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ECONOMIC CHALLENGES AND OPPORTUNITIES FACING AMERICAN AGRICULTURAL PRODUCERS TODAY

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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CONTENTS

Page

HEARING(S):

Economic Challenges and Opportunities Facing American Agricultural Producers Today 1

Wednesday, April 18, 2007

STATEMENTS PRESENTED BY SENATORS

Harkin, Hon. Tom, a U.S. Senator from Iowa, Chairman, Committee on Agriculture, Nutrition, and Forestry 1
Chambliss, Hon. Saxby, a U.S. Senator from Georgia 2

Panel I

Carstensen, Peter C., Professor of Law, University of Wisconsin Law School, Madison, Wisconsin 4
Hamilton, Scott, Poultry Grower, Phil Campbell, Alabama 12
Hayes, Lynn A., Farmers' Legal Action Group (FLAG), Inc., St. Paul, Minnesota 6
Muth, Mary K., Director, Food and Agricultural Policy Research Program, RTI International, Research Triangle Park, North Carolina 8
Schmidt, Tim, Pork Producer, Hawarden, Iowa 10

Panel II

Johnson, Burdell, President, American Sheep Industry Association, Tuttle, North Dakota 38
Nelson, Eric, Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (R-Calf USA), Moville, Iowa 30
Philippi, Joy, National Pork Producers Council, Bruning, Nebraska 34
Queen, John M., President, National Cattlemen's Beef Association, Waynesville, North Carolina 32
Roenigk, William P., Senior Vice President, National Chicken Council, Washington, DC 39
Truex, Ron, United Egg Producers, Warsaw, Indiana 36

APPENDIX

PREPARED STATEMENTS:
- Grassley, Hon. Charles 50
- Roberts, Hon. Pat 52
- Carstensen, Peter C. 53
- Hamilton, Scott 64
- Hayes, Lynn A. 79
- Johnson, Burdell 102
- Muth, Mary K. 107
- Nelson, Eric 116
- Philippi, Joy 137
- Queen, John M. 157
- Roenigk, William P. 170
- Schmidt, Tim 177
- Truex, Ron 179

Page

DOCUMENT(S) SUBMITTED FOR THE RECORD:

National Association of State Departments of Agriculture (NASDA), prepared statement 186

QUESTION(S) AND ANSWER(S):

Grassley, Hon. Charles:
Written questions for Peter C. Carstensen 192
Harkin, Hon. Tom:
Written questions for Mary Muth 194
Roberts, Hon. Pat:
Written questions for Mary Muth 196
Carstensen, Peter C.:
Written response to questions from Hon. Charles Grassley 197
Muth, Mary K.:
Written response to questions from Hon. Tom Harkin 199
Written response to questions from Hon. Pat Roberts 202
Written response to questions from Hon. Charles Grassley 205
Nelson, Eric:
Written response to questions from members 206

ECONOMIC CHALLENGES AND OPPORTUNITIES FACING AMERICAN AGRICULTURAL PRODUCERS TODAY

Wednesday, April 18, 2007

U.S. SENATE,
COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY,
Washington, DC

The Committee met, pursuant to notice, at 9:30 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Tom Harkin, Chairman of the Committee, presiding.

Present: Senators Harkin, Lincoln, Salazar, Casey, Klobuchar, Chambliss, Thune, and Grassley.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Chairman HARKIN. The hearing will come to order, as soon as I turn on my microphone, and we welcome you to one of our smaller hearing rooms that we have here in the Capitol. We have a number of votes coming up, but we will start and we will see how far we can get, and we will have to take some breaks and go vote and come back. But that is life around this place.

Over the last several months, we have heard from a wide range of interested stakeholders to gain their input for writing the next farm bill. Today we will focus on hearing from representatives of the livestock, poultry, and egg industries.

Animal agriculture is very important to the United States. The Economic Research Service estimates the value of U.S. livestock and poultry production in 2007 will be about $125.7 billion. The new farm bill can help play a role in expanding this. The farm bill will be critically important for expanding access to conservation programs, developing much needed research on distillers' dry grains for animal feed, for animal diseases, promoting market access, cellulosic ethanol, and ensuring fair and competitive markets.

As with any farm bill, there will be many different perspectives on all these issues, and I look forward to listening and learning from the witnesses here today.

In the past 15 years, the animal industry has become more consolidated and vertically integrated. Basic open fairness and competition in markets have become a big issue. Today, in some regions of the country, there are only a handful of buyers of livestock left, and they frequently do not buy off of the open market. For some producers, they have only one buyer left, and this is a huge change from the time when I was young.

This sets up an overly tilted marketing system where producers have difficulty getting bids for the livestock or are forced into some take-it-or-leave-it contracts with unfair terms. These producers have nowhere else to go to market their livestock or poultry, and for those producers that speak out against unfair practices or complain, they face retaliation. They stop getting bids on the open market, or they can lose their contracts.

Producers of marketing livestock and poultry in consolidated markets are becoming less inclined to speak out about what they see going on in the marketplace. Producers fear that if they speak out, they will face retaliation, so I especially want to thank the witnesses today for providing testimony before the Committee.

Congress worked to provide fairness in the marketplace before, and it can do so again. In 1921, Congress passed the Packers and Stockyards Act to keep markets fair. The Department of Agriculture has this important authority to enforce the act. But just last year, a report by USDA's Inspector General—a report I commissioned—found widespread inaction, efforts to block investigations of unfair and anticompetitive conduct, and even efforts to cook the books to give the appearance of actual enforcement by the Grain Inspection, Packers, and Stockyards Administration at the Department of Agriculture.

So basic fairness and transparency in the marketplace should be guaranteed in Federal law. If we are going to have a market-based system, if we are going to have true competition, then you have to have transparency.

That is why I introduced the Competitive and Fair Agricultural Markets Act—to improve USDA's enforcement of the Packers and Stockyards Act and to strengthen the Agriculture Fair Practices Act. That is why I have also worked to improve the Livestock Mandatory Reporting Act, along with other important market reforms.

So, again, I look forward to hearing from today's witnesses and working with you all on crafting a forward-looking farm bill that enhances and protects a market-based system.

With that, I would yield to my colleague and our Ranking Member, Senator Chambliss.

STATEMENT OF HON. SAXBY CHAMBLISS, A U.S. SENATOR FROM GEORGIA

Senator CHAMBLISS. Well, thank you very much, Mr. Chairman, and I thank you for holding this hearing, and I certainly welcome all of our witnesses here today and look forward to hearing your testimony on the importance of livestock in the 2007 farm bill.

Today's hearing will allow key stakeholders in the livestock industry to detail their priorities on the upcoming farm bill. Last year, I had the honor of chairing eight farm bill field hearings across the Nation to gather information from farmers and ranchers regarding their farm bill concerns and priorities. I consider this an important part of an open and balanced legislative process. The information obtained during those field hearings and the testimony provided in hearings such as this one today will serve the entire Committee well as we begin our farm bill deliberations.

The hearing today pays particular attention to an issue that is not new to this Committee or to the farm bill process: competition in livestock markets. This issue has been a constant topic since my arrival in Congress in 1994. Everyone who is concerned with agriculture understands the need for cattle, pork, poultry, and other producers to have every fair option at their disposal to market and sell their animals. I, like all of the members of this Committee, understand the importance of enforcing the Packers and Stockyard Act and other important antitrust laws that ensure an open and competitive marketplace.

While I look forward to hearing from all of our witnesses today, I am a little disappointed that certain segments of the livestock industry are not included in this hearing. I am hopeful that as we construct a farm bill that will affect the entire livestock industry, we will include the input of all stakeholders, including the producers who raise the animals; the stockers, feeders, and background operations that feed them; the processors and packers that break them down into salable commodities; and the retailers that ultimately sell the finished product. All of these segments are critical to a competitive thriving livestock industry and marketplace.

I believe in a fair and open marketplace for livestock market participants, and that is why I fought so hard last year alongside Chairman Harkin to reauthorize the Livestock Mandatory Price Reporting Act. That process demonstrated what we can accomplish when we work together with all interested stakeholders to arrive at consensus legislation that enjoys broad-based support. It is not always the easiest approach, but I believe it achieves the best results.

In fiscal year 2003, Congress specified that the Grain Inspection, Packers, and Stockyards Administration of the U.S. Department of Agriculture use $4.5 million to conduct a study to address issues surrounding a ban on packer ownership. We are fortunate to have with us today Ms. Mary Muth of the Research Triangle Institute, the firm that conducted this congressionally mandated study. In attempting to address complex issues such as the proposed ban on packer ownership, it is critical that Congress carefully consider all expert analysis, such as the RTI study, before we determine whether restrictions on the use of captive supplies are warranted.

In my part of the country, the livestock industry is dominated by cow-calf operators who utilize auction markets and alternative marketing arrangements to sell their animals. Many Georgia cattlemen and pork producers utilize alternative marketing arrangements to obtain higher prices for their animals and to accommodate niche markets, such as certified Angus beef. They also use these arrangements in an effort to satisfy export markets and to ensure the production of the higher-quality products that consumers demand. The proposed elimination of these types of arrangements could have a negative impact on my producers. Livestock and poultry producers today must compete in an imbalanced international marketplace that often rejects their product for unjustified and unscientific reasons.

In addition, producers must compete for corn supplies with ethanol facilities, further raising their cost of production and making it more difficult for producers to be profitable. I urge my colleagues to employ a cautious approach as we consider legislative proposals that would potentially limit the options of producers by banning these types of arrangements.

Finally, Georgia is the No. 1 producer of poultry in the United States, producing over 1.3 billion in broilers and over 4.8 billion eggs in 2005, amounting to over $2.7 billion in cash receipts. The poultry industry is obviously an integral component of the Georgia agricultural sector, and I look forward to hearing from our witnesses today who will discuss the poultry and egg industries. It is important that growers are treated fairly as they compete in the marketplace. It is also equally important that we continue critical research in areas such as avian influenza that will have tremendous benefits for humans and animal health.

I again would like to thank everyone for attending this hearing. I look forward to hearing the testimony from all of our witnesses, and, Mr. Chairman, I once again thank you for your cooperation and for calling this hearing today.

Chairman HARKIN. Thank you very much, Senator Chambliss. I again want to thank you, when you guided this Committee last year, for having all those field hearings around the country. They laid great groundwork for our farm bill and relieved me of going around the country and having all those hearings this year. So I really appreciate that.

Also, I just for the record want to say that our staff had invited the American Association of Meat Processors to testify at this hearing, and they were unable to come—or they did not come up with a witness, but they were invited.

Now, I am going to recognize this panel, and we will just go down the line here: Mr. Carstensen and Ms. Hayes, Dr. Muth, Mr. Tim Schmidt, and Mr. Scott Hamilton. All of your statements will be made a part of the record in their entirety. Because we are confronting and facing some possible votes here soon this morning that will cause us to be gone, I am really going to be fairly strict on asking you to hold it to about 5 minutes, give us the essence of what it is that you want us to know, and so we can have more of an interchange with you.

I would recognize Peter Carstensen, Professor, University of Wisconsin Law School, and he has worked a lot on the series of issues involving the relationship of regulation to competition. Professor Carstensen, we will start with you and then just work down the line. Welcome to the Committee.

STATEMENT OF PETER C. CARSTENSEN, PROFESSOR OF LAW, UNIVERSITY OF WISCONSIN LAW SCHOOL, MADISON, WISCONSIN

Mr. CARSTENSEN. Thank you very much, Senator. It is a great honor to be here, and I am particularly pleased to see the bipartisan support for reform in the framework that we have for regulating agriculture.

The thing that I think is most important to appreciate is that agricultural markets, both in the input and the output side, represent special problems in terms of risks of dysfunction in the market. This is partly because of the lags between the time one starts to plant a crop or acquire an animal and the time that it is available for market. But it also has to do with the disproportionate relationship of small producers, large buyers—that is, you have some inherent buyer power problems—with informational issues, with other kinds of negative consequences for the market. And added to that we have serious problems of increased concentration on both the input side and the output side.

The role of law here, and especially the kind of law that this Committee addresses, is to facilitate fair, open market transactions. This legislation, like the Securities Exchange Act, like the Commodity Futures Trading Act, is one that is designed to facilitate the efficient operation of the market, and, unfortunately, it has really not functioned well in a whole variety of agricultural markets. And in my statement, I emphasized the problems first in the dairy world that come from increased concentration and the distortions that have resulted in purchases, buying processes of fluid milk; second, and the primary focus for your concerns here, I think, the livestock and poultry markets that we have, where, again, we are seeing increased concentration. I particularly here am concerned about the pending merger of Smithfield and Premium Standard brands that will greatly increase concentration not only in the Midwest but in the eastern part of the United States. In North Carolina, it will reduce the number of competing processors from two to one. We call that "monopoly," and I am appalled that the Justice Department has not yet moved on that.

I have looked somewhat at the RTI study, and, unfortunately, I think it is deeply flawed in terms of a forward-looking evaluation of alternative means and methods of marketing agricultural products, the marketing particularly here of livestock, in that it makes a simple-minded distinction between the cash market, which is bad apparently, and all other forms of contracting, whatever their flaws, which are apparently good. That is simply not the way to go about a forward-looking study that identifies desirable features of contracting, desirable features of particular cash transactions, and then ask how best can we adjust between and among these different instruments of policy.

As I think you are aware, Mr. Chairman, there are some very serious problems with the way the courts have interpreted the Packers and Stockyards Act, especially in the recent Pickett decision. There is, I am pleased to report, a case out of Texas which takes a better view of the law. Whether that will be upheld on appeal, I do not know. But it is long overdue to revisit how the Packers and Stockyards Act's provisions are interpreted because they absolutely require modernization so that they address unfair practices, discriminatory practices, especially denial of access to the market in a world where contracting is going to be a much more common feature.

I want briefly also to emphasize another area which I think your proposal, Mr. Chairman, would provide important coverage in the market for various kinds of crops, especially corn and soybeans. I have spent some time in my written statement explaining both the emergence of contracting as a major new force in these markets and the particularly pernicious problems that exist because of the use of patented genetics on seeds and the kind of anticompetitive conduct of the genetic patent holders, especially I will name specifically Monsanto here because they are overwhelmingly dominant, in foreclosing important competition in the input side of the seed market. And my prediction of things to come unless Congress does something is that Monsanto is going to start imposing a tax on valuable corn and soybeans because, as I read the law, Monsanto has the legal right, right now, to tell farmers who raise Monsanto genetic soybeans or corn, "Here is the person you will sell to." That is, they can sell the right for Monsanto to foreclose competition downstream.

So the agenda you have got is an enormous one, and I wish you all the good luck in the world in dealing with it.

[The prepared statement of Mr. Carstensen can be found on page 53 in the appendix.]

Chairman HARKIN. Thank you very much, Professor Carstensen.

Now we will turn to Lynn Hayes from the Farmers' Legal Action Group. Lynn was the founding attorney and program director at Farmers' Legal Action Group in St. Paul, Minnesota. She received her BA degree in English from Coe College in Cedar Rapids, Iowa, and a J.D. degree from Columbus School of Law, Catholic University of America—my alma mater.

[Laughter.]

Chairman HARKIN. Welcome to the Committee, Ms. Hayes.

STATEMENT OF LYNN A. HAYES, FARMERS' LEGAL ACTION GROUP (FLAG), INC., ST. PAUL, MINNESOTA

Ms. HAYES. Thank you. Over the past several decades, the markets for farmers' agricultural commodities have experienced rapid consolidation of market share in the hands of a few large companies and a dramatic increase in vertical integration by packers and processors. This has resulted in the vast reduction in the number of buyers to compete for farmers' products, a loss of transparency in the markets, manipulation of prices paid to producers, and an increase in the use of production contracts, and, most importantly, a horrendous imbalance of bargaining power between the farmers and processors.

Today I want to discuss two principal ways the packers and processors have vertically coordinated their production. First is production contracts, using the poultry industry as an example, and the second is captive supply procurement methods in the red meat packing industry.

The vast imbalance of bargaining power is exemplified in the poultry industry, which now 90 percent of production is done production contracts, where the company owns the birds and the producers on contract raise those birds. Those contracts are take-it-or-leave-it contracts written by the companies. There is no negotiating by the farmers for the terms of those contracts, and consequently, they leave farmers with huge risks under those contracts. Farmers are encouraged to participate in these contracts through oral representations of their financial feasibility and the lifestyle benefits, which often are not borne out in the contract terms whatsoever.

For example, the poultry interest broiler growers indicate they receive much less money, have much higher costs, and they have to work many more hours than the companies represented would be the case. However, once they find this out, they have already—

by the time they find this out, they have already made hundreds of thousands of dollars in investments in buildings and other facilities to raise the poultry, and at that point they are at the whim—they are left to the mercy of the companies because in many cases there is only one or two companies that would pick up birds from the growers' area. This leaves the growers with no bargaining power, but when they try to form bargaining associations, they are often retaliated against by the companies, by either manipulating inputs that reduce their prices or possibly just terminating their contracts.

In the poultry industry, particularly the broiler growers are paid under tournament system where the growers are ranked against other growers in feed efficiency. However, the companies control most of the inputs that really control how well the producer is going to play on the feed efficiency front.

Many of the contracts are for only one 7–week period for broiler contracts. The companies usually have the opportunity to terminate the contracts at will. They can require the growers to install thousands of dollars in equipment upgrades during the course of the contract. And the contracts also usually require disputes to be resolved there binding arbitration.

Things that Congress can do to level the playing field on the bargaining power for growers is to require that all production contracts be in plain language and include a cover sheet that summarizes the material risks to the farmers, prohibit any confidentiality clauses or binding arbitration clause in the contracts, prohibit the tournament system of payment for poultry contracts, require that companies negotiate in good faith in all dealings with the growers, and to improve the Agricultural Fair Practices Act by requiring companies to bargain in good faith and not to retaliate against growers who are organizing in associations, and to make it unlawful for companies to participate in production contracts by using unfair, deceptive, or discriminatory practices.

The other area I want to mention is captive supplies in the red meat industry. The Packers and Stockyards Act has for years prohibited unfair and deceptive practices. When Congress passed the act, it intended to prohibit both anticompetitive practices and unfair and deceptive and price-manipulating practices between packers and producers.

Unfortunately, because USDA has failed to effectively regulate and define what kinds of practices are unfair and unjustly discriminatory, as the industries have changed we have lost much of the original intent. And this was demonstrated in the London court cases and the Pickett case that Mr. Carstensen mentioned, where the court had required producers to show anticompetitive practices in order to show unfair practices.

To address these issues, the Packers and Stockyards Act should be amended to close the poultry loophole so that USDA can enforce the act in the same way against poultry dealers as red meat packers. And it should prohibit formula price forward contracts for the procurement of slaughter livestock, and all forward contracts should be traded in open public market. Packer ownership of cattle and hogs more than 7 days before slaughter should be prohibited, and the act should be amended to make it clear that anticompetitive effect is not required to show an unfair, deceptive, or price-manipulating practice in violation of the Packers and Stockyards Act.

Producers should also be allowed to file lawsuits to enforce the act in Federal district court and to be awarded attorneys' fees when successful.

Thank you.

[The prepared statement of Ms. Hayes can be found on page 79 in the appendix.]

Chairman HARKIN. Thank you very much, Ms. Hayes.

We have just been notified that a 15–minute roll call vote started at 9:48. I think we can hear from one more witness before we have to make a mad dash out of here, and so—and I do not know. I am trying to find out if there is one or two votes. I do not know. There are two votes? Well, let us hear from one more witness.

Dr. Mary Muth, Director of the Food and Agricultural Policy Research Program at RTI International, an independent, not-for-profit research institute in the Research Triangle Park, North Carolina. She was the project manager for the congressionally funded GIPSA Livestock and Meat Marketing Study that was completed earlier this year. She has a Ph.D. in economics from North Carolina State University, an M.S. in ag economics from Cornell University, and a B.S. in agricultural and managerial economics from the University of California at Davis.

Welcome to the Committee, Dr. Muth, and please proceed.

STATEMENT OF MARY K. MUTH, DIRECTOR, FOOD AND AGRICULTURAL POLICY RESEARCH PROGRAM, RTI INTERNATIONAL, RESEARCH TRIANGLE PARK, NORTH CAROLINA

Ms. MUTH. Thank you. Good morning, Senator Harkin and members of the Committee. I also wanted to add in with my bio that my husband's family owns a cow-calf operation in western Kentucky, so some of the issues that I talk about hit pretty close to home. I am pleased to be here, and thank you for the opportunity to provide an overview of the findings of the Livestock and Meat Market Study.

The study was conducted from July 2004 through January 2007 by a team of researchers at RTI International, Iowa State, North Carolina State, Montana State, and Colorado State universities and the Wharton School at the University of Pennsylvania. The study addresses the economic effects that alternative marketing arrangements have on the livestock and meat industries. As you know, the cash or spot market includes auction, direct trade, and use of dealers and brokers. In contrast, alternative marketing arrangements include all other marketing methods, such as marketing agreements, marketing and production contracts, packer ownership, and forward contracts.

In the final report for the study, we analyzed the extent of use and price differences across marketing arrangements and the effects of using alternative marketing arrangements on cash market prices; the costs and benefits of various marketing arrangements, particularly as they relate to quality, cost of production, and risk; and the implications of using marketing arrangements on livestock producers, meat packers, and consumers. We used state-of-the-art economic modeling and statistical analysis methods to address the requirements of the study using industry survey data, transactions data, and profit-loss statements from packers, industry interviews, and publicly reported data, including mandatory price reporting data.

In general, the study found that use of alternative marketing arrangements provides benefits not only to meat packers but also to livestock producers and to meat consumers. Therefore, restricting their use would have negative economic consequences on most segments of the industry. However, the cash market serves an important role in the industry, particularly for small producers and packers.

Next I would like to give a broad overview of the specific results of the study.

First, regarding the volumes and prices of livestock under different types of marketing arrangements, based on the data available for the study, we estimate that alternative marketing arrangements represent 38 percent of the volume for fed cattle, 89 percent for finished hogs, and 44 percent for fed lambs sold to packers.

