directing the USDA's

Office of Inspector General (OIG) to conduct a statistically sound survey of the pricing of hogs, cattle, and poultry marketed in several major production regions. The study should compare the prices received for animals under contract, owned by feeders and/or packers, other forms of “captive supplies,” and animals sold on the open market. The USDA OIG is the best agency to carry this out because of its investigatory powers, knowledge and access to USDA data and experts, and reputation for independence and candor.

3. Enforcement of Antitrust Laws

Currently, agriculture antitrust enforcement is split in two parts: under 1921 Packers and Stockyards Act, the USDA has authority to ensure fair trade primarily in the livestock industry, regulating sales and prices. Just a handful (*four* according to the OCM’s important report “A Food and Agriculture Policy for the 21st Century”) of trial attorneys are on the staff of the USDA’s Grain Inspection and Packer and Stockyards Administration to monitor the thousands of facilities and mergers occurring every year.

The Federal Trade Commission and the Department of Justice oversee mergers and acquisitions of companies. They too are grossly understaffed, view agriculture as not a pressing priority, and just recently agreed to add a single new specialist to compile information on food sector industry structure and performance.

Most agricultural input and processing industries already far exceed the level of concentration that is supposed to trigger concern over concentration. Grass-roots pressure for change is growing. In the summer of 2000, Sen. Paul Wellstone (D- Minn.) proposed an 18-month moratorium on further agribusiness mergers. Senator Wellstone had expected 40 votes, but the food industry lobbied heavily against it and, amazingly, so did the American Farm Bureau Federation. The Wellstone bill was decisively defeated in the Senate, but did receive the vote of Republican Senator Charles Grassley.

Senator Tim Johnson introduced a bill to ban packer ownership of livestock. This legislation would, among other things, shift the anti-trust focus from a merger’s impact on consumers to its effects on family farms. In March 2000, Senator Grassley proposed “The Agricultural Competition Enhancement Act.” The bill enjoyed bipartisan support and would grant USDA the power to challenge mergers in federal court if they would cause substantial harm to farmers. The bill would also expand USDA’s ability to investigate and bring enforcement action against food companies that engage in anticompetitive practices. It also would require the Secretary of Agriculture to prepare a report on a proposed agribusiness merger and an economic analysis of whether the merger would substantially lessen competition or tend to create a monopoly.

Minority Leader Tom Daschle of South Dakota sponsored a separate bill similar to Grassley’s but broader in scope – companies would be required to file merger plans with the USDA, which would then issue recommendations to the Department of Justice. USDA would also be given the authority to fine companies that engage in anticompetitive practices. Fines would be distributed among injured farmers – a noble

idea but one without precedent in an area of law and policy that must remain exceedingly consistent across all industries in order to meet legal challenges.

Many farm groups, led by the National Farmers Union, supported both proposals, but American Farm Bureau Federation worked behind the scenes to kill these bills. Senate Agriculture Committee Chairman, Richard Lugar (R-Ind.) opposes both bills. S. 20, Senator Daschle's recent fairness to farmers bill contains many of the provisions proposed in the bill's introduced in 2000.

The Search Continues for a Viable Vehicle for Reform

Sound and constructive proposals have been drafted into legislation, especially the hard-hitting Grassley bill. More legislative proposals are sure to follow and the debate on the need for modest to draconian measures will continue. In the current political climate the odds of passing such new legislation, especially a moratorium bill, are slim. However, much more effort can and should be invested in documenting the recent impact of changes in industry structure and performance.

There should be no need for legislation to compel the USDA to assure that more resources are invested in independent analyses of the impacts of mergers, vertical integration, and the emergence of food chain clusters. A new \$5 million program area annually within the USDA's National Research Initiative's competitive grant program would finance a several-fold increase in solid academic work on industry structure and performance. Answers to lingering questions would emerge much more quickly and decisively if project teams were supported in their analytical efforts by easy access to industry sales, pricing, and profits data through a coordinated USDA "Agribusiness Market Performance and Pricing Information Initiative."

Another factor must be confronted. The full capacity of a newly formed integrator or food chain cluster to amass wealth very quickly, weakening smaller competitors and farmers in the process, is largely unknown but the gyrations in returns to shareholder equity in recent years are ominous. Just a few unseasonably good years across a food chain cluster, especially in conjunction with some unexpected shock in prices because of bad weather or some development in the international arena, can increase profits by several hundred million to a few billion over just a few years. Such windfalls not only weaken the competition, they also create the cash reserves to finish the job of locking in an even greater share of future market sales and profits. Thousands of independent hog producers did not survive the last collapse of hog prices and if another downturn were to occur in the next few years, very few would likely remain. Drawing on their superior access to capital, integrators would fill the void as the market recovers.