Furthermore, we estimate that packer ownership volumes represent less than 5 percent of fed cattle and fed lamb volumes and 20 to 30 percent for finished hogs. Based on the industry surveys and industry interviews we conducted, we expect use of alternative marketing arrangements in the beef and pork industries to remain similar to past use, but to increase somewhat in the lamb industry.

In the beef industry, prices for fed cattle are similar for direct trade and marketing agreements, higher for the small percentage of auction barn cattle, and lower for the small percentage of forward contract cattle. We found that a reduction in the volume of spot market transactions, assuming that volume is shifted into alternative marketing arrangements, results in an extremely small decrease in the spot market price.

In the pork industry, prices for finished hogs are higher for marketing contracts and lower for packer-owned hogs relative to the cash market. We found that there would be a relatively large effect of further increases in the use of alternative marketing arrangements on cash market prices for hogs.

Second, regarding the costs and benefits of alternative marketing arrangements related to costs of production, in the beef industry procurement of cattle through alternative marketing arrangements is associated with lower production costs per head than through cash markets, but we found that this result actually does not hold for all packing plants in the data set. In the pork industry, procurement of hogs through alternative marketing arrangements is associated with a very small decrease in production costs at the packer.

Related to quality of beef and pork, in the beef industry we found that cattle sold through marketing agreements were higher quality and had less variation in quality than cattle sold through direct trade methods. Similarly, in the pork industry, we found that hogs sold through marketing contracts are higher quality than hogs sold through direct trade.

Related to market access and price risk, across all species, alternative marketing arrangements offer some guarantee of market access for both livestock producers and meat packers. Furthermore, use of alternative marketing arrangements generally reduces price or income risk for cattle and hog producers.

Third, regarding implications of the use of alternative marketing arrangements, we conducted simulations of various hypothetical scenarios in which alternative marketing arrangements were restricted. Across all species, the economic modeling simulations indicate losses to livestock producers, meat packers, and consumers due to losses in efficiencies in the market. These losses in efficiencies translate into higher prices for consumers purchasing meat and lower prices for producers selling livestock.

Mr. Chairman, I would like to enter into the record Volume 1 of the report for the Livestock and Meat Marketing Study. This volume contains the executive summary and the overview for the study.

Thank you.

[The prepared statement of Ms. Muth can be found on page 107 in the appendix.]

Chairman HARKIN. Dr. Muth, thank you very much, and we are into the second phase of the vote right now. I guess we have two votes, so if we leave now, we should be able to be back in about 15 minutes, I think. So we will stand in recess for about 15 minutes. We will go vote and we will be right back.

[Recess.]

Chairman HARKIN. The Committee will resume its sitting. Next we will hear from Mr. Tim Schmidt, a pork producer from Hawarden in northwest Iowa. He farms with his three partners in a diversified operation that includes farrow-to-finish hogs, a cattle feedlot, along with growing corn and soybeans. And I am told that most of the corn produced on their farms is used by their livestock enterprises. Tim also serves as the President of the Sioux County Pork Producers. His wife, Mary, and two daughters, Karen and Callie, who both attend West Sioux Community School in Hawarden, so a real family farmer.

Welcome to the Committee, Mr. Schmidt, and please proceed.

STATEMENT OF TIM SCHMIDT, PORK PRODUCER, HAWARDEN, IOWA

Mr. SCHMIDT. Thank you. Good morning, Chairman Harkin and members of the Committee. Thank you very much for inviting me here today to discuss some of the changes and challenges occurring in the U.S. meat production industry. I am Tim Schmidt, a third-generation pork producer from Sioux County, Iowa. My partners and I operate a 250–sow, farrow-to-finish hog operation on a century farm. Prior to entering the partnership, I worked for a major packer in Nebraska for several years and also for an agricultural co-op. The strength and vitality of the U.S. pork industry is very important to me, and I serve in a leadership role in my county pork producer association.

My comments today are about market access and market price changes that I have seen in the industry, stemming from consolidation in the US packing business.

Over the years we have sold weekly loads of hogs after shopping around for bids from packers. Ten years ago, our farm could get multiple competitive bids from several hog buyers. Around 5 to 6 years ago, we began having a hard time getting more than one bid from a group of buyers. Since we were only getting one bid, we ended up selling mostly to just one buyer. Today it is almost impossible to get a competitive bid on the 80 hogs we sell every week. So I have a less competitive bid and fewer market options. When you only receive one bid, the market price liquidity is poor, and market price transparency is questionable at best.

So what changed between 10 years ago when bids were readily available and 5 years ago when they stopped? The packers began aggressively signing contracts for hogs with producers. Those contracts lock in hog deliveries to the buyers and push my cash sale hogs into a residual supply situation which drops buyers' interest in competing for my hogs.

The interesting thing about these contracts is that most of them have price components that are formulas based upon the open cash market. This means that those hogs get priced based on my residual supply. On rare occasions when the hog supply is really short, that spot cash market can spike higher, but when hogs are in adequate supply—which is most of the time—the market is residual and soft. A high supply of hogs can break the market downward hard.

The consolidation of hogs under contract has made the market less liquid and less reflective of the true value of the hogs.

Another point about changes in the approach of the packing industry revolves around our county pork producer association's annual market contest. Each year eight or ten producers would bring in 20 hogs each to a packer on the same day and at the same time. We would have the hogs processed and compare the carcasses to see how well we were marketing and how our hogs compared for meat performance. Because we scheduled the hogs well in advance, the packer always knew when the hogs were coming. They handled that as a spot cash sale. We stopped doing it because the packers would not pay competitively the day the hogs were delivered. Association members, myself included, sold hogs to the same packer on that day that were not part of the market contest and received a higher market price. In essence, the packer took advantage of our desire to improve our hogs and work together as a group. That was disappointing to those that participated.

Currently the Iowa Legislature is debating a bill that would require meatpackers to buy 25 percent of their animals from non-affiliated livestock producers. The bill, SF 504, was passed by the Iowa Senate last month. It is currently awaiting action in the Iowa House.

I support the 25 percent open market bill because it would ensure more liquidity in the market and would ensure that contracts formulated off of the open market accurately reflect market conditions.

I also believe that in order to ensure true market transparency, we need mandatory price reporting so that all hog prices are reported to the USDA and publicly reported each day. Factual information about all market price transactions—cash sales and contract deliveries—is an important key to market transparency.

Besides my personal issues, I am concerned about the next generation of hog producers. Without open, transparent, and competitive markets, the young men and women who are the future of our industry will not have the opportunity to be independent pork producers. Without a level playing field, our rural youth with an interest in hog production will only have two options: to work for an integrator or to find another occupation. To limit their opportunity in pork production because we do not give them a free, open, and transparent marketplace would be a real shame.

At issue today is not whether big farms or small farms are best. It is about independence and freedom that can only be achieved by having and maintaining a fair, free, and honest marketplace. In order to have that, we need more open market transactions in a reportable and transparent market.

Thank you for listening. I appreciate this opportunity. If you have any questions, I would be happy to answer them.

[The prepared statement of Mr. Schmidt can be found on page 177 in the appendix.]

Chairman HARKIN. Mr. Schmidt, thank you very much.

Now we will turn to Scott Hamilton, a poultry grower from Phil Campbell, Alabama. He got into the poultry growing business in 1995, after graduating from Auburn University. He also raises cattle on his farm, lives on the farmstead with his wife and two children, so another real family farmer.

Welcome to the Committee.

STATEMENT OF SCOTT HAMILTON, POULTRY GROWER, PHIL CAMPBELL, ALABAMA

Mr. HAMILTON. Chairman Harkin, Ranking Member Chambliss, and members of the Committee, thank you for the opportunity to testify before you today on this important topic.

As stated, my name is Scott Hamilton. I am a poultry grower from Phil Campbell, Alabama. I also raise cattle on my farm, where I live with my wife and two children. I graduated from Auburn University with a degree in zoology and later graduated from Auburn's Agriculture and Forestry Leadership Program.

The structure of U.S. agriculture has changed significantly in recent decades, and farmers are rapidly losing their independence. For many of us, that independence was lost long ago.

I am here today to tell you a few of my experiences as a poultry grower with regard to the abusive practices that have become commonplace in poultry.

Because of the large size of the poultry loan, growers usually have to put up their farmland and their homes as collateral. For most growers, you cannot shop around for other companies if you disagree with your company's practices. There is very little competition in local areas.

There are no negotiations. Either you sign what is put in front of you, or they do not bring you chickens. If they do not bring you chickens, you cannot make you mortgage payments, and you lose your family farm.

Growers are ranked against each other for their pay. Basically, this means you can grow the heaviest bird and the least amount of feed. This is called the feed conversion. The company controls all of the inputs that determine your success in adding weight to the bird, the quality of chickens and feed, the length of time you keep your birds relative to the other growers. No matter how successful you are at raising their birds, the system is rigged so that half the growers get pay cuts to compensate for the other half that get bonuses.

I am also here today to tell you that retaliation in the poultry industry is real. After I started to be more active in the Alabama Poultry Growers Association, I saw my ranking file and was placed on a probation program. I had sick birds through no control of my own. When you are put on this program, you need to show improvement in the ranking or the next step is termination, even though you have made a huge investment for the purpose of the contract and your ranking may have nothing to do with your own performance.

Perhaps the most abusive contract clause that growers are facing currently in the mandatory arbitration clause. As poultry growers started to win lawsuits against poultry companies over contract abuses, companies started to present new contracts to their growers. These new contracts included provisions that essentially said that growers were waiving their right to take the company to court for any reason. Instead, the growers would be forced into a private system called “mandatory arbitration,” where a private group of arbitrators would hear their case and render the decision.

But the up-front costs of this process are prohibitive. Some growers have been handed bills for as much as $20,000 just to get an arbitration hearing. Further, unlike the public court process, there is limited right of discovery in arbitration, meaning that the grower cannot get access to the evidence that they need to prove their case.

So what is the solution? Senators Harkin and Enzi have introduced legislation, S. 622, that addresses many of the concerns that I raise in my testimony. The bill would amend the Packers and Stockyards Act to give GIPSA the full authority, like in the red meat sector, to crack down on unfair and deceptive trade practices over the entire poultry industry, including breed hen and pullet growers.

It would set a minimum contract standard, such as prohibiting pre-dispute, mandatory arbitration clauses, and assure that equipment upgrades are not made solely at the grower’s expense. It would also require companies to bargain in good faith with bargaining associations.

As a poultry farmer from Alabama, I am honored to be here today providing this testimony. But at the same time, it is a sad commentary on the state of our Nation that I had to seriously consider whether or not my testimony here today would put me in financial jeopardy because of retaliation.

Contracts are vital to the economy in this country. But it also vital that basic standards of fair dealing apply to contract relationships.

In recognition of that fact, over 1200 organizations sent a letter to this Committee in January of this year, urging that a comprehensive competition title be in the 2007 farm bill. A copy of that letter is attached to my written statement.

It is my hope that this Committee will include all of these provisions when the farm bill is drafted later this year.

Thank you.

[The prepared statement of Mr. Hamilton can be found on page 64 in the appendix.]

Chairman HARKIN. Mr. Hamilton, thank you very much. Thank you all for your testimony. I will start now a round of maybe 7 minutes. If you can give me about 7 minutes, Bob, we will start a round of 7–minute questions here.

I would just like to start where Mr. Hamilton just left off. You said in your testimony, “In no way am I arguing that contracting is a bad thing. Contracts are vital to the economy in this country. But it also vital that basic standards of fair dealing apply to contract relationships.”

I cannot think of a better place to start than that because I tend to agree with that sentiment. I have often said that forward contracts and things, if they are done with transparency and with openness, with at least some semblance of equality between the contracting parties, can be a good thing. But there also ought to be a place in there for open markets also and for those that want to partake in an open market system. And as long as contracts like that are open, are transparent, as long as individuals who perhaps do not have a lot of economic power, as long as they are given some abilities to examine it, to be able to discuss those contracts with their families and their attorneys, then that could be OK. But that is not the situation we have right now.

I just wanted to clear up a couple things about the study because, Dr. Muth, you were in charge of that study that we had set up. Now, again, you said it was a scientifically based sample, but there are about 67,000 hog producers nationwide. Your survey team surveyed 229 producers. Now, again, I am not a statistician so I do not know, but it seems to me that 229—can you assure us that that is a statistically valid sample? And why didn’t you get more than just that number?

Ms. MUTH. Well, one thing to explain is that we did draw a much larger sample, it was a random sample drawn from the population, and we drew a much larger sample—a lot more producers than that were given the opportunity to respond to the survey. But ultimately we received 229 responses.

Based on conversations with our statistician, who specializes in survey sampling procedures, this is close to adequate to represent the practices in the industry. You need a certain number to represent a large population, but it does not need to be a very large number.

Chairman HARKIN. The RTI study assumes that hogs are sold through a national market where all producers are treated the same and have the same number of buyers. But, again, that is not realistic. The marketing of hogs is regional. Some regions have fewer buyers than others. So area’s producers have only one buyer, as we have heard. Market power is clearly different for different regions of the country, especially if one packer can dictate complete control over the producer. RTI stated that further investigation into market power was outside the scope of the report.

So my question is: Why didn’t RTI examine the hog industry as a regional marketing system?

Ms. MUTH. When we conducted the study, we were following the specific scope of work that was given to us under the contract, and under that contract, we were to look at the national-level effects of these alternative marketing arrangements. And we developed economic models to represent those relationships within the industry based on the questions we were asked to address in the study. And in terms of the specific regional differences, those were accounted for in a lot of the analyses by use of binary variables to account for differences in the regions.

Furthermore, I did want to point out that in the study we did look at testing for the existence of market power in the pork industry. We used two different methods—one that is a more traditional, new empirical industrial organization approach, and another that was based on a more state-of-the-art modeling technique. In both of those instances, we did, in fact, find that there is evidence of the existence of market power in the pork industry. However, I also want to emphasize that in developing those models, you can find evidence of market power, but you cannot find intent to exercising that market power to take advantage of producers. So that goes beyond what we can say.

Chairman HARKIN. So what you are saying is that the Department of Agriculture's instructions to you was to base it on a national market rather than looking at regional? Is that right?

Ms. MUTH. Right, to base the core economic models on a national market and to make adjustments for differences in regions.

Chairman HARKIN. But could you have not looked at the regional markets to see how they operate and fold that into a national market?

Ms. MUTH. Based on the data that are available, further analyses of regional differences could be conducted.

Chairman HARKIN. Well, you said that RTI thought that further investigation into market power was outside the scope of the report. Is that right?

Ms. MUTH. Actually there were analyses of market power in the study. That statement that comes from one portion of the report is at the conclusion where we have looked at two different methods of testing for market power.

The study did not ask us to investigate whether or not—it was not focused specifically on market power, but on the use of alternative marketing arrangements. So we focused our analysis primarily on the use of alternative marketing arrangements and the effects of those on the market.

Chairman HARKIN. I guess that is a criticism I have of the study, but maybe I have to direct this also to the Department of Agriculture. But we will figure that one out, you know, where the responsibility lies, whether it lies with RTI or with the Department of Agriculture. I am not certain about that yet.

But, again, the conclusions in the report, I think, assume that Congress wants to prohibits contracts. There is currently no legislation in Congress that would prohibit contracts. This report also assumes that if there was a ban on packer ownership, the packers would incur increased costs that could then be passed on to producers and consumers.

Why did RTI assume that if there is a ban on packer ownership, packers will have increased costs due to having to buy off the open market? Don't you think that packers would instead increase the number of contracts they enter into with producers instead?

Do I need to repeat the question?

Ms. MUTH. Yes, there are multiple parts to that question.

Chairman HARKIN. Why does RTI assume that if there is a ban on packer ownership, packers will have increased costs due to having to buy off the open market? Why wouldn't you assume that they might just increase the number of contracts they have?

Ms. MUTH. Well, when we conducted the analyses, we were asked to develop simulation scenarios to look at what the effects of different types of restrictions would be. Those were developed by the study team because the intent was not that we would give policy recommendations, but that we would look at some different types of scenarios that might possibly exist based on the judgment of the team members.

When we looked at the ban on packer ownership, it was one of three scenarios that we looked at. We applied that in the hog industry to look at what those effects would be. One of the reasons why we assumed that there would be increased costs is because we assumed that if there was a ban on packer ownership, those hogs would be on the spot market. A different assumption could have been developed, but these were based on scenarios as we designed them for the study to look at some different alternatives.

Chairman HARKIN. Well, I guess I am just wondering why that other scenario was not looked at, because obviously since there is no legislation that would ban contracts pending, then a ban on packer ownership, then you would have to look both at maybe increased contracts as well as open markets. But you only looked at one aspect.

Ms. MUTH. Yes. Well, we also looked at a couple of other scenarios, and understand, again, these were not to look at particular policies that had been under consideration. These were just to give some comparisons so that you could see some relative magnitudes of differences, depending on what the situation might be.

Chairman HARKIN. Thank you very much. My time has more than run out.

Senator Chambliss?

Senator CHAMBLISS. Thank you, Mr. Chairman.

Mr. Carstensen, in your testimony, you request that Congress correct problems in the livestock market legislatively. You then go on to say, "The enforcement of current law, despite its limitations, is also a critical concern." And I agree with that assertion that current law must be enforced if we are to have an open and competitive marketplace. I am concerned, however, that one of the remedies you advocate is the limitation of options for producers.

Do you think it is appropriate for the Federal Government to decide how producers should and should not market their livestock?

Mr. CARSTENSEN. Well, sir, the law constructs most markets. There are contract terms that are illegal for the sale of any kind of good. Where we get to more complex markets—and here, again, as I said in my earlier testimony, I think of securities markets and complex futures markets—there are all kinds of contract terms, practices of buyers and sellers that are outlawed because Congress has reviewed what makes markets work efficiently.

The problem with a completely unstructured market is that you do not get the most efficient behaviors because the advantage of strategic conduct, of insider trading, of other kinds of behavior, outweigh the community's benefit from having an efficient, fair, and open market.

So that the law from the very earliest times has tried to restrict the alternatives that buyers and sellers can use to focus them on efficient market practices. This does not mean—and I think the Chairman has emphasized this—that I am against contracts. I think that contracting needs to be regulated so that we have fair and just terms, so that we make the market work efficiently.

Senator CHAMBLISS. OK. Is there any available data for the Committee's review that supports the argument that livestock producers would enjoy less volatility and higher prices if alternative marketing agreements were limited or prohibited?

Mr. CARSTENSEN. Again, as we have just heard, one of the problems with the RTI study is that they did not do the kind of sophisticated forward-looking analysis that would have permitted us to identify those contractual practices that really contribute to market stability, those practices that contribute to market volatility and, therefore, help us identify the alternative marketing agreements, as I think is the generic term here, that were economically, competitively desirable.

I am going to be very interested to talk to some of my colleagues in the ag econ department at Wisconsin to see whether we can mine the data because it does sound as though there may be some very useful information in this very expensive project that collected a lot of data that might help us answer your question. But it appears that RTI, which has the data, was not asked those questions and, therefore, has not done the analysis that would be necessary.

Senator CHAMBLISS. But you do not know of any other study that parallels that that might provide some of that data?

Mr. CARSTENSEN. Not off the top of my head. I will make further inquiries, sir, and if I come up with some suggestions, I will let you and the Chairman know.

Senator CHAMBLISS. Good. Thank you.

Ms. Muth, in your testimony you state that the use of alternative marketing arrangements provides benefits not only to meat packers but also to livestock producers and meat consumers. You conclude that restricting their use would have negative economic consequences on most segments of the industry.

Can you expand on those statements for the benefit of the Committee? I am particularly interested in how livestock producers can benefit from these types of arrangements.

Ms. MUTH. There are essentially three key ways. The first one is in reduced price risk and income volatility, and looking at the different types of marketing arrangements, we did find that there was substantially less price volatility under alternative marketing arrangements, particularly under marketing contracts for hog producers and marketing agreements for cattle producers, and also reduced income volatility under production contracts for hog producers that use those.

The second thing is that they can benefit producers who use them when it allows them market access so that they can ensure that they have a market for their animals.

And the third way that it can benefit them is in terms of providing the capital that they need in order to operate their production operations. In many cases, by having an ensured buyer for their animals, that allows them to raise the capital that they need to continue their operations.

Senator CHAMBLISS. It is a common belief in some circles that alternative marketing agreements limit the marketing capability of small producers and will ultimately force them out of business. Based on that logic, limiting the use of alternative marketing agreements would ensure small producers a more competitive marketplace where they would enjoy higher prices.

Your testimony seems to contradict that belief. For example, you state that increasing the hog cash market share to 25 percent from the current 11 percent would cause hog producers and pork consumers to lose economic surplus. This would indicate that small producers would not benefit from banning alternative marketing arrangements.

Can you explain that a little bit further?

Ms. MUTH. Well, in terms of, going back to looking at what some of the benefits might be, there is increased efficiencies at the packer level, that this allows them to continue their operations and to ensure that they have sufficient capacity utilization to operate their plants. By operating those plants, they are allowing a market for smaller producers. In some cases, packers are not able to secure enough livestock to operate their plants. There are substantial economies of scale in the packing industry. When you reduce volumes at those plants, their costs increase substantially and makes it less viable for the packer. If you have packing plants closing, that is also reducing market access for producers, including small producers.

Senator CHAMBLISS. Mr. Hamilton, you raised several concerns about unfair contracting practices in the poultry industry, and you cite several instances that you have personally observed. And as you know, the poultry industry today is defined by vertical integration and companies that contract with family farmers.

If there is one thing that could be done legislatively to address the many issues that you raise, what would it be?

Mr. HAMILTON. If I had to pick one thing for you to do to help us?

Senator CHAMBLISS. Right.

Mr. HAMILTON. Get rid of arbitration, because if we can get rid of arbitration to where that we can discover what is going on, if we can go back to the courts, I think that you will see some of the companies, if they are doing what they are doing, they will stop it, because you are going to see it show up in the courts.

Right now there is no cop on the beat. We have a hard time proving anything because we do not have access to the records, for one thing. We have to take everything as it is right now at face value. If they say they have brought me X amount of weight of feed, if they say they have brought me this type of bird, that they have been held to anything, I do not have access to the records of that flock number to indeed prove that.

So if I had to choose one thing, it would be get rid of arbitration in my contract because then the court—that will give us access to the courts. You will probably see a rush of some lawsuits, and then after that, I think you will see it decline back down because you are going to have a cop on the beat regulating what is going on, and that will force them to eliminate some of the practices that they are doing.

Senator CHAMBLISS. OK. Thank you, Mr. Chairman.

Chairman HARKIN. Thank you, Senator Chambliss.

Let's see. Down the list next would be Senator Salazar.

Senator SALAZAR. Thank you very much, Chairman Harkin and Senator Chambliss. Thank you for holding the hearing on the economic challenges and opportunities regarding livestock, poultry, and competition issues. I would also like to thank the witnesses for sharing their time and their expertise with our Committee today.

Mr. Chairman, I would like to commend you for the hearing process so far on the farm bill. This is the first farm bill that I work on, and I have found the hearings that we have had thus far to be immeasurably valuable.

In 2002, in the chairman's mark at that time, there was a title on competition, and it included such subjects as country-of-origin labeling, packer ownership ban, contract items, USDA enforcement, and management provisions of USDA, and a whole host of other things. Let me ask a couple of questions of the witnesses.

In terms of country-of-origin labeling, you probably have taken a look at that and have an opinion on it. Is it something that you think that we ought to move forward with? I know that in the agricultural community in Colorado there is a split of opinion and that there are some who think we ought to move forward with country-of-origin labeling and others who do not.

Mr. Hamilton, I noticed in your testimony and in the letter that was submitted by all of the producers that signed up on your letter, country-of-origin labeling was included in there as something that we ought to do. So can you provide me and the Committee with some of your positions relative to country-of-origin labeling?

Mr. HAMILTON. Yes. As a consumer, I want to see country-of-origin labeling because as a producer and being active as I am—and I think I keep up with things pretty well—I realized that there are some things going on in some other countries that we are not allowed to do here. In Alabama, for instance, a few months back the Commissioner of Agriculture condemned a load of catfish imports into Mobile because they had been using a substance that had been banned in this country for quite some time. So as a consumer, I am for it because I have seen it as a producer that some of these other countries, they are doing things that we cannot do, for whatever reason. And, you know, I do not want to get into that. But from the production standpoint of it, it has shown me—I believe that we have the safest and best food supply. And as a consumer, that is what I want to buy. If you want to buy different, have that choice. But if there are oranges from Florida and there are oranges from Mexico, give me the choice in the grocery story and let me as the consumer choose which ones I want to buy.

Senator SALAZAR. Thank you.

Mr. Schmidt?

Mr. SCHMIDT. I would agree with Mr. Hamilton. I have supported country-of-origin labeling, and I believe the county pork board that I am on also supports that.

I know there are some issues with country-of-origin labeling as far as it does not have enough scope, does not cover some products, especially hotel retail, institutional products. I also know there are some concerns that maybe some agricultural commodities are not covered in that. But from my standpoint, I believe in country-of-origin labeling, and I think it needs to be done.

Senator SALAZAR. Dr. Muth?

Ms. MUTH. Yes, in terms of what we looked at for our study, we did not look specifically at country-of-origin labeling, but one of the implications of country-of-origin labeling is that it would actually encourage individuals in the industry to move more toward alternative marketing arrangements so they can increase traceability in the industry.

Senator SALAZAR. Ms. Hayes?

Ms. HAYES. I believe that country-of-origin labeling is necessary, I think both for the reasons that Mr. Hamilton and Mr. Schmidt said, that there is concern about production practices in other countries, and that is a concern of the consumers as well as the producers in this country and that they should be allowed—consumers should have the opportunity to make choices on the kinds of production practices that they want to meet.

I think it is also appropriate, however, that producers and consumers be able to support American industry by choosing to buy American products and American-raised products, not just because they are a higher quality but also because it is a way of supporting economically our own communities.

Senator SALAZAR. Mr. Carstensen?

Mr. CARSTENSEN. I would join in the general consensus that better consumer information is desirable. It is part of making markets transparent.

Senator SALAZAR. Let me ask you, Peter, a question regarding your testimony. In your testimony, you state the importance of properly enforcing the laws that we have on the books, and so my question to you is: Do we need more laws or do we just need to have proper enforcement of the laws through USDA?

Mr. CARSTENSEN. Both. That is, the problem—and the Chairman, when he started, mentioned the Packers and Stockyards Act was written in 1921. It has been modified a little bit. As Mr. Hamilton, I think it was, discussed, with poultry it no longer works in terms of the way the industry has evolved.

So the arbitration issues, a number of issues like that, I think are best addressed by a revisiting of the statutes, expanding their coverage so that they will cover crops, so that they will be much more comprehensive than just the particular fixes that Congress imposed at various times in the past.

I put dairy on the table as well because I think that that is a major area that needs reform.

That said, Congress can only do so much. After that, you have got to have somebody who is willing to enforce the law. If there is some way to do something to get the Department of Agriculture under, I regret to say, both Democrats and Republicans, to understand that it is supposed to be a law enforcement agency and not a tool of special interests, that would solve a great deal of our problems. If that is not going to happen, then we are going to need to find other ways to make those laws workable. And, again, as Mr. Hamilton pointed out, if poultry growers can go to court, get some damages, get some injunctions, that is an alternative way to enforce the law, and you really need to think through how the law will be enforced, not just——

Senator SALAZAR. Let me interrupt you, since we have very limited time.

Mr. CARSTENSEN. Yes, sorry.

Senator SALAZAR. In terms of, you said, both Democratic and Republican administrations have failed to enforce the law out of USDA, why do you think that happens?

Mr. CARSTENSEN. My guess is that there is a certain kind of political pressure brought on the Secretaries of Agriculture and those who make decisions in the Department of Agriculture that causes them to ignore their duties to enforce the law.

I think there are also some complexities in terms of the history of how GIPSA has operated, the kind of economic support it has had; that is, it has not had an adequate staff, it has not had adequate enforcement authority within the Department of Agriculture. So that combination of factors and a long history of inactivity makes it very hard to get it restarted.

Senator SALAZAR. Thank you very much. My time is up.

Thank you, Mr. Chairman.

Chairman HARKIN. Thank you, Senator Salazar.

Let's see. Next would be Senator Casey.

Senator CASEY. Mr. Chairman, thank you very much. I want to thank you and Senator Chambliss for this hearing today, and especially with regard to the challenges and the opportunities that face the livestock industry. If the Chairman will permit me to do a little bragging about my State, we are known as the Dairy State, as members of this panel know, but I am also happy to inform you that we have got a tremendous ag production history, and we are about No. 3 in that. We have a great deal of hog farming in Pennsylvania. So the issues that you are discussing today are critically important to Pennsylvania and, of course, the Nation. And a lot of the farmers in our State who have come to visit us recently have discussed important issues like the classification of manure as a toxic waste under Superfund access to new export markets, and a whole range of other issues. We are going to be spending even more time with them.

But I think one thing that I wanted to focus on today in the limited time that we have are the questions surrounding dairy farmers in Pennsylvania. Professor, I wanted to ask you one or two questions about this.

First of all, with regard to your testimony today on a whole range of issues, but in particular with regard to dairy farming, do you think that allowing dairy farmers to forward contract directly with the processor of their choice would help alleviate some of the problems associated with having just a few processors control the market? And I have one additional question after that.

Mr. CARSTENSEN. First of all, as somebody from Wisconsin, of course, we claim to be the Dairy State. I just need to get that into the record here.

There is a potential for forward contracting or other direct contracting with fluid milk processors to provide an alternative. I think one has to be—because what we have heard from chicken, pork, beef, you really need to think through carefully the terms and conditions for the forward contracting, and you need—and this is the access point. Then you need to really say to fluid milk processor, “You have got to engage in this activity. You have got to offer those contracts,” because right now the problem is that the fluid milk buyer, the dominant one, has entered into an exclusive dealing contract with a single cooperative, which has foreclosed access to the market. And if you are not willing to block that kind of contracting, your forward contracts will not exist.

Senator CASEY. And I wanted to ask you about the principal dairy problem in our State, which is the gross differential between what it costs the dairy farmer to produce the milk that he or she will produce versus the price that they can obtain. And I have spent a good deal of time not just talking about this issue, but also visiting people kind of on the ground, so to speak. One of them up in Wayne County in northeastern Pennsylvania, Joe Davitt, and his family have been doing dairy farming for years, but he is at the end of his rope. He said something which really made an impression on me. This young man is a college graduate, but he said, because of the challenges he faces, “What I have learned as a dairy farmer”—and the struggles he has had to endure, he said, “There is not a wall big enough to fit that diploma.” And I thought it was an insightful way of talking about how difficult this work is.

But do you have any advise or any comments on the question of how we can bridge that gap between the cost of production and the price that our farmers can obtain for fluid milk?

Mr. CARSTENSEN. It is an extremely difficult problem to resolve. I was quite enthusiastic about the—I think it is the MILC program.

Senator CASEY. MILC, right.

Mr. CARSTENSEN. Because it provided a guarantee that varied with the degree to which your milk was used for fluid milk so that it had the appropriate direction. It was also capped so that it focused on supporting the small to middle-size dairy farm and left the very large cow operations, if they want to be in the market, they can be in the market.

I think that something like MILC is probably the best route to provide the underlying support for dairy farmers to assure them of a basic kind of income. There are also market reforms that would facilitate increased price flowing down to the farm gate. One of the problems we had is that the price of milk has gone up at the grocery store because of concentration there, and that increased price has been split between the fluid milk processor and the grocery chain, and the farm gate has not seen any of that increased revenue.

And so there are some other proposals out there that I am, frankly, a little more leery of that might put collars on prices and essentially say if you are going to raise the price of milk, that increased price has got to flow down to the farmer. But I think that is the goal. If price can go up in the market, the farmer needs to get a share of that.

Senator CASEY. Thank you.

Chairman HARKIN. Thank you, Senator Casey.

Senator Klobuchar?

Senator KLOBUCHAR. Thank you, Mr. Chairman, and thank you for holding this hearing on the issue of competition in the livestock industry.

The State of Minnesota has many livestock producers. In fact, we produce about $1 billion worth of beef and nearly $2 billion worth of pork each year, and a little-known fact is that we are the Nation's leading turkey producer. You did not know that, Senator Casey.

My question is first of our Minnesota witness, Ms. Hayes, and I wanted to follow up first about what Mr. Hamilton was talking about, and that is the arbitration clauses. Do you think there is a legitimate need for mandatory arbitration clauses in livestock contracts, or are these being used to a farmer's disadvantage?

Ms. HAYES. I think the arbitration clauses are definitely being used to a farmer's disadvantage. One thing about arbitration to keep in mind is that the farmer, in order to attempt to resolve a dispute through arbitration, actually has to pay what can be quite large arbitration proceeding expenses as well as the fees for the arbitrator. So it is essentially like having to pay for a judge to hear your case. So it can cost tens of thousands of dollars to go to arbitration, even on a relatively small issue.

In addition to that, arbitration is the problem because it does not have any precedential effect, so once a case decides, for example, that the use of the tournament contract system was an unfair practice or something under the Packers and Stockyards Act, something like that, it is not going to hold true for any other grower, that it is going to apply just to the individual growers.

And then another issue that was raised earlier was that there is no discovery in an arbitration proceeding in most instances, and discovery is the way in a court system you would have the opportunity to find out all of the evidence, essentially. So growers go into arbitrations without adequate evidence essentially to prove their case because that evidence is in the hands of the company rather than the grower themselves.

Senator KLOBUCHAR. So what do you think would be a better way to help the farmers in this situation?

Ms. HAYES. Definitely, I think, a ban on arbitration provisions in this. You know, there may be a rare instance where a grower, fully informed of the consequences of arbitration, could, after a dispute was raised, agree to go to arbitration. But, generally, I think they should be banned from being included in production contracts, partially because production contracts are essentially contracts of adhesion. They are written wholly by the company, but the growers have absolutely no negotiating power on the terms of those contracts. Therefore, the contracts protect the company, not the grower.

Senator KLOBUCHAR. And I also noted you were nodding your head when Senator Casey was asking Mr. Carstensen about the enforcement issues with the Agriculture Department. Could you talk a little bit about that?

Ms. HAYES. Yes. I think there are a couple of important things to keep in mind under the Packers and Stockyards Act. For the poultry industry, one of the enforcement problems is that USDA does not have the authority to bring adjudicatory actions to enforce the unfair and deceptive trade practices section of the act against poultry dealers. They do have that authority to bring enforcement actions against red meat packers. They have not done a very good job of that, and I think that another way that the agency has failed to enforce the act is they have very broad regulatory authority, and it is very clear in the legislative history of the Packers and Stockyards Act that it was intended to be used to keep up with the changing structure of the industry. So they should have been looking at the industry as it became more concentrated and more vertically integrated and started defining what is unfair, what is unjust discrimination, what is price manipulation in this new context. And they have not been doing that.

As a result of that, we have essentially through court decisions started to lose some of the original intent of the Packers and Stockyards Act—not that it was not there, it is just that it is not getting enforced because the agency is not doing it and the courts now have come out and started saying that you have to prove anti-competitive effect. Essentially you have to prove there is an anti-competitive effect between the packers in order to prove that a practice is unfair to a producer, which was never the intent of the statute.

That is the reason why we need specific legislation that comes in and makes it clear that in order to prove an unfair practice or a price-manipulating practice, you do not have to prove an anti-competitive effect. So those are ways that the statute needs to be amended.

We will always need the enforcement authority of the agency because, to a great extent, producers cannot afford many times to bring actions to enforce the act. Another way that you could improve that would be to authorize the award of attorneys' fees for private causes of actions to enforce. But the agency will always be needed to be there, and what needs to be impressed upon them is the need to start defining unfair, unjust price-manipulating practices in the structure of this current industry.

Senator KLOBUCHAR. Thank you.

Mr. Carstensen, you talked about how the consolidation of the livestock industry is having the effect of putting farmers at an economically disadvantaged and vulnerable position. What would you say to producers who say that they actually prefer a production contract with the animal feed supply because then they do not bear a risk or have the liability?

Mr. CARSTENSEN. Well, it may be individually rational to enter into various kinds of contracts in the context where your next best alternative is worse. So that a production contract that guarantees you something is going to look better than a cash market that we are now being told by the RTI study has an increasingly bad price consequence for farmers, as the point was made earlier in the pork industry in Minnesota and Iowa. So that, you know, compared to my alternative, this contract is good if we can regulate—this is why I keep saying the law needs to construct a set of rules that facilitate fair, efficient market operation, whether it is by contract or by cash market transaction.

So it is perfectly rational to take a bad choice if your alternative is worse. That does not make the bad choice desirable.

Senator KLOBUCHAR. Nicely put. Thank you.

Chairman HARKIN. Thank you very much, Senator.

Now we go to Senator Thune.

Senator THUNE. Thank you, Mr. Chairman, and I want to thank the panel for your testimony. These are important issues, and based on my experience in my home State of South Dakota with livestock growers and organizations, sometimes these are not issues that generate agreement. There are differences of opinion between different agricultural organizations, as there are differences between individual neighboring producers in some cases. But to me the competition title in the farm bill ought to strengthen our antitrust laws to ensure that no single entity has so much market power that livestock producers and consumers are negatively impacted. And in my home State of South Dakota, we have a proposed acquisition of Premium Standard Farms by Smithfield. If approved, this merger would eliminate Premium Standard Farms as a buyer of hog and hog-feeding services.

Now, the Department of Justice is currently reviewing this particular merger, which would have serious repercussions for hog producers throughout the Midwest and other parts of the country. In my view, this is a clear example of why our antitrust laws need to be strengthened, particularly as they pertain to the agricultural industry.

What I would like to do is direct a question, if I could, to Mr. Carstensen regarding that merger. You referenced it in your testimony. What do you think would be the impact of the Smithfield-Premium Standard Farms merger on the competitiveness of the Midwestern hog market?

Mr. CARSTENSEN. Well, as Dr. Muth pointed out, we already have clear evidence of market power in hog processing. This merger will significantly increase that kind of market power and will cause two kinds of problems in the Midwest. I should say it is going to cause even more problem in North Carolina, but I realize your focus is on the Midwest, sir.

In the Midwest, we have two things that will happen. As you eliminate the competition between Smithfield and Premium Standard, you will reduce the ability of farmers to get the benefit of competition, and in the buyer power world, we need multiple competitors. And although Premium Standard's operation is in northern Missouri, this is going to have a spillover or a reverberating effect, where I think it is very likely to see Smithfield pull out of South Dakota, move out of that more competitive part of the Midwest hog market, relocate its activities to the less competitive southern part of the Midwest, and thus, all hog producers throughout the Midwest are going to suffer lower market prices.

The other thing that will happen is because Smithfield will be more vertically integrated after this merger, its incentive to engage in both price manipulation on the cash market which directly affects its contract prices and its incentive to use that strategically to harm both hog producers and its competitors will be increased.

So, in my view, it is a very, very bad merger, and I am perplexed as to why the Justice Department has not objected to it strenuously already.

Senator THUNE. And I want to follow up on that question, your view on Justice's role in this, the Department of Justice, and whether or not they have been thorough in adequately reviewing this merger, if I could get you to comment on that as well. I know you have made some reference again to it in your testimony.

Mr. CARSTENSEN. I did have the privilege of talking with a major investigative team from the Justice Department last October, along with some others, to raise concerns. My sense is that at a staff level, they have staffed this adequately. They have got people who are well trained—since one of them is one of my former students—and quite able to do the analysis.

They have a terrible track record of following through and getting the top management to actually bring lawsuits. They have not brought a major merger lawsuit now in a number of years. And at this point, there is no transparency in their process.

I know that they have asked for a further delay in the merger. They have got another 30–day delay in the closing of the merger so that they can continue their review. That is somewhat unusual, and it suggests that they are giving serious attention. The proof of the pudding is whether they are actually going to take action, and on that one I wish I knew more. I could make a fortune in the stock market, I suppose. But, no, that would not be right. But, more importantly, we would all be able to know what is going on. But, unfortunately, I do not and I do not think anybody outside of Justice does.

Senator THUNE. Let me ask you another question with regard to another proposed merger, and that has to do with, in the past several years, Monsanto, the world's biggest seed enterprise, has acquired considerable market power in biotechnology, trademarked most notably its Roundup Ready corn and soybeans. Does the Delta Pine and Monsanto merger have additional anticompetitive implications for the corn and soybean market in the Midwest? And how is Monsanto's increasing market power affecting the independent seed companies? If you could address that.

Mr. CARSTENSEN. Yes. Again, this is another merger that has been under study at Justice for a long time. They actually had objected to it in 1998 when it was first proposed. The parties backed away. Now they are back again seeing whether they can sneak it through.

The harm to the broad market is this: Delta and Pine Land is a major cotton seed producer and has contractual arrangements with several competitors of Monsanto. They are developing competitive genetic—herbicide-resistant genetic pesticide characteristics.

If the merger is blocked, Delta Pine will be a principle developer of the technology and application first in cotton, but what that means is that it opens the door to being able to transfer these genetic characteristics to corn and soybeans. The minute we get competing genetic technologies for herbicide resistance and pesticide resistance in corn and soybeans, the price of corn and soybean seed is going to go down.

So farmers in the Midwest have an enormous stake in how this merger is evaluated because, on the one side, we are going to get a much more competitive market in genetics, and that is very much to the benefit of farmers. To the other side, if it is not blocked, that competition is going to be further impaired as we go down the road, as new technologies are not made available. And as I laid out in my statement, the additional risk for farmers is that Monsanto, dominating all of this, is going to be in a position to start imposing a tax on the farmer. Every time the farmer wants to sell a soybean or a corn kernel that has a Monsanto gene in it, the farmer may have to pay a tax to Monsanto, or Monsanto will sell the right to buy from that farmer to particular grain elevators.

A very, very serious problem here that needs to be addressed.

Senator THUNE. Thank you.

Mr. Chairman, I have questions for other members of the panel. I did not want to turn this into a two-way dialog here, but I do think as we review this issue that obviously the market works when there is competition, and in order for competition to be effective, there has got to be good transparency. And I hope as we look at these issues with regard to the next farm bill that we will keep that in mind, and we obviously want to be sensitive to making sure that the market can work and that the producers can manage their risk effectively, but that we have got an appropriate, effective level of competition out there and the transparency that is necessary to ensure that.

So I thank you all for your testimony, and thank you, Mr. Chairman, for holding the hearing.

Chairman HARKIN. Thank you, Senator Thune. Again, I look forward to working with you on this in the farm bill and obviously ask for any advice and consultation that you have on this issue. Obviously you know a lot about this, and I would respect your views and any input that you would have on this. So I ask for that.

Next I turn to my colleague from Iowa, Senator Grassley.

Senator GRASSLEY. Thank you, Senator Harkin, for holding such a very important hearing. Probably over the long haul, getting more competition in agriculture will do more for farmers' income than what we do through the farm bill, although we will be doing both, hopefully, having competition very strongly involved in the debate in the Senate. And I think I made it clear that my position is to ban packer ownership of livestock and to get rid of mandatory arbitration clauses. Those are things that I worked on in the last farm bill. We did get it through the Senate. It did not survive conference, but hopefully this year these things of that nature will survive Congress.

I am going to put an opening statement in the record, Mr. Chairman, and I have just a few questions.

[The prepared statement of Hon. Charles Grassley can be found on page 50 in the appendix.]

I am going to start with Mr. Carstensen. Isn't it true that when the spot market drops to less than 10 percent with fewer packers—I said that wrong. Isn't it true that when the spot market drops to less than 10 percent with a few packers, the risk of price manipulation increases?

Mr. CARSTENSEN. Definitely.

Senator GRASSLEY. OK. Do you agree that consumer meat prices do not follow cheaper livestock prices?

Mr. CARSTENSEN. I am sorry. Say that again?

Senator GRASSLEY. Do you agree that consumer meat prices do not follow cheaper livestock prices?

Mr. CARSTENSEN. The correlation is very weak.