Accordingly, it is critically important now for the economic performance and behavior of rapidly restructuring industries to be monitored more rigorously and in real time, so that corrective actions can be implemented as soon as evidence emerges of predatory behavior harming farmers, cutting off technological options, or restricting consumer choice.

Need to Focus on Distinct Markets

The crops and products being produced and sold in a given region define agricultural markets. There are also regional markets for the inputs and services needed as food moves from the producer to the consumer –

- A plethora of choices in corn seed varieties adapted to the soils of central Indiana is of little solace to farmers 400 miles to the south or north who might have just six varieties to choose from for a given soil type, five of them genetically engineered. (This is far from a hypothetical scenario, see "Prevalence of Genetically Modified Traits in the Corn and Soybean Varieties Offered to Midwestern Farmers in the Crop Year 2000", Ag BioTech InfoNet Technical Paper #3, <http://www.biotech-info.net/technical_paper3.pdf>).
- The pork market in Alabama is not significantly impacted by a new processing plant in North Dakota.
- Wheat herbicides sold in the High Plains, a major wheat-producing region, may have little to do with the supply of herbicides offered to wheat growers in the Southeast.

In most cases, the Federal Trade Commission (FTC) has focused on national market concentration data, and has missed the much higher levels of concentration and monopolistic pricing behavior in certain regions and for certain products or services. In the food retail sector, the national four-firm concentration ratio is on the order of 40 percent but exceeds 80 percent in many major metropolitan markets.

For this reason, the USDA should work with the FTC and Department of Justice to define geographically distinct markets in which concentration ratios and pricing behaviors should be assessed, separate from national data and impacts. These regions will vary by sector and crop, but will provide a much more accurate appraisal of the consequences of concentration.

4. Accountability for Environmental and Food Safety Performance

Most of the focus among farm groups, the FTC, and Congress has been on the impacts of concentration on pricing and the distribution of profits. But scale and vertical integration impact other important dimensions of industry performance, in particular impacts on food safety, public health, and the environment, especially water quality.

Chapter 4 describes steps needed to do better job managing manure – an asset now treated as a waste on mega-livestock farms. Chapter 5 outlines the growing evidence linking the scale and intensity of animal agriculture to animal health and disease status, the need for and use of drugs, especially antibiotics, and human health consequences and medical costs.

The economic impacts of illness traced, at least in part, to how animals are raised and animal products processed are enormous – certainly over \$40 billion annually. No one knows what portion of these costs can be avoided through use of best available technology and preventive strategies on the farm and throughout the food system. But several USDA economic analyses suggest that a 50 percent reduction is readily achievable, especially when preventive measures on the farm are coupled with state-of-the-art HACCP protocols in packinghouses. But what if a merger makes it less likely that such steps will be taken?

The Congress needs to direct the USDA and FTC to broaden the scope of consequences assessed when considering the impacts of manor food industry mergers. Even if food safety and environmental impacts are not grounds for stopping a proposed merger, the FTC can highlight possible adverse consequences and call upon other government agencies to intensify monitoring of possible adverse consequences. The FTC can require merging companies to agree to participate in government survey and monitoring activities as a condition of approval.

In all likelihood, the trend toward concentration will continue and all sectors of the food industry will be impacted, since concentration at one level in the system seems to soon trigger defensive actions at other levels in an attempt to match market clout with market clout.

If this proves the case, greater attention must be focused on the role of government in monitoring and better controlling the performance of integrators and those companies at the hub of food chain clusters. New policy tools and enforcement mechanisms will likely be needed.

In the absence of more effective policies and enforcement tools, citizens, communities, and companies who feel they have been adversely impacted will turn to the courts for relief, a trend that is already on the upswing. Litigation imposes its own costs on society. It tends to divide people into camps and forces people to chose among artificially constrained solutions. While there are often some big losers and big winners, the process typically leaves society less able to cooperatively solve problems and the outcomes too often miss the real problems and the easy solutions. But eventually the scale of liability judgments may well bring about changes in how animals are raised, processed and sold in America.

Other more direct approaches would achieve much more constructive change sooner and at lower cost, yet for this to happen the Congress and federal and state government agencies must confront the new realities of today's industrial food system. This will take new tools designed for new tasks and a broadened notion of both progress and corporate responsibility.