Senator GRASSLEY. OK. If you were selling, for example, a handmade product at a local auction, isn't it true that you would rather have ten bidders than two or one?

Mr. CARSTENSEN. Again, definitely.

Senator GRASSLEY. OK. And then for Tim Schmidt, we have heard from the packers that contracting is necessary to provide quality incentives. But isn't it true that the quality payment system and quality incentives are the same for hogs sold under both contract as well as in the open market?

Mr. SCHMIDT. Yes, exactly. I follow all their quality requirements and need to meet those in order to sell my hogs to their facilities.

Senator GRASSLEY. OK. Mr. Chairman, I have no other questions, and I will submit the others for the second panel.

Chairman HARKIN. Thank you very much, Senator Grassley.

Our time is running out, but I just want to ask one question. I will just go down the line and just kind a one-sentence or two-sentence answer I would certainly appreciate to this one question that I hope kind of sums it up.

What do you think needs to happen to ensure that there is a fair and open market for small and medium-size hog operations and poultry operations like Mr. Schmidt and Mr. Hamilton, small and medium-size livestock operations? What do you think needs to happen to ensure that there is a fair open market for small and medium-size livestock operations? Mr. Carstensen.

Mr. CARSTENSEN. First of all, we need full disclosure of contract terms; second, we need access for all producers through some form in which they can tender their livestock; and we need fair contract terms whenever we are going to be using a contract, and that is the regulatory structure that I have talked about.

Chairman HARKIN. You are talking about getting rid of mandatory arbitration.

Mr. CARSTENSEN. Yes.

Chairman HARKIN. Ms. Hayes?

Ms. HAYES. I believe that we need a ban on packer ownership of livestock. We need a restriction on forward contracting that would require all forward contracts to have a fixed-based price, not a formula-based price, because it is through the formula pricing that manipulation can occur, that all forward contracts be traded in an open and public market that makes it available to all producers, including small producers, and ensures transparency of those transactions. And then we also need to ensure that the Packers and Stockyards Act can be enforced for unfair and deceptive trade practices and make sure that terms in production contracts are fair and that there is adequate bargaining power between growers and the companies.

Chairman HARKIN. Thank you very much.

Dr. Muth?

Ms. MUTH. Based on our experience working with transactions data from packers and profit-and-loss statements, to ensure the ability to conduct thorough analyses, to look at the relationships in the industry, standards for how transactions data and profit-and-loss statement data are maintained would facilitate analyses of those relationships over time.

Chairman HARKIN. Mr. Schmidt.

Mr. SCHMIDT. I believe that pork producers should be allowed to sell at least a portion of their hogs on the open negotiated spot market, and I believe that those prices should be reported to the USDA Market Service along with alternative contracts, with the prices those producers are receiving also.

Chairman HARKIN. Thank you very much.

Mr. Hamilton.

Mr. HAMILTON. We need balance. We need negotiation with our companies. We need them as much as they need us. The problem is everything is shifted to their side right now.

Chairman HARKIN. But what needs to happen to ensure there is a fair open market for small and medium-size operations?

Mr. HAMILTON. We need transparency in the market, and on the poultry side of it, the arbitration is the biggest thing. I think that needs to go.

Chairman HARKIN. OK. Good enough. Thank you all very much for your testimony and for being here today. We appreciate it very much. You have added greatly to our thoughts and our information on developing this aspect in the farm bill. So we will dismiss this panel. Thank you again very much.

We will call up our second panel: Mr. Eric Nelson, Mr. John Queen, Ms. Joy Philippi, Mr. Ron Truex, Burdell Johnson, and Mr. William Roenigk.

Now, again, while the previous panel that we had was focused on the competition title in the farm bill, what we are going to do strictly on competition, this panel is more broadly based. I have asked you to come and just basically testify on broader issues. It does not have to be on competition at all, but on areas that affect you or the organizations that you represent.

And so, again, the same thing, if you can sum up in 5 minutes—we are supposed to be out of here by 12:30, so we are going to have to move. So I would ask you if you could just sum it up in 5 minutes or so, I would sure appreciate it, and we will just down the line.

Mr. Eric Nelson and his wife own and operate a beef feedlot along with a cow-calf farming operation in western Iowa near Moville. Eric is a fourth-generation farmer-cattleman and operates the same land his great-grandfather purchased in 1920. They have five children. He serves as Region VI Director of R-CALF and the Iowa Membership Chair.

Mr. Nelson, welcome to the Committee and please proceed.

STATEMENT OF ERIC NELSON, RANCHERS-CATTLEMEN ACTION LEGAL FUND, UNITED STOCKGROWERS OF AMERICA (R-CALF USA), MOVILLE, IOWA

Mr. NELSON. Good morning, Chairman Harkin, Ranking Member Chambliss, and members of the Committee. I appreciate the opportunity to testify about including livestock and competition issues in the 2007 farm bill.

Again, as stated, my name is Eric Nelson and, along with my wife, Carol, and our five children, we do operate a beef feedlot, cow-calf, and farming operation in western Iowa, and as was stated, I am a member of the board of directors of R-CALF USA and am President of the Independent Cattlemen of Iowa.

R-CALF USA is a nonprofit cattle producer association that represents thousands of U.S. cattle producers in 47 States, along with over 60 State affiliates and local affiliates. R-CALF USA's mission is to ensure the continued profitability and viability of independent U.S. cattle producers. The demographics of the R-CALF USA's membership are reflective of the demographics of the U.S. cattle industry, with membership ranging from the largest of U.S. cattle producers to the smallest. R-CALF USA's membership consists primarily of cow-calf operators, cattle backgrounders, and feedlot owners. The 2007 farm bill presents an important opportunity to strengthen the cattle sector and create a competitive playing field, at home and abroad, for United States cattle producers.

Ensuring a market framework that provides participants in the U.S. live cattle industry with the opportunity to remain profitable should be a central focus of the 2007 farm bill. A profitable and vibrant U.S. cattle industry is vitally important to the health of our citizens and the overall welfare of rural America. Today's production agriculture, which, in addition to its principal role of producing an abundance of safe, wholesome, and high-quality food, now includes the development of biofuels and a heightened emphasis on international trade. This makes for a highly complex and dynamic industry that has created many overlapping and interconnected relationships.

To effectively address the new complexities that were brought about by changes in national policy, we must adhere to sound market principles. For example, R-CALF USA believes that each segment of U.S. agriculture should have the opportunity to prosper at the same time, without pitting one group against another. This belief is based on our knowledge that competitive markets have long assimilated increased production costs without rendering entire industry segments unprofitable.

When applying this principle to the Nation's current policy of achieving more energy independence through alternative energy promotion, R-CALF USA does not join critics who claim the Government's ethanol incentives are inappropriate. Instead, R-CALF USA believes the proper response by the U.S. cattle industry to this National Energy Policy is to work aggressively to remove the barriers that currently prevent the U.S. cattle market from assimilating necessary increases in productions costs. If appropriate reforms are made to enable U.S. cattle producers to begin receiving their competitive share of the consumer's beef dollar and their competitive share of the consumer beef market, then they will be able to recover increased production costs from the competitive marketplace. Such reforms should be included in the farm bill's competition title. These reforms would be inclusive of limiting packer ownership of livestock and packers' use of certain captive supply contracts, strengthen the Packers and Stockyards Act, improve price transparency, allow interstate shipment of State-inspected beef, and, very importantly, put mandatory country-of-origin labeling into place.

The removal of current market competition barriers from the U.S. cattle market would generate another benefit for the U.S. cattle industry, besides that of accommodating the Nation's desire to achieve energy independence. Production agriculture is a capital-intensive endeavor, making it very difficult for young people to gain entrance. For generations, livestock production has served as the means by which young entrepreneurs have gained entry into agriculture.

In 1930, my grandfather, with help from my great-grandfather, built a barn that still stands on our home farm. It took a lot of faith to build that large structure back in 1930, just months after the stock market crash of 1929. But they were livestock producers, and less than 10 years earlier, the Packers and Stockyards Act had reestablished a competitive livestock market, which provided hard-working entrepreneurs with a genuine opportunity to prosper in the livestock industry. The 2007 farm bill could again reestablish competitive livestock markets that would afford that same opportunity to a whole new generation of livestock producers. The core problem facing the cattle industry today that the 2007 farm bill can help to correct is that the overall framework that defines how our industry operates is no longer adequate to ensure a balanced and properly functioning competitive marketplace. The present industry framework comprised of the statutes, regulations, and policies that govern contracts and market competition, consumer information, and information disclosure, heath and safety, and trade have evolved under the considerable influence of the Nation's largest meatpackers, and without sufficient counterbalance from producers. As a result, the balance of power within the present industry framework is tilted in favor of the meatpackers, resulting in a pricing advantage for them and an erosion of competition for livestock producers.

Independent producers cannot match the economic or political power held by the Nation's largest meatpackers. We cannot expect to level the playing field by correcting the deficiencies within our industry's framework through negotiations with the meatpacking sector. Ironically, we are in an intense competition to win back competition. Therefore, our success in winning back our competitiveness will depend on you, the Congress.

Thank you again for allowing me the opportunity to provide input in this important hearing. I welcome any questions from members of the Committee.

[The prepared statement of Mr. Nelson can be found on page 116 in the appendix.]

Chairman HARKIN. Thank you very much, Mr. Nelson.

Now we will turn to John M. Queen, President of the National Cattlemen's Beef Association. He is the own of John Queen Farms, a third-generation cattle farm founded in 1917 and located in the western mountain region of North Carolina. His background in the beef industry includes cow-calf producer, stocker, backgrounder, feeder, and grazer. He is now currently serving as President of the National Cattlemen's Beef Association.

Welcome to the Committee, Mr. Queen, and please proceed.

STATEMENT OF JOHN M. QUEEN, PRESIDENT, NATIONAL CATTLEMEN'S BEEF ASSOCIATION, WAYNESVILLE, NORTH CAROLINA

Mr. QUEEN. Thank you, Mr. Chairman. My name is John Queen, and I am a third-generation cattle producer and livestock market operator from Waynesville, North Carolina. I am President of the National Cattlemen's Beef Association and am pleased to be with you to discuss our policy on market structure issues, a policy which was brought forward by, debated by, and voted on by our rancher members. This is grass-roots policy where one-member/one-vote has always been the standard.

When it comes to market structure and competition issues, the National Cattlemen's Beef Association's position is simple: We ask that the Government not tell us how we can or cannot market our cattle. The way we market cattle has changed significantly over the years, and it has come from recognition within our industry that we are not just cattle producers but beef producers and must be responsive to the consumers' demands. The consumer focus has led to many innovative marketing programs that have improved the quality of beef, giving the consumer what they are asking for and allowing ranchers to get paid for the value they add to the animal.

In addition to being responsive to our consumers, participation in these marketing arrangements provides a rancher with tools that help their operations and herd management. The ability to manage price risk is one of the most valuable of these tools. Taking advantage of marketing arrangements such as forward contracting allows producers to make a price that allows him to be profitable. If the price does not fit their needs, they can walk away and find another buyer. Being a "price maker" rather than a "price taker" puts ranchers in control of their business. Many ranchers who participate in these programs get information back from the feedlots telling them how their cattle performed. Information also comes back from the packer in the form of yield and quality grades. This information is critical in managing our herd and focusing on the traits which produce the highest quality animals.

The benefits of the AMAs, or the alternative marketing arrangements, which we heard about earlier, was commissioned by GIPSA under the direction of Congress. The study took 3–1/2 years and $4.5 million of taxpayer dollars and was billed as the "definitive answer" on these issues we are discussing here. The study supports what many ranchers across our country have known all along—a market-driven system works. The overwhelming conclusion of this study is that overall, alternative marketing arrangements help all sectors of the industry, not just those that participate.

The report states that the leading reasons ranchers participate in AMAs are the ability to buy or sell higher-quality cattle, improve supply chain management, and obtain better prices.

When talking about improved supply management, we have to once again go back to the consumer. The consumer does not come into their local Safeway looking for Rancher's Reserve beef only on Tuesdays. The consumer demands the convenience of picking up a package of Rancher's Reserve beef any day of the week. To meet that demand, the retailer and packer need a steady and consistent supply of cattle that meet the qualifications of the store-branded program. If the packer is limited in its ability to source those cattle, the branded programs go away, the consumer chooses other products, and cow-calf producers get less money.

So far, I have talked only AMAs, but approximately 62 percent of the cattle marketed today is done through cash or spot markets. Spot markets, such as auction barns, are critically important to the U.S. cattle industry. Ranchers who market this way cite several reasons for their choice. One reason is independence. Flexibility is also important to these producers. Selling on the spot market gives ranchers the opportunity to participate in market rallies. We must remember, however, that this only gives them the opportunity to catch the rally. Timing the market is always a difficult task and adds to their price risk.

Even with traditional means of marketing, we have seen innovations that have been market-driven. One of these innovations is video livestock auctions. With this method, ranchers can auction their animals by video and reach consumers all across this country.

The results of these innovations are telling. Demand for beef has grown over 20 percent since 1998—never heard of before in the history of our country. Consumers spent a record $71 billion dollars on beef in 2006. And consumer confidence in our product is at 91 percent—higher than it was in 2003, when we had the BSE cow in Washington State.

The study concludes that restrictions on AMAs would cause a decrease in the supply of cattle, quality of beef, and feed or cattle prices. These results would set our industry back and place the burden on the individual cow/calf producer.

At a time where we continue to see an increase in feed costs due to competition with ethanol for corn, as well as an increase in fuel costs, the last thing we need to do is add more burdens to our ranchers. Keep in mind that for every agreement made by a packer, there is an individual rancher on the other side of that transaction who has decided that that agreement is in their best interest, and they should be allowed to conduct that business privately, just like any other industry. Restrictions or bans on AMAs will eliminate or significantly reduce these programs and hamper the progress we have made in keeping ranching a viable industry.

In the end, we must have a Government that works to help our industry and not one that limits or removes choices for cattlemen in the marketing of their cattle.

Thank you.

[The prepared statement of Mr. Queen can be found on page 157 in the appendix.]

Chairman HARKIN. Thank you very much, Mr. Queen.

Now we will turn to Joy Philippi, a pork producer, a row crop farmer from Bruning, Nebraska; Immediate Past President of the National Pork Producers Council, co-chair of the NPPC Farm Bill Task Force, and Chair of the NPPC's Working Group on Foods and Ethanol and Livestock.

Ms. Philippi, thank you very much for being here. Please proceed.

STATEMENT OF JOY PHILIPPI, NATIONAL PORK PRODUCERS COUNCIL, BRUNING, NEBRASKA

Ms. PHILIPPI. Good morning, Chairman Harkin, Ranking Member Chambliss. My name is Joy Philippi. I am a pork producer from Bruning, Nebraska, and a row crop farmer, and I am also the Immediate Past President of the National Pork Producers Council. NPPC is an association of 43 State pork producer organizations and represents the interests of America's 67,000 producers.

Pork producers have a keen interest in the next farm bill. NPPC formed a 2007 Farm Bill Policy Task Force to gather input from producers from around the country. As the next farm bill is written, we hope Congress will consider the needs of the Nation's pork producers. Our desire is to maintain the industry's competitive advantage globally, strengthen our competitiveness, and defend our competitiveness by opposing unwarranted and costly provisions and regulations. Please let me address some of the issues that likely will be considered in the next farm bill.

Pork producers support the development and the use of renewable and alternative energy as a way to reduce our country's dependence on foreign oil. But we continue to have the jitters over the rapid expansion of the corn-based ethanol industry and the challenges that expansion presents to maintaining our competitiveness.

We are concerned about not having an adequate transition period to adjust to this expansion, the availability of corn to feed our pigs, and about market prices. And that is why we support allowing a 51–cent-per-gallon blender's tax credit and the 54–cent tariff on imported ethanol to expire, incentives for capturing and digesting methane from swine farms as an alternative energy source, and releasing early and incrementally, without penalty, CRP acres so they can go back into crop production. As you fashion your energy title, please consider our concerns.

With regard to conservation, pork producers would like to see dismantled the regulatory hurdles we face in trying to incorporate conservation planning into our operations. Pork producers want to continue participating in USDA's Working Lands Conservation Programs such as EQIP, but EQIP funds have not been allocated fairly to pork producers who, from 2003 through 2005, received just 3 percent of the cost share assistance provided for all livestock. NPCC would like more EQIP funds for pork operations and would like those funds to be allocated for specific on-farm practices that have a clear environmental benefit.

Animal well-being is a top priority for myself and for my fellow pork producers. We raise our pigs in a humane and compassionate manner, and our industry has a 20–year history of developing and using progressive animal well-being programs such as pork quality assurance and trucker quality assurance. We have invested hundreds of millions of dollars in research and practical applications that enhance our swine well-being.

But our industry is under attack by those who would legislate how farmers raise livestock and poultry for food. In the next farm bill, so-called animal rights groups are planning to push for a number of provisions that, if adopted, would be very detrimental to the viability of the U.S. pork industry, including a ban on non-ambulatory or fatigued hogs from entering the food supply, a ban on certain antibiotics, and a ban on the use of sow stalls on farms that produce food animals that are purchased by the Federal Government.

There are also efforts to limit how we market our pigs. The U.S. pork industry has enjoyed unparalleled prosperity over the past 3 years, and this success has come while the structures of the U.S. pork industry and the pork and hog markets have changed. We urge Congress to focus not on structural issues but on the more important efficiency measures of conduct and performance as you deliberate the wisdom of any Government intervention.

But we believe—and a recent GIPSA study concurs—that U.S. pork producers will not be well served if a particularly marketing or pricing mechanism is eliminated or mandated. Pork producers strongly support free trade agreements, but the extent of any future increase in global pork trade hinges heavily on continued efforts to bring about further agricultural trade liberalization. We support funding increases for the Market Access Program and the Foreign Market Development Program. We also encourage Congress to pass trade agreements which were negotiated with Peru, Colombia, Panama, South Korea, and also extend trade promotion authority.

To protect the U.S. pork exports, we support programs such a Federal revenue-based assurance option that would assist producers should our export markets ever be interrupted. And, last, we would like to see continued funding for Government research related to our industry, including research on improving the swine genetics by completing the mapping of the swine genome, testing and deploying new and improved animal vaccines, further increasing animal productivity, and developing new and environmental and management and mitigation technologies.

NPPC and the many pork producers we represent thank you for holding this hearing, allowing us to share the U.S. pork industry thoughts. We look forward to working with you, the Committee, as you craft the 2007 farm bill, and I would be glad to answer questions at the appropriate time.

[The prepared statement of Ms. Philippi can be found on page 137 in the appendix.]

Chairman HARKIN. Thank you very much, Ms. Philippi.

And now we turn to Ron Truex, President and General Manager of Creighton Brothers, LLC, United Egg Producers. Mr. Truex is the President and General Manager of Creighton Brothers and an egg producer in northeast Indiana. He has been in the egg production business for 37 years, has held several leadership positions in the industry, having served as President of the Indiana State Poultry Association, Chairman of the American Egg Board, and currently as Chairman of the Government Relations Committee of United Egg Products. Ron also serves his community as an elected county commissioner in Indiana.

Mr. Truex, welcome to the Committee and please proceed.

STATEMENT OF RON TRUEX, UNITED EGG PRODUCERS, WARSAW, INDIANA

Mr. TRUEX. Good morning, Chairman Harkin, Senator Chambliss. It is a privilege to be here this morning. As you said, I am Ron Truex, and I am President and General Manager of Creighton Brothers, a family owned farm since 1925 in Warsaw, Indiana. I chair the Government Relations Committee of the United Egg Producers. The United Egg Producers is the Nation's egg organization. Almost 90 percent of all eggs in the United States are produced by our members. We appreciate being included in this hearing. The farm policies that you adopt will definitely affect our industry.

In the past year, we have been affected by the booming demand for ethanol and biodiesel. Production costs for eggs have skyrocketed as rising demand for biofuels has driven up feed prices. About 55 percent of the cost of producing a dozen eggs is feed; 63 to 65 percent of our typical layer diet is corn.

From September of 2006 through the end of February in 2007, a typical egg operation saw almost a 60–percent increase in feed costs. During that period corn prices rose from around $2 a bushel to more than $4 per bushel. The cost of getting a dozen eggs to the grocery store went up around 10 cents a dozen.

United Egg Producers supports alternative fuels as a part of the Nation's strategy for energy independence, but we believe that U.S. policies must take into account the needs of egg, poultry, and livestock and dairy producers.

In the 2007 farm bill, Congress should expand research to: one, commercialize technologies to make ethanol from cellulosic biomass; two, modify the DDGs and other byproducts to expand their use in layer rations; three, develop other renewable energy sources, such as power generation, using manure and mortality.

Although tax incentives are not a part of the farm bill, we believe that any tax credit or similar benefits available to ethanol or biodiesel should also be available for other sources of renewable fuels, including products of the livestock and poultry industries. We also suggest that you explore making tax credits countercyclical so that they would be lower when oil prices are very high.

During recent years our organization has spent more time on animal welfare than any other single issue. We feel strongly that animal welfare standards should be based on science, not emotion or politics. In the late 1990's, we commissioned an independent, unpaid Scientific Advisory Committee that recommended industry-wide guidelines for animal husbandry. About 85 percent of the producers have voluntarily adopted these guidelines, which are known as the UEP Certified Program. These guidelines have been well accepted by our retail and food service customers and provide assurance to consumers that the eggs they buy were produced under animal husbandry standards.

We want this Committee to know that the private sector has been actively working on animal welfare because we are concerned that when you take the 2007 farm bill to the Senate floor, a variety of amendments could be offered that would be hostile to animal agriculture. These amendments may or may not have anything to do with eggs directly, but they might target other species groups instead. But our request to you is simple: Please vote against hostile, anti-livestock amendments that may be offered. Instead, please support our industry and its use of science, not emotion, to develop and implement voluntary animal husbandry guidelines in the private sector.

We also feel strongly that the Nation should invest more in basic and applied agricultural research extension and education. Compared to the other scientific fields, Federal funding for agricultural research has been stagnant at best. The CREATE–21 proposal endorsed by land grant institutions is an important contribution to this debate, and we support its goals.

We do feel that while better coordination between intramural and outside research is important, the Agricultural Research Service should remain a separate agency. For animal agriculture, research can help us not only make our farms more viable, but also serve the public goods. For example, the Government has paid increasing attention to air emissions from livestock and poultry operations. Already there are several technologies that show promise in reducing air emissions. The next step is to test them on actual farms in order to demonstrate their efficacy and economic feasibility. Once this is done, producers can begin to adopt new technologies. We hope this Committee will consider authorizing air emission mitigation research in the farm bill.

Mr. Chairman, my written testimony provides additional details on these and other issues that are important to us. Once again, I appreciate your including the livestock and poultry industries in your hearings on the 2007 farm bill. Thank you.

[The prepared statement of Mr. Truex can be found on page 179 in the appendix.]

Chairman HARKIN. Mr. Truex, thank you very much for your testimony, but you left out the single most important part of your written testimony, and that was knowing that Iowa is the No. 1 egg producer in the Nation.

Mr. TRUEX. That is true.

Chairman HARKIN. I just want to make note of that for the record.

Now we move to Mr. Burdell Johnson, President of the American Sheep Industry Association, a fourth-generation lamb and wool producer, who raises Columbia and Hampshire ewes and feed sheep through the family business, Diamond J Livestock. He also raises cattle and grows several crops, including wheat, corn, barley, oats, and sunflowers. He is a former ASI Executive Board representative for Region VI and also served on numerous ASI committees. He is currently President of the North Dakota School Board Association and serves on the North Dakota Insurance Reserve Fund. He and his wife have three children and two grandchildren. Again, another good family farmer, so welcome to the Committee, Mr. Johnson. Please proceed.

STATEMENT OF BURDELL JOHNSON, PRESIDENT, AMERICAN SHEEP INDUSTRY ASSOCIATION, TUTTLE, NORTH DAKOTA

Mr. JOHNSON. Thank you, Mr. Chairman and members of the Committee. I am honored to be here today to visit with you and follow up with the conversations you had at the field hearings with my fellow producers in Montana and Nebraska.

I am very proud of the accomplishments that our industry has made in previous years, not too far off. We had our Flock Expansion Program that we have increased numbers in a couple of years. We have a successful industry-supported promotion program, and we have put American wool on the international market. The 2002 farm bill deserves a lot of credit for us being able to accomplish a lot of this.

One of the things that did come out of the 2002 farm bill was our Wool Loan Deficiency Program. This was a program for shorn wool and unshorn pelts on the LDP program. However, we feel that the loan base rate should be set at $1.20 rather than what it is right now. The way it is set now, only one out of the nine categories are being utilized. If it is set at $1.20, it will involve a lot more producers to use it.

Another successful program for USDA is the National Sheep Industry Improvement Center. This is a program used to assist lamb and wool businesses through loans and grants to rebuild our infrastructure that was declining because of the loss of numbers. This came out of the 1996 farm bill. The only problem is we did not get to finish it before it run out. There was still $20 million that was authorized in the 1996 bill. We would like to see it reauthorized so we could continue to finish this program. I am a firm believer that once you start something, you finish it, and that is why I am pushing to reauthorize the National Sheep Industry Improvement Center. It has been a great program for industry.

On the conservation side of the farm bill, we support a priority for prescriptive grazing using sheep to control noxious weeds and invasive species on the rangelands in the U.S., which is a big problem with these, and sheep can contribute tremendously in that area.

We look forward to working with the Committee to reauthorize these two programs. They have been helpful not only to individual producers, but also to the entire industry.

On the competitive side, we urge implementation of an interstate shipment of State-inspected meat. By allowing this to happen, it will open up more marketing opportunities in lamb.

Also, mandatory price reporting is a big issue for us. This is what our price protection that we just got approved hinges on, mandatory price reporting, and it has a great effect on our industry.

We also support the country-of-origin labeling with lamb. We have always been in favor of that.

On the international level, we would like to see the Federal Government look at the sheep meat trade reform. Currently, the European government subsidizes their sheep industry $2 billion annually, and they have a very strict quota system on imported lamb.

The industry looks forward to working with you in the future on a successful farm bill, but I would also like to add my appreciation for the disaster assistance that is in the works because of drought conditions. Examples of the drought conditions like in New Mexico, we have examples of where weaning lamb crops was as low as 35 percent because of the drought. And the drought has continued all the way from Texas to my ranch in North Dakota. With this drought, higher fuel costs, and feed costs, disaster assistance will help a lot of struggling producers, which is happening at the time.

Thank you very much.

[The prepared statement of Mr. Johnson can be found on page 102 in the appendix.]

Chairman HARKIN. Thank you, Mr. Johnson.

Now our last witness of the day, William Roenigk, Senior Vice President of the National Chicken Council. This organization represents companies that produce and process over 95 percent of the young meat chickens, broilers, in the United States. Mr. Roenigk oversees projects that involve industry and consumer market surveys. He serves on the U.S. Department of Agriculture's Agricultural Technical Advisory Committee for Trade in Animals and Animal Products, and prior to his present position as Senior Vice President, he was Director of Economic Research and Membership Services for the National Broiler Council.

Welcome to the Committee, Mr. Roenigk, and please proceed.

STATEMENT OF WILLIAM P. ROENIGK, SENIOR VICE PRESIDENT, NATIONAL CHICKEN COUNCIL, WASHINGTON, DC

Mr. ROENIGK. Thank you. Good morning, Chairman Harkin, Senator Chambliss. The National Chicken Council appreciates this opportunity to present our views and recommendations on the important issues in today's hearing. My name is Bill Roenigk. I am Senior Vice President of the National Chicken Council, and I would note that in today's operating environment, the number of challenges seem to far outweigh the number of opportunities. And for the record, Chairman Harkin, we do wish there were more chickens in Iowa, broiler-type chickens. I would also note that Georgia is the largest broiler-producing State, and so we are very pleased to be able to recognize that.

Senator CHAMBLISS. If we could ever get them to Hatch some eggs, we might keep up with you guys.

Chairman HARKIN. You have got the eggs. We have the broilers.

Mr. ROENIGK. I would like to bring the Committee's attention to what we think is a rather interesting and serious development, and that is, for the first time in 32 years, broiler production this year will be less than it was last year. Now, it does not happen very often—32 years, the last time was 1975. If you have had a chance to look at my chart on page 8, you are probably struck by the very sharp and continual uprise in our production. But if you notice from 1970 to 1975, there was a very flat period during that time. I hope I am wrong, but I believe we may be in now a period where we are going to go into another flat period of production. This is going to limit the opportunities not just for chicken companies, but it is going to limit the opportunities for growers.

Companies have lists of people, growers who would like to add houses. They have people who would like to become growers. Those lists are going to become longer if our production stays flat rather than continue to increase.

The reason production may not increase in the next few years is, as my statement says, due to Government policy—not entirely but primarily Government policy. That was the case in 1975 and 1973 when our production last turned down. The primary policy I refer to is what some of the other people on the panel said, and that is, corn-based ethanol is causing a real change in our feeding arrangement.

You will notice in my statement, if you look a year ago when USDA first made the forecast on per capita consumption of the various meats, it was a rather rosy forecast, especially for broilers, at over 88 pounds per person. Now they say 85 pounds. When you add up all the meats, it is a change of 5.6 pounds from the first forecast, not all due to ethanol but a significant part of it is. And these fewer pounds mean fewer opportunities to generate income, jobs, and local and national economic activity.

The challenge to getting back on the upward track is to make sure there is enough corn, not just for ethanol and not just for exports, but for animal agriculture also.

In my statement, I list two ideas that could be applied to the Conservation Reserve Program, and time does not permit me to get into that. One of those was borrowed from the soybean producers, which I think is a pretty good idea.

I also suggest in my statement that there needs to be a relief valve in case there is a significant shortfall in the corn crop. And I understand corn has a difficult time going into the ground in the Midwest due to the cold and wet ground. We need to get the corn in, we need to get it up, and we need to have an excellent harvest if we are not going to have a problem. If we do have a problem, there needs to be some way to address a significant shortfall.

I also mention in my statement that the USDA and related agencies are doing an excellent job on biosecurity safeguards and firewalls, keeping highly pathogenic avian influenza out of our flocks, and there needs to be continued good budget and resources to allow those agencies to do that. If we did get influenza in our flocks, I believe the issues before this Committee would be much different than whether or not mandatory arbitration is the most appropriate mechanism in a contract.

The Foreign Agricultural Service and APHIS have been very supportive in building our exports. We need exports, especially our leg quarters. The American consumer prefers boneless skinless breast, and the export market allows us to move our leg quarters into foreign markets.

USDA's Environmental Quality Incentive Program, as was mentioned earlier, needs to be fully funded. Growers are good stewards of the land, water, and air, and EQIP will allow them to continue to do that.

The Committee has talked quite a bit about market structure, but we would respectfully submit that priorities for the Committee and Congress should be not necessarily on restructuring the vertical integration and contract arrangement in the chicken industry. It has worked well for more than 50 years, and as I mentioned, companies have lists of people who would like to get into growing chickens. Some of the panelists today would like the Committee to believe that somehow the companies have been able to successfully misinform for more than 50 years not only the growers but the people who provide substantial quantities to finance these operations. I submit that the system is working pretty well.

I appreciate the opportunity to provide our views and comments and look forward to your questions.

[The prepared statement of Mr. Roenigk can be found on page 170 in the appendix.]

Chairman HARKIN. Thank you all very much for your testimonies. I just have a few questions, and then I will yield to my friend from Georgia.

I am going to get off of the issue of competition. I heard all your testimonies, and I have that. I would like to delve into a couple of other areas.

Ms. Philippi, your testimony points out that pork producers have not benefited from the EQIP program as much as other producers. You stated that pork producers only receive about 3 percent of the cost-share assistance provided to other livestock producers. Some of this is due to EQIP giving priority to producers needing immediate help rather than providing assistance to improve existing system. But what recommendations would you have to address this issue?

Ms. PHILIPPI. One thing that we believe we need to do with the EQIP dollars is make sure that it is easy, that we can go in and with the right application, that they are available for us. You know, I talk about getting rid of some of the hindrances to the program. One of the things that we need to do is look at how operations need to be improved. They go through the permitting process, and then quite often they have to wait to find out how they could get EQIP dollars.

We would like to see the livestock industry get the dollars that were appropriated the last time. The last time you talked about that we should get the lion's share of the EQIP dollars to use for our projects. And it seems like we just got slowed down in the qualification process, and we did not get access to the money as we should.

Chairman HARKIN. For all of you, and if I can just get a one- or two-sentence answer to this question, I would appreciate it. USDA for several years now has made an attempt to implement a national animal identification system. I have heard from producers upset that they do not what is expected of them or how the system will cost their operations or if the information will be kept confidential. I also hear from producers concerned that it is taking USDA too long to implement the system.

Again, I am told by my staff that we can expect a report coming out soon from GAO, a report of an investigation we asked for, that will shed light on how well USDA has implemented the system.

So my question basically is: Do you think USDA has implemented the animal identification system in a common-sense manner? And what would be the best action to get Animal ID back on track to ensure that it is a feasible, practical system? Mr. Nelson.

Mr. NELSON. Well, R-CALF USA I guess would look at the journey that Animal ID has been on to date, and, you know, it initially started out it was going to be a mandatory program and then moved to a voluntary system. And we have actually made a proposal that there is a workable program that has already been in place, and it revolves around the brucellosis testing program that is already in already in place with permanent metal ear tags that go on the females in the cow herd, and it already allows the traceback system. It has been proven, it is workable, and it would not be burdensome, expense-wise, on producers.

Chairman HARKIN. I will go down the line, is there anybody else that wants to add to this, Mr. Queen?

Mr. QUEEN. Yes, Mr. Chairman. We at NCBA have always been for a voluntary, cost-efficient, market-driven Animal ID system, and I think it should be that way because the ID adds value to our commodity, but it should be a willing or voluntary effort on those producers. It does not make our commodity any safer. There is no science-based evidence out there that shows that beef is safer if it has an ID button in it.

So voluntary ID should be what we strive for in this industry, here again not dictating to those producers out there what they have to do with that animal.

Chairman HARKIN. Ms. Philippi?

Ms. PHILIPPI. The swine industry believes that ID should be mandatory. We have used it——

Chairman HARKIN. Should be what?

Ms. PHILIPPI. ID needs to be mandatory. We have used it since we had the pseudo-rabies program put in place. It worked to eradicate that disease. We believe in mandatory premise registration and a mandatory ID system that will protect the herd health of our industry.

Chairman HARKIN. Thank you.

Mr. Truex?

Mr. TRUEX. The egg industry has no problem, and as you know, we have worked for a flock ID instead of an animal ID because of just the numbers of poultry in a building. And then our concern would be the confidentiality of that information.

Chairman HARKIN. All right. Mr. Johnson, lambs?

Mr. JOHNSON. The American sheep industry already has a mandatory identification through the Scrapie Eradication Program, and we feel as long as this NIS is put together in conjunction with that so we can run it together, we have no problem with it.

Chairman HARKIN. Does it affect you at all, Mr. Roenigk?

Mr. ROENIGK. I would suggest that we already have flock identification. Essentially, all commercial companies participate in the National Poultry Improvement Plan, and that does identify the flocks. So I would suggest that we are already there.

Chairman HARKIN. Thank you.

Mr. Johnson, I am intrigued that in your written testimony you discussed how invasive species and noxious weeds are damaging land productivity, decreasing water quality and quantity, and degrading wildlife habitat. And you talked about how sheep can provide biological control of weeds.

Now, again, obviously this has to do with conservation, what we are going to be doing on conservation lands and things like this. What types of incentives would you like to see in the Conservation Title that would encourage the use of sheep to control invasive plants?

Mr. JOHNSON. Well, if you put programs together where you can take sheep into areas where there are noxious weeds growing and pay these producers to graze them there, it would give them a little more income. Sheep will eat noxious weeds where other species will not touch them. It has been proven, especially with leafy spurge in my particular area, where we can get lamb back into production by grazing sheep on the spurge, and then you can follow with cattle afterwards. It works very well.

Chairman HARKIN. Repeat again for me. Are there any incentives, anything we need to put in the Conservation Title? Tell me again.

Mr. JOHNSON. Well, one of the biggest things with this is predator management, when you move them out into areas where there are wide open spaces. So if you can have more money for predator control and also incentive for sheep ranchers to take their sheep out into other areas on land that they do not own or lease, just to graze, to get a multispecies grazing program going to enhance the production of grass.

Chairman HARKIN. I am running out of time. One last question. For many years there have been efforts to remove the restrictions on interstate shipment of meat from State-inspected facilities. Somebody mentioned that in their testimony. Was that you?

Mr. JOHNSON. Yes, Mr. Chairman, I did mention that.

Chairman HARKIN. But to give some perspective on this, I have been around this a long time, and I chaired the Livestock, Dairy, and Poultry Subcommittee in the House in the early 1980's, and I chaired a hearing on this issue. For many years large meatpackers opposed the legislation. Now they seem to be more open. But now the food safety advocates oppose it, so it kind of gets bounced around. As I say, I have been watching this for 25 years.

For those on this panel, does everyone agree that there should be interstate shipment of meat from State-inspected plants? And would interstate shipment of meat from State-inspected plants help to improve competition in the meatpacking industry? So two questions. Do you support that? And if you do, do you think this might increase competition?

I would just, again, go down the line. How would you feel about this?

Mr. NELSON. Yes, we definitely support the interstate shipment and feel that it would definitely improve competition.

Chairman HARKIN. Mr. Queen?

Mr. QUEEN. We, too, sir, and this is the No. 1 thing that can help competition within the packing industry.

Chairman HARKIN. Ms. Philippi?

Ms. PHILIPPI. Well, that is an issue that we do not talk about as much as we probably should at times, and we do not see there could be any advantage competitively.

Chairman HARKIN. You do not have a position on interstate shipment of State-inspected meat?

Ms. PHILIPPI. No, we do not.

Chairman HARKIN. Thank you.

Mr. Truex?

Mr. TRUEX. Nor does the egg industry.

Chairman HARKIN. Mr. Johnson, obviously you do.

Mr. JOHNSON. We do support it, but we also are a little cautious that the State programs have a high enough standard so we know the inspection service is there.

Chairman HARKIN. Mr. Roenigk, do you have anything?

Mr. ROENIGK. We would ask the question, if the State inspector plant meets all the USDA requirements, why not be a USDA plant? If there was a change for poultry, I do not think it would, as far as competition, change things very much.

Chairman HARKIN. Well, you know, Mr. Roenigk just raised something. My time is up. I assume in your answer you are saying as long as they meet the Federal standards, right? I see you nodding. I think that is probably generally accepted. Thank you all very much.

I will turn to my colleague, Senator Chambliss.

Senator CHAMBLISS. We talked about animal ID. What about country-of-origin labeling? Mr. Nelson, let's start with you.

Mr. NELSON. Mandatory country-of-origin labeling is very important. We spend a lot of time talking about value-added agriculture, and being able to have the country of origin on meat is being able to retrieve the value-added price; otherwise, you reward imported, lower-quality products that could be marketed at a higher price without an identification.

Senator CHAMBLISS. Mr. Queen?

Mr. QUEEN. Well, I do not think there is a cattle producer in America that would not approve some type of country-of-origin labeling. The law as we have it today that will soon be implemented is flawed, and to spend the money, if we cannot restructure this law the way it is intended to be spent today, is not a level playing field, certainly not for the beef industry. The purpose of this bill is to identify imported product into our country, aside from our domestic products here. Less than 8 percent of the imported product would be affected by this law. Also, other meat segments in our industry—and I was pleased to hear some of the panelists here in the chicken industry say earlier that they would like to have country-of-origin labeling. At this point they are not included in this country-of-origin labeling law. Food service is not included in this law, and how we segregate that, I am not sure, because, you know, 54 percent of all the beef in the United States is served in the form of ground beef, and that is a blended commodity using imported product with our domestic product.

So how we differentiate here, I am afraid if we do much differentiation, we are going to have a lot of marketplace disruption out there. We are going to create a non-safe attitude with our consumers, and it could set us back considerably if we do this.

So a lot of issues have to be worked out, but, yes, if we can get this worked out, I do not think there is a cattleman alive that would not like a country-of-origin labeling law.

Senator CHAMBLISS. Ms. Philippi?

Ms. PHILIPPI. The pork industry supports voluntary country-of-origin labeling because we just think it is all cost and no benefit back to the producer, and because of the exclusions of poultry and the food service items, it just does not seem like it is a program that would be workable for us.

Senator CHAMBLISS. Mr. Truex?

Mr. TRUEX. The egg industry does not have a position on country-of-origin labeling, but I can assure you gentlemen that if you eat an egg in this country, there is a real high probability it was produced here.

[Laughter.]

Senator CHAMBLISS. Mr. Johnson?

Mr. JOHNSON. Over 50 percent of the lamb that is consumed in the United States is imported, and a lot of that is being passed off as American lamb because American lamb is a better product. So we definitely are in favor of country-of-origin labeling.

Senator CHAMBLISS. Mr. Roenigk?

Mr. ROENIGK. As was mentioned, poultry is excluded from COOL at the moment. We are comfortable with that position. If there was reason to change, we would be willing to look at it. But with food service and prepared products excluded, imported product—the burden would fall on retail grocers. I am not sure that that would benefit what is trying to be done.

I will leave it at that.

Senator CHAMBLISS. Mr. Johnson, I really appreciate your comment relative to the European Union subsidies and import quotas issue. The problem we have had in our attempts to complete the Doha Round, is getting the attention of the Europeans relative to import quotas and import tariffs, as well as their subsidies, which are significantly higher than U.S. support programs. So I am pleased to hear you say that.

Ms. Philippi is the only one to mention the South Korean Trade Agreement. I am actually meeting with the USTR this afternoon, and I am curious as to what the attitude of everybody else is relative to that agreement. I have got a feeling I know what the beef folks are going to say, but let me hear from you, Mr. Nelson.

Mr. NELSON. Well, we definitely need to be able to get the beef channels open back to that country before we would look favorably on that trade agreement.

Senator CHAMBLISS. Mr. Queen?

Mr. QUEEN. Well, we at the National Cattlemen's Association certainly would love to have a free trade agreement with South Korea, considering that they do have full trade of all U.S. beef at the time that free trade agreement comes forward. If we do not have that agreement in June, when it comes time for the President to sign onto this free trade agreement, we would certainly hope that this Congress would step forward and block this free trade agreement until we have full beef trade with South Korea.

Senator CHAMBLISS. Anything else, Ms. Philippi, from you?

Ms. PHILIPPI. The only thing I am going to add is it is one of the best agreements that has ever been put together for the pork industry, and we appreciate the effort that went into that.

Senator CHAMBLISS. OK. Mr. Truex?

Mr. TRUEX. The egg industry generally supports this agreement.

Senator CHAMBLISS. Do we export eggs?

Mr. TRUEX. Yes, sir. Currently this year we have exported more eggs than we have in the last 3 or 4 years. But we are very actively exporting eggs now.

Senator CHAMBLISS. Who is our primary customer?

Mr. TRUEX. I do not know that. We export through the U.S. Egg Marketers, and they do the dealing with those, and then the egg industry as a member of U.S. Egg Marketers ships our eggs through that system.

Senator CHAMBLISS. OK. Mr. Johnson?

Mr. JOHNSON. I just like to use the term "fair trade" instead of "free trade."

Senator CHAMBLISS. Mr. Roenigk?

Mr. ROENIGK. The Chicken Council supports a Korean agreement. We have issued a statement to that effect. Korea last year was our tenth largest poultry market. We think the agreement could move that on up in terms of importance. We look forward to that agreement getting passed, and there are a couple other ones that are ahead of that. We hope those get approved, too.

Senator CHAMBLISS. Well, let me say I share the concern of Mr. Nelson and Mr. Queen relative to the beef issue. As I said in my public statement, I am losing patience with the Koreans. We have been very cooperative with them on the BSE issue, and I think it is really ridiculous that they have responded in the way they have, particularly with this agreement. And I think Senator Harkin and I share this concern, and we want to see this agreement come to fruition. It does look like it is a positive agreement. But we have got to have the free and open trade of U.S. beef going into Korea as a part of this agreement before we are going to be able to support it. And I am very hopeful that we are going to see that in the short term.

Mr. Roenigk, you heard the previous testimony, I am sure, from Mr. Hamilton relative to these arbitration clauses in integrator contracts. What is your thought or position on that?

Mr. ROENIGK. The question was asked of the previous panel whether or not they knew of a better mechanism, and I did not hear an answer to that question of a better mechanism. We are open to a better mechanism. We do not know one. We need something that is timely, efficient, and there are differences and we need to resolve those. Until someone comes up with a better idea, mandatory arbitration seems to be the best mechanism.

Senator CHAMBLISS. Well, I am a little leery of opening up a can of worms on litigation even though I am a lawyer myself. I am still recovering from that.

[Laughter]

But arbitration sounds like a good alternative to litigation, but at the same time, if the current situation is not working right, as apparently it is not—because I hear this all the time from my poultry producers across Georgia—we need to either change the rules of the road in the current contracts, or some change needs to be made to give them more authority from a legal perspective.

So I do not know what the answer is, but I would just urge you to take that message back to your industry because this will be up for discussion and I am sure probably some action as we move into the farm bill.

Mr. ROENIGK. I will make sure that that message is delivered, and I will also assure you that we will come back to you with something in terms of a more concrete idea as to what might be an alternative.

Senator CHAMBLISS. Good. Thank you, Mr. Chairman.

Chairman HARKIN. Thank you, Senator Chambliss.

I have no further questions. Again, I thank you all very much for your testimony, for being here today, and again, as we proceed on with the farm bill, if you have further thoughts, suggestions, advice, consultation, please let us know, on these or any other issues that we will be addressing in the farm bill.

So, with that, thank you all very much, and the Committee will stand adjourned.

[Whereupon, at 12:22 p.m., the Committee was adjourned.]

APPENDIX

APRIL 18, 2007

Statement

Senator Chuck Grassley

Thank you Mr. Chairman, for holding this hearing today on the issues the American farmer is facing in trying to market their livestock.

I would like to thank the witnesses for appearing before the Committee today.

During the last Congressional recess just a couple of weeks ago, I conducted a series of farm bill town hall meetings at local COOPs in Iowa.

Thinking back I had at least one farmer at every meeting bring up on what my position was on vertical integration by the livestock industry.

I told the local farmers that I was fighting for the elimination of packer ownership of livestock and getting rid of mandatory arbitration clauses in the last farm bill, and here we are again.

During my discussions with local producers, I would ask if they were for or against my positions.

I only had one person support the industry position and when I asked where he farmed at "he said he didn't farm, he told me he worked for Tyson."

Some of the witnesses today may have the same concerns as me that the packers have extremely strong incentives to push prices lower to cheapen procurement costs.

Just recently in the Iowa statehouse a bill similar to my 25% spot market bill passed out of Iowa Senate.

Iowa is a leader in hog production and hog packing in the country and this shows Iowa's call for Congress to take notice and make it national policy and finally get something done to put an end to the abuses going on in the livestock industry.

Time permitting I will close and move to some questions for the witnesses.

Thank you Mr. Chairman.

Sen. Roberts Statement and Questions
Sen. Ag Committee Livestock Hearing
April 18, 2007

Opening Statement:

Thank you Mr. Chairman and Mr. Chambliss for calling this hearing today. I represent a state where cattle outnumber people more than 2 to 1 and represented 61% of agricultural cash receipts by generating over $6 billion in 2005.

I tell you this so you understand me when I say the livestock industry is vital to the Kansas economy and our livelihoods.Competition issues are nothing new to this committee and I agree that our producers need to be able to compete in today's markets.

It is the role of the government to protect producers from unfair practices and monopolies. And I understand the calls from some for increased government involvement. At the same time, we must take careful steps to ensure that in any action we might take, we do not suffer from the law of unintended consequences and risk the significant gains the industry has experienced.

I'll leave with this thought. At a time when consumer demand for beef is high, prices are profitable, and our producers already face challenges of growing government intervention; how can I go to Ulysses, Kansas or anywhere else and explain to a producer who chooses to use alternative marketing agreements for whatever reason, that the federal government has decided they shouldn't be allowed to make their own marketing decisions?

Thank you Mr. Chairman.

Economic Challenges and Opportunities Facing American Agricultural Producers Today: Restoring Efficient, Fair and Open Markets in Agriculture

Statement of Professor Peter C. Carstensen,
Professor of Law,
University of Wisconsin Law School
before
The Senate Committee on Agriculture, Nutrition, and Forestry
April 18, 2007

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Introduction

It is an honor to asked to present my views on competition policy as applied to agricultural markets as this Committee undertakes the task of revising and re-enacting the Farm Bill. I have had the privilege of testifying before this committee in the past and I have always been impressed with the commitment of its members to understanding the competitive issues that confront agriculture. I am particularly impressed with the bipartisan commitment to improving the workings of these markets manifested in the various legislative proposals from Senators Harkin, Grassley, and Enzi among others. Indeed, it is essential that the next Farm Bill address the problems of creating and maintaining fair, transparent, accessible and efficient markets. The changing characteristics of those markets are steadily eroding the capacity of farmers to find and get the benefit of workable competition.

For the last ten years, I have focused a significant part of my attention on the specific competitive issues that confront agricultural markets on both the input and output side.[1] As a result, I have been studying these issues from a variety of perspectives as well as learning from many experts in the field. I have made a number of presentations to various groups on competition policy issues.[2] I also have a background in some aspects of these issues. As a government lawyer some 30 years ago, I reviewed the old meat packing consent decree and in the process came to appreciate the context within which Congress crafted the Packers and Stockyards Act. In 1995, I served in Wisconsin on a committee that reviewed and proposed modifications for the regulations governing contracts for vegetables being purchased for canning. I have also done an extensive examination of the grain marketing industry in connection with a study of the famous Chicago Board of Trade decision which is a landmark antitrust case.[3] In addition, my work on the competitive implications of other kinds of vertical distribution arrangements has provided me with relevant background on some of the key issues being considered today.[4] In September 2001, I was one of six invited academic experts in the U.S.

[1] Carstensen, Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy, 2000 Wis. L. Rev. 531.

[2] This testimony draws in part on my recent presentation (April 5, 2007) at the Tufts University, Friedman School of Nutrition Science and Policy symposium on Power in the Global Food system: Mapping Food Production and Food Sovereignty in the 21st Century.

[3] Carstensen, The Content of the Hollow Core of Antitrust: The *Chicago Board of Trade* Case and the Meaning of the 'Rule of Reason' in Restraint of Trade Analysis, 15 *Research in Law and Economics* 1 (1992).

[4] E.g., Carstensen, The Competitive Dynamics of Distribution Restraints: The Efficiency Hypothesis Versus the Rent Seeking, Strategic Alternatives," 69 *Antitrust Law Journal* 569 (2001); Carstensen & Dahlson, Vertical Restraints in Beer Distribution: A Study of the Business and Legal Justifications for Restricting Competition, 1986 *Wisconsin Law Review* 1; Carstensen,

Department of Agriculture's Public Forum on Captive Supplies held in Denver, Colorado.[5] We were asked to evaluate the need to adopt regulations under the Packers and Stockyards Act to deal with concerns about anticompetitive and inequitable treatment of farmers and ranchers who raise beef cattle. I have also been an invited witness in hearings before this committee and the Senate Subcommittee on Antitrust, Business Rights and Competition on agricultural competition issues.

Overview

The American farmer faces increasingly dysfunctional markets for both the inputs and outputs of the farm. The resulting squeeze threatens the traditional structure of American agriculture and is likely to result in the gradual reduction of many of those producing food and fiber in this country to a kind of economic serfdom. Moreover, the economic results of this transformation will be increased costs to consumers, a long-run reduction in innovation and technological progress in agriculture, as well as impoverishment of rural communities. In sum, the failure of agricultural markets to function efficiently and fairly is going to impose major costs on the entire economy.

As it considers the next Farm Bill, this Committee and Congress should take account of these pressures and do what it can legislatively to correct the problems and restore fairness, accessibility, transparency and efficiency to those markets. There are indeed several very worthwhile proposals that merit adoption that would substantially improve the legal framework of these markets. I would suggest that with respect to dairy and grain markets additional legislative action is required.

Unfortunately, good legislation is only effective if it is adequately enforced and therein lies a second major problem for American agriculture. Neither the United States Department of Agriculture (USDA) nor the two antitrust enforcement agencies, the Justice Department's Antitrust Division and the Federal Trade Commission (FTC), has enforced the existing laws to protect the market process. This is regrettable because, despite their limitations, those laws both constitute the markets for agricultural products and establish competition policy applicable to those markets and could be and should have been used to ameliorate many of the problems that exist.

One of the most important changes in the market for agricultural products is the decline of cash markets and their replacement with various kinds of contractual relationships. There are

Legal and Economic Analysis of Vertical Restraints: A Search for Reality or Myth Making, in *Issues After A Century of Federal Competition Policy*, Wills, Culbertson, Caswell, ed., 95 (1987).

[5] The written statements made at that forum are available at the U. S. Department of Agriculture website: www.usda.gov/gipsa/forum/forumprogram.htm

some efficiency arguments for this change, but there are also strategic reasons why major buyers would prefer the less transparent contract system to the more open and accessible transaction market. Moreover, there is a further problem that results from the decline in the public cash markets. Those markets continue to produce the price signals on which many contractual arrangements depend. Yet as the volume in the public market declines the risk of market manipulation increases. As a result, the emerging system of contracting needs careful and thoughtful oversight to ensure that it operates in a fair and equitable manner.

Agriculture presents some very specific problems for the development of efficient and open markets for products. First, there are long lag times between the time a crop is planted or an animal received for feeding and the sale or delivery of that crop or animal. This increases the risks to which the farmer is exposed with respect to changes in market price. Contracts are a way to shift risk and potentially can create more efficient allocation of risk. But, in the case of farming, even the largest producers are often relatively small in relation to the buyers. Hence, by contract, powerful buyers can shift risks of loss to farmers in ways that insulate the buyer and leave the farmer with disproportionate exposure to such risk relative to the potential for upside gain. When markets are more competitive and farmers are better informed about the alternative contracts, much more equitable risk allocation is possible. But this can happen only when farmers have access to information and have workably competitive buying markets into which they can sell their products. A number of the current proposals in Congress seek to ensure better information and more competition in those markets. This is important to the restoration of workable competition in the markets for agricultural commodities.

A central and recurring concern in these markets is the existence and abuse of buyer power. Historically, Congress through such statutes as the Packers and Stockyards Act and Capper Volstead Act has sought to redress the balance between buyers and sellers as well as insure that markets operate in fair and open ways. Unfortunately, with the changes in the structure of many of the markets for agricultural products and changes in the methods of buying those products, these older statutes have had increasingly less relevance to the ways in which modern markets operate. Some of the problem, however, comes from the failure of the USDA to use the authority Congress conferred on it to develop and implement rules that would restore the relevance of these statutes. I am particularly concerned with the failure to adopt rules under the PSA to regulate the contracting process in livestock and poultry markets. Equally distressing the total failure of the USDA to revise the regulation of milk market orders to limit the unfair and inefficient conduct of a few dominant cooperatives and their customers. In subsequent sections of this statement I will spell out in some greater detail my concerns on these topics.

In the last decade a new threat to American agriculture has emerged in the form of the expansive definition of the rights of patent holders to control the post-sale uses of crops produced with patented genetics. To date these rights have been used to exploit farmers in the purchase of seeds in ways that grossly exceed any legitimate interest in the promotion of innovation, but with the rapid increase in the value of some of the crops farmers raise with such seed, there is a clear risk that the patent holders will seek to appropriate some or all of the gains coming from higher prices for corn and soybeans. Given the attitude of the Antitrust Division toward patent rights, only Congress can protect the American farmer from this new threat of exploitation.

These forces are driving competition from the market for agricultural products and the current legal framework for these markets greatly facilitates these forces. In addition, the failure to have a vigorous merger policy has contributed greatly to the concentration of buyer power. If Congress fails to restore workable competition so that the prices are fairly and competitively set whether in connection with contracts or direct sales, then I think it is quite likely that Congress, in order to preserve American agriculture, will eventually be compelled to resort to direct controls over contract prices. Such controls would compel buyers to pay no less than some minimum amount to compensate for the productions services provided by farmers. I phrase it that way because the failure of competition will destroy the last vestiges of a cash market and only contracts for production services will remain. When that happens, Congress will find it necessary to set the minimum terms for such contracts. This is not an desirable or efficient outcome, but it is the kind of economic regulation that will become inevitable if the number of competitors and their methods of doing business continue in the current direction.

I have been asked to discuss the present state of the competition in agricultural markets as well as how this sad state of affairs has emerged. In my view, there are three legal elements that are relevant to the state of competition in any market. First is the set of rules that constitute the market; these are rules that define the kinds of permitted or forbidden transactions as well as the rights of buyers and sellers. Second is the structure of markets including both the market shares held by buyers and sellers as well as their relative strengths; markets with few large buyers and many small sellers (or the reverse) have greater need for legal regulations compared to markets in which both sides are more nearly comparable in relative size. Third is the actual conduct of firms in the market. The rules constituting the market and its structural characteristics define the range of reasonably possible conduct while antitrust rules can impose limits on the conduct that firms can actually pursue if such rules are actively enforced.

I have focused this statement primarily on the need for better market facilitation regulation. This topic falls squarely under the jurisdiction of this Committee. However, the rules facilitating market access and competition in supply must be framed in terms of the market structure and on-going conduct of the buyers in the market. Hence, this discussion will also focus on the implications of weak antitrust enforcement which effects both the structure and conduct in these markets.

The following sections will discuss briefly the current state of markets for inputs to and outputs from agriculture with an emphasis on specific current or recent past actions that have undermined or will undermine the capacity of these markets to be fair, accessible, transparent and efficient. I have organized this discussion around the three major agricultural activities: dairy, livestock and crops. In addition, the structure and resulting conduct of the downstream markets including the retail grocery business merits discussion as well.

I. Dairy

It should a source of concern that there does not appear to any effort to include significant changes in the way in which farmers are paid for milk. The current situation is one in which a handful of milk processors dominate the fluid milk market. Farmers need access to that market in order to participate in the Federal Milk Order pools that provide the best returns. The dominant firms have in turn entered into long term exclusive supply contracts with a small group of cooperatives even in regions where those cooperatives do not have members. The result is individual dairy farmers and their cooperatives have been forced to merge with or affiliate with these dominant cooperatives. The end result is that at the farm gate where it counts the dairy farmer is getting less than before even though in many regions with concentrated supermarkets, the price of milk has continued to rise.

Another problem in dairy is that milk is being trucked long distances so that it can be included in the pools with the highest fluid milk prices. The farmers in the receiving region pay for the shipping and receive lower farmgate prices for their own milk. The premium that they should expect for producing milk near to the place of consumption is diluted by the unnecessary importation of milk from remote sources. This is an inefficient and counterproductive activity, but it reflects the enormous power of the dominant cooperatives.

Several provisions of the milk order law have facilitated this outrageous situation. First, the major cooperatives have the right to cast all their members votes. Hence, they can approve any order terms that the USDA will propose even if it is contrary to their members interests. Second, the law recognizes the cooperative as the legal seller of the milk and so while it must get the minimum order prices, its farmers members have no comparable right. Third, because there are few other fluid milk outlets except those with exclusive dealing contracts with the large cooperative, farmers cannot easily withdraw from the cooperative. Moreover, the major cooperatives have lobbied successfully to have the rules changed to increase the volume of milk that must be delivered for fluid use and the length of time it must be delivered. This makes it even harder for independent cooperatives to survive because, once again, the major cooperatives have tied up most of the outlets for fluid milk. Fourth, the cooperative can pool funds across orders and allocate the money as the cooperative desires. This encourages the shipping in of out-of-area milk whether it is needed or not if it belongs to a major producer who has friends in the cooperative's top management.

It should be noted that much of this problem is a direct result of the Antitrust Division's decision to allow Suiza to merge with Dean. This created a single milk processing giant with more than 30% of the milk processing business. Worse, to get approval the parties sold a group of plants to National Dairy Holdings which in turn has Dairy Farmers of America as a major stockholder. After the merger was approved, Dean also entered into an exclusive supply contract with DFA. Thus, directly and indirectly DFA controls access to a very substantial part of the total fluid milk market in the entire country. Moreover, its share of fluid milk supply rights reaches monopoly proportions in some regions of the country. Thus, antitrust enforcement has failed to control structure and to date, despite a lengthy investigation, the Antitrust Division has so far failed to challenge any of DFA's conduct.

The USDA could have remedied much of this abuse. It has the authority to make rules that would ban most of this conduct as unfair competition. But it has totally failed to exercise any control over the destruction of the competitive market in milk. Congress must intervene and use the farm bill to reduce the power of very large cooperatives to manipulate the milk order process for the benefit of insiders and the detriment of ordinary dairy farmers.

II. Livestock and Poultry

Once again, the first competitive fact that requires recognition is the continued increase in concentration in pork, beef and poultry processing. Most notably, the antitrust authorities permitted Pilgrims Pride to acquire Gold Kist thus increasing concentration in chicken processing. In addition, the government is currently evaluating the proposed acquisition of Premium Standard Brands by Smithfield. If allowed, this merger would reduce the number of major pork processors in the Southeastern part of this country from two to one. Moreover, it would also reduce competition in pork processing in the Midwest by eliminating PSB as an increasingly important factor in buying hogs and hog feeding services. It would also increase the vertical integration of Smithfield which in turn makes it more feasible for that company to engage in price manipulation on the cash market. The Antitrust Division has been studying this merger since last September and recently announced that it was extending its review until the end of this month. Despite this prolonged review, most media reports suggest that ultimately the merger will be allowed. If this happens, it will have a seriously negative effect on the ability of farmers to get competitive bids either to provide feeding services or to sell their hogs in the cash or contract markets. At the same time, Swift is planning on selling its operations in both beef and pork. If the antitrust enforcers allow an existing competitor acquires those assets, this will further increase concentration in both the areas.

Also, undermining the operation of the markets, the federal courts have been unwilling to interpret the Packers and Stockyards Act to provide protection against discriminatory practices in both pork and beef markets. In particular the 11th Circuit has imposed a requirement that such discrimination have an adverse effect on competition. Worse, it has created a sweeping defense that excuses any discrimination that has any business justification even if there are less harmful ways to accomplish any legitimate business purposes. A recent decision from a federal court in Texas involving chicken growers has adopted a different interpretation of the discrimination standard that is substantially more in line with the language of the statute.[6] Whether on appeal, the reviewing court will sustain that interpretation is at best uncertain.

In terms of the pending Farm Bill, the increased concentration in both livestock and

[6] Order denying motion for summary judgment in Wheeler v. Pilgrim's Pride, 5:02-CV-135-DF (E.D. Tex)(March 30, 2007)

poultry processing combined with the substantial use of contracts to obtain animals point toward the need for revising the PSA to make it more relevant to contemporary business practices and to clarify its intent to protect individual farmers from discrimination and other unfair practices without regard to the overall effect on competition. In my view, one of the most serious problems is the ability of buyers to refuse to deal with willing sellers offering the commodity the buyer wants. One of the most invidious ways that large buyers exercise their power is by refusing to offer favorable contracts to producers. This discrimination works to intimidate sellers and ensure that they do not seek out competitive alternatives for fear of losing their primary customer. The justifications for the use of contracts do not wrrant the refusal to deal with all producers who are ready, willing and able to provide the necessary products. It is vital to ensure viable competition in livestock production that all producers have the ability to make contract sales if they so choose. This also means that any effort to keep "grids" or other contract terms confidential must be prohibited. Only with full disclosure can farmers know what their options might be and make informed decisions.

A related problem is the decline in the size of the cash market in livestock. It has entirely disappeared in poultry. As the volume in these markets declines, it is easier for interested parties to manipulate the resulting prices in their own interest. There are already well documented examples of such manipulation in cheese and butter markets. Various proposals exist to remedy this problem. If the cash market is to remain an important base point for contracts, it is essential that there be a sufficient depth to those markets to ensure reliable prices. This suggests either that the use of other buying methods in beef and pork must be limited or that some other, deeper market must be used as the base on which prices can be based.

In sum, it is vital that the next Farm Bill revise the PSA to make it more relevant to the contemporary market for livestock. This must also include more ways for farmers to enforce its protections directly. This is essential in light of the continuing failure of the USDA to engage in any meaningful enforcement of this statute. I want to emphasize that this failure has occurred under administrations of both political parties. This means the failure is systemic and can be remedied best by providing for enhanced direct action by those who are harmed as a result of discriminatory and unfair buying practices.

III. Crops

With respect to crops, we are seeing a sudden surge in prices for corn with a resulting shift in planting that will reduce supplies of soybeans and cotton. Those reductions are likely to create upward pressure on the prices for those crops. At the same time, we are seeing a marked increase in the use of contracts and other strategies to reduce or avoid the impact of the cash market. Moreover, currently, farmers producing crops do not have the protections, such as they are, of the PSA. I applaud the proposal to expand the coverage of the PSA to all agricultural production. There is no logical reason not to require fair treatment for farmers regardless of the type of farming they engage in.

As in other areas, we are seeing increasing concentration on both the buying side and the production of key inputs, especially seed. In this area, the most troublesome pending proposal of Monsanto, the overwhelming dominant firm with respect to genetically modified seed, to acquire Delta Pine and Land which is the dominant seller of cotton seed. Overall, DPL has about 50% of all seed sales and a much larger share in some regions. If this merger, which is under investigation by the Antitrust Division, is allowed Monsanto can foreclose significant potential competition in the production of new genetic modifications for cotton seeds. In addition, it will be able to keep seed prices high reflecting its dominance of seed genetics thus denying cotton farmers the advantage of a more competitive market in seed technology.

I want to bring to your attention two other issues related to the use of patent law that have or are likely to affect farmers substantially. The first is Monsanto's practice of granting seed producers and through them the farmer only a limited right to use the genetics to plant one crop. In other words, a farmer can not save seed and replant it. The farmer must buy new seed. This protects the interest of seed producers but is not essential to protecting Monsanto's interest in its intellectual property. Monsanto could, assuming that it even has the right to restrict such replanting, establish a system by which farmers pay it for the right to replant. This would ensure full compensation for any rights Monsanto has in saved seed and would result in substantial savings to farmers. This system is in use in other countries where patent rights are more limited. Unfortunately, the Federal Circuit has upheld Monsanto's right to impose any post sale restraint it wants on farmers. While I remain skeptical about the lawfulness of this expansive right,[7] to date the courts have taken a different view and applied it expansively including authorizing Pioneer to restrict the resale of corn seed that include patented genetics eventhough there was no realistic risk that the buyer could appropriate any element of Pioneer's intellectual property.[8] The implications of this expansive patent right is that patent holders can exploit farmers beyond any legitimate interest that they have in their inventions. This results in transferring the values created by farmers to the patent holders and the other seed companies who act in concert with them.

Today, with the increased value of crops, especially corn, I foresee a second and even more anticompetitive use of the expansive rights conferred on patent holders. As patent law now stands, I see no reason why a Monsanto or a Pioneer can not impose restrictions on the farmers' right to sell their crop. Thus, the patent holder would in return for a payment from ADM or Cargil restrict the right of those planting seeds with patented genetics in them to sell the resulting crop to any buyer other than one approved by the patent holder. By this device, the patent holder could appropriate most of the increased value that we are now seeing in corn and the expected spillover price increases in other crops. So far as I know, none of the major seed genetic patent

[7] I have discussed this issue at greater length in a recent article. Carstensen, Post-Sale Restraints via Patent Licensing: A "Seedcentric" Perspective, 16 *Fordham Intel Prop. Media & Entertainment L. J.* 1053-1080 (2006).

[8] See *id.* for a discussion of this case as well.

holders has yet attempted to impose a restraint on resale of crops of this sort, but I think there is a clear and present danger that they will attempt it given the state of patent law.

The expansion of the PSA rights to all types of contractual relations involving the sale of crops provides a means to limit the scope of patent rights as they relate to the sale of farm commodities. I would suggest prohibiting any restraint by input suppliers on the sale of crops resulting from the planting of seeds that contain patented genetics or are patented themselves.[9] It would also be very desirable if the same prohibition were to apply to resale or replanting of such seeds provided the seller or re-planter has paid a patent royalty to the patent holder.[10]

IV. Concentration in Downstream Markets Including Supermarkets

It is important to recognize that improving the fairness, efficiency and transparency of the upstream markets in which farmers sell their products is necessary but not sufficient to ensure the proper overall operation of the marketplace. Downstream buyers with market power can impose significant burdens on upstream producers even two or more levels away. This was illustrated in the cheese price manipulation case. There the goal was to lower the price of cheese, but the effect was to reduce the price of milk used to produce cheese. Hence, the victims were dairy farmers and not the cheese makers.

A central overall concern, therefore, is that if downstream markets become more concentrated, the resulting buyer power will result in lower prices at the farmgate regardless of the efficiency, openness, fairness, etc., of the upstream market. We are in fact seeing this problem emerging in both agricultural and non-agricultural markets. Recent work in the U.K. shows that there a grocery chain with 9% of total grocery purchases in the country has substantial buyer power. It can use that power to cause its suppliers to impose discriminatory and exclusionary terms on smaller customers as well as to drive down the prices of such suppliers. These suppliers in turn impose price reductions on their suppliers, especially those who have relatively weak bargaining positions. Ultimately, it is dispersed and powerless groups such as farmers who bear the ultimate burden.

[9] Such a ban would need to have a "safe harbor" for legitimate contracts in which a third party, whether patent holder or other business, has contracted with a farmer to produce a crop at the expense of the other party for its use or resale.

[10] When seed in the original package is bought and resold, the buyer has paid the relevant royalty to the patentee in the first sale. Hence, no restraint should apply to such transactions. When seed is saved and replanted, however, the farmer would, under this proposal, have the obligation to pay a royalty to the patent rights holder. In practice, the most likely party to provide the fee collection service in most instances would be a seed cleaner. Seed cleaning is essential in cotton and highly desirable in soybeans (the two crops where saving and replanting seed is feasible). Hence, the seed cleaner can act in a role similar to producers of new seed in collecting and remitting to the patent holder any royalties that the patent holder is entitled to.

There has been a very substantial increase in concentration in the retail sale of groceries. As a result a handful of major retailer chains now have very substantial buyer power. This increased concentration is in significant part a result of the failure to enforce vigorously the antitrust law prohibitions on mergers that may harm competition. In addition, there have been a number of mergers in the food processing industries that have also gone unchallenged. These mergers are often rationalized as necessary to give the merging firm the capacity to withstand the power of the merger grocery chains. In addition, of course, to creating greater downstream bargaining power, these mergers increase the ability of these firms to add to the pressure upstream on the dispersed and powerless producers of agricultural commodities. Fair, efficient and accessible markets at the farmgate will not fully protect farmers from the impact of such downstream buyer power.

There is little that this committee can do in the Farm Bill to remedy the broader problem of increased concentration downstream from agricultural commodity markets. Yet it is important to recognize the broader linkages that exist in the economy. For that reason, I urge you to advocate to your colleagues the need for stronger and more active merger enforcement.

Conclusion

I am impressed with the number of good proposals for enhancing the facilitation of competition in agricultural markets. The bipartisan support for better regulations to facilitate the efficient and fair operation of these markets is very encouraging. Legislative action is long over due. If it is not forthcoming soon, there will be an even more serious crisis in American agriculture. At that point, as I have suggested, it will be necessary to impose even more draconian regulation. Indeed, if that time were to come, the regulations would necessarily have to replace the market and impose direct controls over prices and contracting. Such a dire outcome can be avoided, if the next Farm Bill incorporates a competition chapter that provides effective and relevant statutory standards to facilitate a fair, accessible, open and efficient market. As I have repeatedly noted in this discussion, good legislation is necessary, but it will not be sufficient unless there is also active enforcement of its terms as well as a renewed commitment to enforcing the antitrust laws in these markets.

Testimony of Scott Hamilton
Phil Campbell, Alabama

before the

Committee on Agriculture, Nutrition, and Forestry
United States Senate

for a hearing on

"Economic Challenges and Opportunities Facing American Agricultural Producers Today"

April 18, 2007

Chairman Harkin, Ranking Member Chambliss, and Members of the Committee-

Thank you for the opportunity to testify before you today on this important topic.

My name is Scott Hamilton. I am a poultry grower from Phil Campbell, Alabama. I also raise cattle on my farm, where I live with my wife and two children. I graduated of Auburn University in 1995 with a degree in Zoology, and also later graduated from Auburn's Agriculture and Forestry Leadership Program.

I am very pleased that this hearing is being held, because it demonstrates that this Committee understands the importance of competitive markets and fairness standards to the family farmers of this country. The structure of U.S. Agriculture has changed significantly in recent decades, and the American farmers are rapidly losing their independence. For many of us, that independence was lost years ago.

I am here today to tell you a few of my experiences as a poultry grower, as well as those of other poultry growers, with regard to the abusive practices that have become commonplace in poultry.

Poultry has been grown under production contracts since the 1950s and contracting is nearly universal today, particularly for broilers. In 2004, the Winston-Salem Journal in North Carolina did a series of articles entitled "Plucking the Farmer" about the abuses that poultry growers face in the contract relationships with large, vertically integrated poultry firms. An editorial in this series stated it well when it described the relationship as follows:

> "The companies own the chickens, control what kind of birds the farmers get, control the feed, control the pay system and can cancel a contract at almost any time. The farmers take out loans to build the chicken house they own, but the companies often ask for expensive improvements such as new fans, scale systems, egg-collector conveyors, lights and other equipment.... The U.S. Department of Agriculture has little authority in cases involving unfair or illegal practices involving contract chicken farmers. And the way the contracts are written gives farmers little recourse in courts."

An even more extensive series of articles of the poultry industry's mistreatment of growers ran in the Baltimore Sun in 1999, and stated that:

> "[The] imbalance of power begins and ends with a farmer's contract."

When I first decided to get involved in the poultry growing business in 1995, it was my hope and expectation that I would be in a close working partnership with my poultry company. After all, I was putting up $350,000 of borrowed capital for single-use poultry houses on my farm, built to the poultry company's specifications, in order to raise their chickens to full slaughter weight. But instead of a partnership, I quickly learned what so many other poultry growers have learned, that the poultry growing relationship is more like a dictatorship or a feudal system of serfdom.

Often a grower does not even see a written contract until after they've gone to the bank to get the loan to build the houses on their land. The bank often makes the loan based on a letter of intent from the poultry company. Because of the large size of the loan, growers usually have to put up their farmland and their homes as collateral. So once the grower actually sees the written contract, they are in no position to argue. The extreme debt required to get into the poultry growing business and the fact that there are not alternative uses for the poultry houses, give the poultry company total control. For most growers, you cannot shop around for other poultry companies if you disagree with your company's practices. There is very little competition in local areas. Even in those unusual instances where two companies overlap a certain area, companies are very reluctant to pick up a grower who has disagreed in any way with another company.

There are no negotiations, because the company has total power. Either you sign what's put in front of you, or they don't bring you chickens. If they don't bring you chickens, you can't make you mortgage payments, and you lose your farm and home.

So it is from this basic imbalance that all of the abuses experienced by poultry growers originate. The company has total leverage and the grower has absolutely none.

Let me briefly describe some of the abusive contract clauses that growers face as a result of this imbalance of power.

The Ranking System of Payment

Most poultry growers are paid based on a "ranking system" which pays you in competition with other growers. Essentially, the company has you compete with other growers based on your success in putting weight on the bird during the 7-to-9 week grow-out period, relative to how much feed you used. This is called the feed conversion. But the catch is that all the inputs that determine your feed conversion are controlled and supplied by the company itself. From the day-old chicks, to the feed, to the specifications of your poultry house, all are controlled by the company. Often one grower will receive different inputs than another grower in the same "ranking," which can influence your feed conversion greatly. Yet those growers are still ranked together as if it were a straight-up, fair competition. The difference between a top ranking and a bottom ranking can mean many thousands of dollars to a grower for a 7-to-9 week flock.

The irony is that while the company portrays this system as a competition, there is really only one winner, and that is the company. Because no matter how successful you are at raising their birds, the system is rigged so that half the growers get pay cuts to compensate for the other half that get bonuses. This system also helps to make growers suspicious of each other, to minimize the potential for any group action by growers.

But some growers have seen through that smoke screen to understand that only through working together will they gain the leverage to demand better contracts. Often the lack of transparency in the ranking system has been a tool for companies to retaliate against growers who attempt to speak out about the abuses or organize with other growers to try to bargain for better contract terms. It is very common for such outspoken growers to suddenly see their ranking fall drastically, costing them thousands of dollars.

In my personal experience, after I started to be more active in the Alabama Poultry Growers Association, I saw my ranking fall and was put on a probation-like program. I had sick birds, through no control of my own. I was told that I was doing poorly as a grower, and would need to do better. When you are put on this program, you need to show improvement in the ranking or the next step is termination, even though you've made a huge investment for the purposes of the contract and your ranking may have nothing to do with your own performance.

In a more extreme example, a breeder hen grower in Georgia, Chris Burger, was the victim of severe retaliation by his poultry company when he tried to organize a breeder hen grower group in his area. The company deliberately targeted him and delivered chickens with cholera to his farm. He was able to sue and years later he won his case after it was proven that the company deliberately targeted him with the bad birds because of his organizing efforts. But his victory in court palled in comparison to the loss of his farm and the loss of his family to divorce related to the stress of those years.

Forced Equipment Upgrades at the Growers' Expense

A major part of the leverage that the companies hold over growers is their debt. Growers without debt are growers that are in a position to say "no" to the company, or to insist on a better contract, because they have less to lose.

So it's not surprising that as growers pay down their loans, the companies will often put pressure on them to take out new loans to upgrade their houses, even though the houses they originally built were constructed based on the company's own specifications. The companies want to experiment with new technologies, but they force the growers to pay for those experiments. In some cases they may offer small pay increases to those who agree to make the upgrades, but never are the increases enough to cash flow the new debts and the additional energy costs needed to power the new equipment. Almost always, those growers who decline to upgrade are threatened with contract termination.

I have a neighbor whose company is pressuring him to upgrade his four chicken houses. In order to make the upgrades, he would need to spend $157,000. In exchange, he would be given an increase in pay of about one-third a penny per pound. Based on his average weight, that equates to about

$9700 per year, less than the cost of the interest on the loan. And even that return would not be guaranteed.

Flock to Flock Contracts

There is no such thing as a long-term contract in poultry. Even when growers think they have a signed agreement for a multi-year contract, the company will often come back with a new, shorter and less favorable version of the contract. Either you sign or you get no new birds. Again, if you don't get birds, you can't make your mortgage payment and then you risk losing your farm in bankruptcy. It is becoming more and more common that growers are actually given "flock to flock" contracts, meaning that they can terminate you at any time. Remember, most growers have made investments of about $500,000 to $1 million. If they knew going in that the guarantee of income would be for one 7-to-9 week flock, would any grower have made that investment? No.

Arbitration Clauses

And perhaps one of the most abusive contract clauses that growers are facing currently is the mandatory arbitration clause. As poultry growers in the 1980s and 1990s started to win lawsuits against poultry companies over contract abuses, companies started to present new contracts to their growers. These new contracts included little-understood provisions that essentially said that growers were waiving their right to take the company to court for any reason. Instead, the growers would be given access to a private system called mandatory arbitration, where a private group of arbitrators would hear their case and render a decision. But the up-front costs of this process are prohibitive. Some growers have been handed bills for as much as $20,000 just to get an arbitration hearing. In some cases, these upfront costs are actually in excess of the claim itself. Further, unlike a public court process, there is limited right of discovery in arbitration, meaning that the grower can not get access to the evidence that they need to prove their case. And lastly, the outcome of an arbitration proceeding is not public, so the horror stories that are commonplace in poultry are kept under wraps.

In the mid-1990s, a grower by the name of Tom Greene and 38 other Alabama contract poultry growers were pressured by their poultry company to sign a new contract that included a mandatory arbitration clause. As described in the 1999 Baltimore Sun article I mentioned earlier:

> "The farmers said the company's new contract was unfair and a ticket to the poorhouse. Local bankers agreed… [T]he farmers refused to sign. They might as well have challenged a tank squadron with pitchforks. In the year that followed, ConAgra defied or intimidated nearly every institution that usually calls the shots in small-town America. The banks surrendered. The local newspaper softened its punches. Government regulators watched but did nothing, prompting one state investigator to quit in exasperation. Real estate agents sensed a raw deal but fearfully kept their mouths shut Of the 39 growers who first stood up to the company, 20 quickly caved in and signed the contract they despised. The other 19 tried to sell their farms, but ConAgra undermined every offer to buy. On January 7 [1999], Tom Greene became the third farmer to low his land to foreclosure.

In a more recent example in Mississippi, 67 year old Gertrude Overstreet, a contract poultry grower since 1976, was alleging that her poultry company had violated the terms of their agreement, and she wanted to have her case heard in court. Mrs Overstreet only had two chicken houses so her income before her termination was minimal as shown in the court record. However the company had previously added an arbitration clause to her contract that would require her to pay over $ 20,000 in up-front costs before she could get an arbitration hearing.

In a rare occurrence, the U.S. District Court recognized the injustice of this arbitration clause and ruled that it was unconscionable and therefore unenforceable. The Court reiterated in its opinion that Mrs. Overstreet and her husband's total monthly income, including food stamps was less that $ 1000 per month. The Court further stated that Mrs. Oversteet only had a 10th grade education, had no savings or property, real or personal, other than a car and miscellaneous household appliances. Mrs. Overstreet's testimony that no one from the poultry company had ever explained arbitration to her and she had no idea about the cost of arbitration went uncontested by the poultry company. Additionally, the Court's opinion stated that the Oversteets' could not even afford to buy their required medications which were prescribed for them by their doctors. Mr. Overstreet has since passed away. The District Judge in his opinion stated simply that "My conscience is shocked."

The poultry company appealed the Judge's ruling and amazingly, the 5th Circuit Court of Appeals panel overturned the District Judge's opinion.

This should shock any reasonable person's conscience.

Why is this Permitted to Happen?

First, in any situation where one party has total control over another, the opportunity for abuse is great. Second, unlike other contact relationships, such as real estate contracts or car contracts, poultry contract relationships are largely unregulated.

While the Packers and Stockyards Act makes it unlawful for a livestock packer or live poultry dealer "to engage in or use any unfair, unjustly discriminatory or deceptive practice or device, or to give any unreasonable advantage to any particular person or locality," it does not give USDA the administrative enforcement authority to take action against a poultry company.
In contrast, when violations of the Act are discovered in the livestock industry, GIPSA has the authority to take administrative actions, including holding hearings and assessing civil and criminal penalties. However, GIPSA does not have this administrative enforcement authority in the poultry industry.

When violations of the Act are discovered in the poultry industry, GIPSA can only issue an order to cease illegal conduct. In extreme cases, GIPSA can send the complaint to the Justice Department. From the poultry company's perspective, breaking the law and increasing company profits through fraudulent or deceptive practices carries little financial or legal risk.

In addition, even the limited authority that USDA does have in the poultry sector does not apply to protection for breeder hen or pullet growers, even though those growers are a vital part of that poultry production process and equally vulnerable to abuse.

Without question, USDA's Grain Inspection, Packers and Stockyards Agency can and should be more aggressive in pursuing abuses in the poultry sector. But we must also acknowledge that they do not have as much authority as the need to do that job well.

In reality, there is no cop on the beat for poultry growers.

What's the Solution?

Senators Harkin and Enzi have introduced legislation (S.622) that addresses many of the concerns that I raised in my testimony. The bill would:

1) Close the "poultry loophole" by amending the Packers and Stockyards Act to give USDA the full authority to enforce against poultry companies that use unfair and deceptive trade practices against poultry growers. It would also provide protection for breeder hen and pullet growers, not just broiler growers.

2) Clarify that the Packers and Stockyards Act provides protection to producers for unfair, deceptive, and anti-competitive practices, without them having to prove an effect on competition. This is necessary in light of a recent court decision that suggests that competitive harm must be shown to the market more broadly before a farmer can be granted relief under the Act.

3) Amend the Agricultural Fair Practices Act to close loopholes that have made the Act difficult for USDA to enforce, and would set minimum contract standards of fairness for agricultural contracts. Specifically-

- it would prohibit pre-dispute, mandatory arbitration clauses, and would assure that decisions to pursue arbitration are voluntary. (Senators Grassley and Feingold have introduced similar legislation on this topic, which is also being addressed in the Judiciary Committee)

- it would specify that if growers were required to make major capital investments for purposes of servicing an agricultural contract, that they could have their contracts terminated without 180 days of forewarning, and that they be told the reason for the termination and be given the right to remedy the problem.

- It would further specify that a grower can't be forced to make an equipment upgrade at their own expense, unless both parties to the contract agree ahead of time and the company fairly compensates for the expense.

-

4) And perhaps most importantly, the Harkin bill would require companies to bargain in good faith with producer associations, so that competition can truly work and farmers can have the leverage to bargain for fair contracts, instead of having a take-it-or-leave it contract forced on them.

Closing

As a poultry farmer from Alabama, I am honored to be here today providing this testimony. But at the same time, it is a sad commentary on the state of our nation that I had to seriously consider whether or not my testimony here today would put me in financial jeopardy because of retaliation.

In no way am I arguing that contacting is a bad thing. Contracts are vital to the economy in this country. But it also vital that basic standards of fair dealing apply to contract relationships.

The poultry model of contract production is spreading rapidly into other sectors of agriculture-hogs, tobacco, peanuts, specialty grains, and others. While the issues of market concentration and loss of competition may be presenting themselves differently in different sectors of agriculture, all of these manifestations are examples of that same problem.

Therefore, over 200 organizations sent a letter to this Committee in January of this year, urging that a comprehensive competition title in the 2007 Farm Bill. The letter spelled out 8 specific legislative solutions to this problem, including those in the Harkin-Enzi bill that I mentioned above. But it also included many other proposals of great importance to hog farmers and cattle ranchers. A copy of that letter is attached to my written statement.

It is my hope that this Committee will include all of these provisions when the Farm Bill is drafted later this year.

Thank you.

January 18, 2007

The Honorable Tom Harkin
Chairman, Senate Committee on Agriculture, Forestry and Nutrition

The Honorable Saxby Chambliss
Ranking Member, Senate Committee on Agriculture, Forestry and Nutrition

The Honorable Collin Peterson
Chairman, House Committee on Agriculture

The Honorable Bob Goodlatte
Ranking Member, House Committee on Agriculture

The Honorable Patrick Leahy
Chairman, Senate Committee on the Judiciary

The Honorable Arlen Specter
Ranking Member, Senate Committee on the Judiciary

The Honorable John Conyers, Jr.
Chairman, House Committee on the Judiciary

The Honorable Lamar S. Smith
Ranking Member, House Committee on the Judiciary

Dear Chairmen and Ranking Members:

The over 200 undersigned organizations strongly urge you to make the issues of agricultural competition and market concentration a top priority as Congress considers the crafting of agricultural legislation and the next Farm Bill. During the 2002 Farm Bill debates, public testimony provided clear and compelling evidence of the need for free market competition and fairness for the nation's farmers and ranchers. Since that time these concerns have become even more urgent and prominent in the public eye.

Today, a small handful of corporations overwhelmingly dominate our food supply. The concentration of market control in the top four firms in U.S. food retailing, grain processing, red meat processing, poultry processing, milk processing, and nearly every category of food manufacturing is at an all time high. Corporate mergers and buyouts have concentrated the power of these firms and increased their ability to unfairly manipulate market conditions in their favor. This unprecedented level of horizontal market consolidation effectively eliminates free market competition to the detriment of independent family farmers and consumers.

Compounding the problem associated with horizontal consolidation is the rapid trend toward vertical integration. Manufacturers, processors, and packers increasingly control all stages of production and inventory through commodity ownership and one-sided contracts. This corporate control of production unnecessarily eliminates market transparency, creating an environment ripe for price manipulation and discrimination. It replaces farm-level decision making with centralized corporate planning and leaves farmers trapped in long-term debts tied to short-term, non-negotiable production contracts. In addition, top retailers and packers increasingly engage in relationships with dominant suppliers that exclude smaller competitors and minimize price competition. Because both supply and demand are controlled by the same few players in the market, the basic principles of supply and demand cannot function.

A critical role of government is to ensure fairness by facilitating properly operating markets and balance in the economic relationships among farmers/ranchers, consumers and food companies. Currently, inadequate federal legislation and the lack of enforcement of anti-trust policies allow a handful of corporations to continue to consolidate market power, manipulate prices, and create anti-competitive market structures. Federal government inaction has a dramatic, negative impact on not only farmers and ranchers, but also on rural communities, the environment, food quality, food safety, and consumer prices. It undermines sustainable production practices and state and local laws that support family-scale, sustainable farm and ranch operations.

Policy makers often voice the laudable policy goals of maintaining a diverse, farm-and-ranch-based production sector and providing consumers with a nutritious, affordable food supply. However, government failure to redress industry concentration--both vertical and horizontal--is thwarting these policy goals and driving the earnings of farmers and ranchers down and consumer prices up.

To address these problems, we urge you to champion a strong, comprehensive Competition Title in the 2007 Farm Bill. We also ask that you co-sponsor and support any of the following measures of this comprehensive package if they are introduced as separate or combined bills and to work for speedy congressional consideration of these proposals.

• LIMIT PACKER CONTROL/MANIPULATION OF LIVESTOCK MARKETS

*1. **Captive Supply Reform Act:*** This legislation will bring secret, long-term contracts between packers and producers into the open and create a market for these contracts. The Captive Supply Reform Act would restore competition by making packers (and livestock producers) bid against each other to win contracts. Currently, formula contracts and marketing agreements are negotiated in secret, where packers have all the information and power. These formula contracts and agreements depress prices and shut small and independent producers out of markets. The Captive Supply Reform Act would require such contracts to be traded in open, public markets to which all buyers and sellers have access.

*2. **Prohibition on Packer-Owned Livestock**:* Meat packers such as Tyson, Cargill, and Smithfield Foods use packer-owned livestock as a major tool for exerting unfair market power over farmers and ranchers. This practice fosters industrial livestock production and freezes independent farmers out of the markets. Packer-owned livestock has been proven to artificially lower farm gate prices to farmers and ranchers while consumer food prices continue to rise. By prohibiting direct ownership of livestock by major meatpackers, a packer ban addresses a significant percentage of the problem of captive supply which packers use to manipulate markets, and would help increase market access for America's independent producers who currently experience great restrictions in market access due in part to packer ownership of livestock.

• INCREASE FAIRNESS IN AGRICULTURAL CONTRACTS AND MARKETS

3. Fairness Standards for Agricultural Contracts: In order to address the worst abuses contained in processor-drafted contracts, legislation that provides a set of minimum standards for contract fairness is urgently needed. Such standards should include at a minimum the following:

(a) prohibition of the use of forced, mandatory arbitration clauses, which have been used by some packers or integrators to force growers to give up their access to the courts, even in the case of fraud, breach of contract, misrepresentation or other blatant contract abuses by the integrator or packer firm;
(b) clear disclosure of producer risks;
(c) full prohibition on confidentiality clauses;
(d) recapture of capital investment so that contracts that require a significant capital investment by the producer cannot be capriciously canceled without compensation; and
(e) a ban on unfair or deceptive trade practices, including "tournament" or "ranking system" payment.

4. Clarification of "Undue Preferences" in the Packers & Stockyards Act (PSA): Packers commonly make unjustified, preferential deals that provide unfair economic advantages to large-scale agriculture production over smaller family owned and sustainable farms. Courts have found current undue preference legal standards virtually impossible to enforce. Additional legislative language is needed in the PSA to strengthen the law and clarify that preferential pricing structures (those that provide different prices to different producers) are justified only for real differences in product value or actual and quantifiable differences in acquisition and transaction costs. Specifically, we are asking to:

(a) Make clear that farmers damaged by packer/processor unfair and deceptive practices need not prove "harm to competition" to receive a remedy.
(b) Make clear that "pro-competitive effects" or "legitimate business justifications" are not recognized packer defendant defenses, and not necessary for farmer-plaintiffs to prove the absence of, in a court case under the PSA.
(c) Require courts to award attorneys fees to successful producer plaintiffs under the PSA.

5. Closing Poultry Loopholes in the Packers & Stockyards Act (PSA): USDA does not currently have the authority under the PSA to bring enforcement actions against poultry dealers. Poultry producers should have the same basic enforcement protection that is offered to livestock producers when packers and livestock dealers violate the PSA. We seek legislation to clarify that USDA has authority over PSA violations involving poultry dealers in their relations with all poultry growers, including those who raise pullets or breeder hens as well as broiler producers. The PSA enforcement loophole for poultry dealers should be closed.

6. Bargaining Rights for Farmers: Loopholes should be closed in the Agricultural Fair Practices Act of 1967 (AFPA) and processors should be required to bargain in good faith with producer organizations. The AFPA was enacted to ensure that livestock and poultry producers could join associations and market their products collectively without fear of retribution by processors. These goals have not been attained due to loopholes in that Act. Retaliation by processors is commonplace in some sectors. Legislation should be enacted that promotes bargaining rights and prevents processor retaliation.

• ASSURE ADEQUATE MARKET INFORMATION AND TRANSPARENCY FOR PRODUCERS AND CONSUMERS

7. Livestock Mandatory Price Reporting: The Livestock Mandatory Price Reporting Act of 1999 (LMPRA) requires packers, processors, and importers to provide price, contracting, supply and demand information to USDA, which then uses the information to create price reports for livestock producers. Since its implementation, bureaucratic inertia has blocked effective enforcement of the LMPRA and prevented the Act from operating to benefit independent livestock producers. The Government Accountability Office, at the request of Senators Harkin (D-IA) and Grassley (R-IA), has reviewed USDA implementation of the Act. In December 2005, the GAO issued a report documenting lengthy lag times for USDA corrections to missing or incorrect information from packers, and the failure of USDA to inform the public about violations of the Act revealed in USDA audits. The LMPRA was reauthorized in September 2006 without including GAO recommendations to improve the Act. If USDA does not implement these recommendations, Congress should amend the Livestock Mandatory Price Reporting Act in 2007 by incorporating the GAO report recommendations as legislative directives to USDA in implementing the Act.

8. Mandatory Country of Origin Labeling: Country of origin labeling (COOL) for beef, lamb, fresh fruits, fish and shellfish was passed as a provision of the 2002 Farm Bill. Mandatory COOL for the fish and shellfish commodities was implemented by USDA in April of 2005, but COOL implementation for all other commodities has been successfully stymied by the meatpackers and retailers. Country of origin labeling is a popular measure that allows consumers to determine where their food is produced and also enables U.S. producers to showcase their products for quality and safety. It also limits the ability of global food companies to source farm products from other countries and pass them off as U.S. in origin. Congress should reauthorize COOL to reiterate its benefits to producers and consumers and should provide funding to ensure that USDA undertakes immediate implementation of COOL.

In conclusion, farmers, ranchers, and consumers across the country are asking for these legislative reforms to ensure fair markets and a competitive share for family farmers and ranchers of the $900 billion dollars that consumers pay into the food and agriculture economy annually. Market reforms remain a key ingredient for rural revitalization and meaningful consumer choice. The legislative reforms summarized above are key to achieving the goals of promoting an economically healthy and diverse agricultural production sector and providing consumers with healthy, affordable food.

Thank you.

Sincerely,

A Little Taste of Everything
A Taste of the North Fork (NY)
Adams County Farmers Union (ND)
Agricultural Missions, Inc. (NY)
Agriculture and Land Based Training Association (CA)
Agriculture of the Middle
Alabama Contract Poultry Growers Association
Alabama Sustainable Agriculture Network
Alliance for a Sustainable Future (PA)
Alliance for Sustainable Communities (MD)
Alternative Energy Resources Organization (AERO) -MT
American Corn Growers Association
American Society of Agronomy
Appalachian Crafts (KY)
Art & Nature Project (NY)
Beartooth Stock Association (MT)
Berkshire Co-op Market
Bird Conservation Network
Blessed Kateri Tekakwitha Region, Secular Franciscan Order, NYS
Bronx Greens
California Dairy Campaign
California Farmers Union
California Institute for Rural Studies
Californians for GE-Free Agriculture
Campaign for Contract Agriculture Reform
Campaign for Family Farms and the Environment
Caney Fork Headwaters Association (TN)
Catholic Charities Diocese of Sioux City, IA
Catholic Charities of Chemung /Schuyler Counties (NY)
Catholic Charities of Kansas City - St. Joseph, Inc.
Catholic Charities of Louisville, Parish Social Ministry Dept. (KY)
Catholic Rural Life, Archdiocese of Dubuque, IA
Cattle Producers of Washington
Center for Food Safety
Center for Earth Spirituality and Rural Ministry (MN)
Center for Popular Research, Education and Policy (NY)
Center for Rural Affairs
Central Colorado Cattlemen's Association
Chemung County Church Women United (NY)
Chemung County Council of Churches (NY)
Church Women United of NYS
CitySeed (CT)
Community Action Resource Enterprises (OR)
Community Food Security Coalition
Concerned Citizens of Central Ohio
The Cornucopia Institute (WI)
Corson County Farmers Union (SD)
Court St Joseph #139, Catholic Daughters of the Americas, Corning (NY)
Court St Joseph #139, Corning/Elmira, Catholic Daughters of the Americas (NY)
Crop Science Society of America
Crowley-Kiowa-Lincoln Cattlemen's Association (CO)
Cumberland Counties for Peace & Justice (TN)
Dakota Resource Council
Dakota Rural Action of SD
Delmarva Poultry Justice Alliance
Delta Land and Community, Inc.
Eagle County Cattlemen's Association (CO)
Endangered Habitats League (CA)
Environmental Action Committee of West Marin (CA)
Environmental Coalition of Mississippi
Family Farm Defenders
Family Farms for the Future (MO)
Farm Aid
Farm Fresh Rhode Island
FH King Students of Sustainable Agriculture at UW Madison
First Nations Development Institute
Florida Organic Growers
Food Alliance (OR)
Food and Water Watch
FoodRoutes Network
Foodshed Alliance of the Ridge and Valley (NJ)
Friends of Rural Alabama
Georgia Organics
Georgia Poultry Justice Alliance
Global Exchange
Government Accountability Project
GRACE/Sustainable Table
Grassroots International
Hahn Natural Foods (PA)

Harding County Stockgrowers Association (SD)
Harvest Co-op Market (MA)
Heartland Center / Office of Peace and Justice for the Diocese of Gary, Indiana
Hispanic Farmers and Ranchers of America Inc.
Hispanic Organizations Leadership Alliance
Horseheads Grange #1118, Chemung City (NY)
Humane Society of the United States
Idaho Rural Council
Illinois Farmers Union
Illinois Stewardship Alliance
Independent Beef Association of North Dakota
Independent Cattlemen of Iowa
Independent Cattlemen of Nebraska
Independent Cattlemen's Association of Texas, Inc.
Indiana Campaign for Economic Justice
Indiana Farmers Union
Institute for Agriculture & Trade Policy
Institute for Responsible Technology
Iowa Citizens for Community Improvement
Iowa Farmers Union
Just Food (NY)
Just Harvest, Pittsburgh
Kansas Cattlemen's Association
Kansas City Food Circle
Kansas Farmers Union
Kansas Rural Center
Kerr Center for Sustainable Ag (OK)
Kit Carson County Cattlemen's Association (CO)
La C.A.S.A. de Llano (TX)
Ladies of Charity of Chemung County (NY)
Land Stewardship Project (MN)
Little Seed CSA (NY)
Madera County Cattlemen's Assoc (CA)
McKenzie City Energies & Taxation Association (ND)
Merced-Mariposa Cattlemen's Association, (CA)
Mesa County Cattlemen's Association (CO)
Michigan Farmers Union
Midwest Organic and Sustainable Education Service
Minnesota Farmers Union
The Minnesota Project
Mississippi Contract Poultry Growers Association
Mississippi Livestock Markets Association
Missouri Farmers Union
Missouri Rural Crisis Center
Montana Cattlemen's Association
Montana Farmers Union
National Campaign for Sustainable Agriculture
National Catholic Rural Life Conference
National Center for Appropriate Technology (NCAT)
National Family Farm Coalition
National Farmers Organization
National Farmers Union
National Hmong American Farmers, Inc.
National Latino Farmers & Ranchers Trade Association
National Organic Coalition
National Poultry Justice Alliance
Nebraska Farmers Union
Network for Environmental & Economic Responsibility
Nevada Live Stock Association
New England Small Farm Institute (NESFI)
New York Beef Producers Association Southern Tier Region
NY Sustainable Agriculture Working Group
Nojoqui Ranch Produce (CA)
North Carolina Contract Poultry Growers Association
North Dakota Farmers Union
Northeast Organic Dairy Producers Alliance
Northeast Organic Farming Assoc -MA
Northeast Organic Farming Assoc -NY
Northeast Organic Farming Assoc-CT
Northeast Organic Farming Assoc-VT
Northern Plains Sustainable Agriculture Society
Northern Plains Resource Coun (MT)
NYS Safe Food Coalition
Ohio Environmental Council
Ohio Farmers Union
Oregon Livestock Producer Association
Oregon Tilth
Organic Consumers Association
Organic Seed Alliance (WA)
Organization for Competitive Markets

The Partnership for Earth Spirituality (NM)
Past Regents Club, Diocese of Rochester (NY)
PCC Natural Markets (WA)
PCC Farmland Trust (WA)
Pennsylvania Association for Sustainable Agriculture
Pennsylvania Farmers Union
Perkins County Farmers Union (South Dakota)
Platte County Farm Bureau (NE)
Powder River Basin Resource Council (WY)
Producers Livestock
Provender Alliance (OR)
Putting Down Roots (PA)
Rainbow Natural Grocery (MS)
R-CALF United Stockgrowers of America
Red Tomato (MA)
Regional Farm and Food Project (NY)
Rochester Farm Connection (NY)
Rochester Roots (NY)
Rocky Mountain Farmers Union
Rural Advancement Foundation International-USA (RAFI-USA)
Rural Coalition/Coalición Rural
Rural Life Committee of the North Dakota Conference of Churches
Selene Whole Foods Co-op (PA)
Sevananda Natural Foods Market
Sierra Club Agriculture Committee
Social Concerns Office, Diocese of Jefferson City
Social Concerns/Rural Life Department, Catholic Charities, Diocese of Sioux City, IA
Soil Association
Soil Science Society of America
South Dakota District IV Farmers Union
South Dakota Farmers Union
South Dakota Stockgrowers Association
Southern Colorado Livestock Association
Southern Research & Development Corp. (LA)
Southern Sustainable Ag Working Group
Spokane County Cattlemen's Association (WA)
St John the Baptist Fraternity, Secular Franciscan Order, Elmira NY
Stevens County Cattlemen's Association (WA)
Sustainable Agriculture Coalition
Temple Beth El of Flint, Michigan
Texas Mexico Border Coalition Community Based Organization
Tilth Producers of Washington
United Hmong Association
The Urban Nutrition Initiative (PA)
Utah Farmers Union
Valley Stewardship Network (WI)
Virginia Association for Biological Farming
Washington Cattlemen's Association
Washington County Stockmen's Assoc (CO)
WA Sustainable Food & Farming Network
West Carroll Cattleman Assoc. (LA)
Western Organizations of Resource Councils
Wisconsin Farmers Union

FOR FURTHER INFORMATION, CONTACT:

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A COPY OF THIS SIGN-ON LETTER AND BACKGROUND INFORMATION ON THE 2007 FARM BILL'S COMPETITION AND CONCENTRATION ISSUES ARE POSTED ON THE NATIONAL CAMPAIGN FOR SUSTAINABLE AGRICULTURE'S WEBSITE AT: http://sustainableagriculture.net/CompConc2007.php.

FLAG

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TESTIMONY OF

LYNN A. HAYES

FARMERS' LEGAL ACTION GROUP, INC. (FLAG)

BEFORE THE

SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

APRIL 18, 2007

FLAG

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My name is Lynn Hayes. I am an attorney and the Program Director at Farmers' Legal Action Group, Inc. (FLAG), in St. Paul, Minnesota. Thank you for the opportunity to present this testimony regarding "Economic Challenges and Opportunities Facing American Agricultural Producers Today." The concerns I raise have been developed through our work with the Campaign for Contract Agriculture Reform, Rural Advancement Foundation International–USA, Western Organization of Resource Councils, and other farm organizations, as well as FLAG's work with individual farmers and ranchers.

I. FLAG's Work Related to Contracts, Competition, and Concentration in Agriculture

Farmers' Legal Action Group, Inc., is a nonprofit, public interest law center that provides legal education, training, and support to family farmers and ranchers and their lawyers and advocates across the country. Over the past two decades, FLAG has provided legal education or assistance to thousands of small- and mid-sized family farmers throughout the nation who produce agricultural commodities under contract.

FLAG's former executive director published one of the first law review articles on the subject of agricultural production contracts.[1] FLAG later led a project which resulted in publication of a detailed report, including results of a survey of over 1,400 poultry growers, a contract review and analysis, a legal review and analysis, and broiler grower legal educational materials.[2]

FLAG attorneys have addressed the rights and responsibilities of contract growers in dozens of training sessions around the country, and have fielded hundreds of calls, letters, and e-mail messages from farmers and their attorneys across the country on these topics.

FLAG submitted an extensive petition for rulemaking to regulate the use of captive supplies in the beef industry on behalf of the Western Organization of Resource Councils, which USDA published for comment in the *Federal Register*. In the course of USDA's consideration of this petition, FLAG participated in numerous meetings with then-Secretary Glickman, USDA economists and lawyers, and GIPSA officials on captive supply issues in beef industry. No final agency decision on the petition for rulemaking has ever been issued.

[1] Randi Ilyse Roth, *Redressing Unfairness in the New Agricultural Labor Arrangements: An Overview of Litigation Seeking Remedies for Contract Poultry Growers*, 25 U. MEMPHIS L. REV. 1207 (1995).

[2] ASSESSING THE IMPACT OF INTEGRATOR PRACTICES ON CONTRACT POULTRY GROWERS, (FLAG, *et. al.* 2001) (*hereinafter* ASSESSING THE IMPACT), available on the Internet at http://flaginc.org/topics/Contracts/index.php.

II. Topics of Testimony

Over the last few decades, the markets for farmers' agricultural commodities have experienced a rapid consolidation of market share in the hands of a few large companies and dramatic trend toward more vertical coordination by processing and packing companies. These trends have resulted in huge reductions in the number of buyers available to compete for farmers' products, a loss of transparency in the markets, manipulation of prices paid to farmers, a sharp increase in the use of production contracts, and a horrendous imbalance in bargaining power between farmers and processors.

My testimony addresses predominantly the problems farmers face as a result of two prominent methods used to accomplish vertical integration or coordination in today's highly concentrated agricultural commodities markets: the use of production contracts of which the poultry industry is a prime example, and the use of captive supplies procurement methods (forward contracts, marketing agreements, and packer ownership of livestock) in the hog and cattle sectors.

III. Improving Fairness In Production Contracts

A. Introduction to the Issue

One of the most dramatic recent trends in the agricultural sector is the rise of vertical integration through production contracting. The poultry industry pioneered this business model several decades ago. Today nearly 90% of poultry is raised through production contracts.[3] Although more recently, production contracting has increased dramatically in other agricultural sectors—notably the hog sector where, by 2003, nearly 58% of hogs were being produced through production contracts[4]—it has reached its zenith in the poultry industry. For this reason, I will use predominantly examples from the poultry industry to illustrate the problems farmers face under production contracts. I acknowledge that each type of agricultural commodity will present some unique production contracting issues. However, my recommendations on legislative actions addressing methods to begin to reduce the vast disparity in bargaining power between farmers and companies would apply to all agricultural commodities.

A typical poultry production contract is drafted by the company and presented on a "take it or leave it" basis. Growers are described as "independent contractors." The company owns the poultry and contracts with farmers to provide the labor, facilities, and services necessary to raise the birds. Even though it is not unusual for growers to invest $500,000 or $1 million in a poultry farm, the contracts are usually of a short duration, such as one seven-week period for a flock of broiler chickens. Even where contracts appear to be for a number of years, there is typically a clause which allows the company to cancel the contract at will. In addition, the contracts leave to

[3] USDA/ERS, *Agricultural Contracting Update: Contracts in 2003*, Economic Information Bulletin No. 9, January 2006.

[4] *Id.*

the company's discretion when the grower will receive flocks, how much time will pass between flocks, and how many flocks a grower will receive in a year. In most contracts for boiler chickens, the company provides the inputs needed by the grower, such as chicks, feed, and medications, though the grower is responsible for fuel and other costs. Broiler growers, for example, are generally paid according to a "tournament" or "ranking" system, in which a grower's flock production efficiency is ranked against that of other growers whose birds are processed in the same time period. The formula to calculate production efficiency essentially compares the number and weight of chickens harvested to the number of chicks and pounds of feed delivered to the grower, thus measuring the efficiency with which the flock converts feed to weight gain. Under this system, a grower will be paid more or less than other growers in the group depending on where the flock falls in the ranking system. Despite being paid based on the flock's efficiency in converting feed to weight gain, the grower has little or no control over key elements affecting how the flock will perform, e.g., the quality of the chicks, feed, and medications which are all provided by the company.

B. Need for Disclosure of Risks of Contracts

1. Background

As in the poultry industry, in most production contracting situations the companies draft the contracts and present them to farmers on a take-it-or-leave it basis. The farmers have little or no opportunity to negotiate the terms of the contract. As would be expected under these circumstances, contract terms are primarily designed to minimize the risks to the company rather than to protect the interests of the farmer. Thus, it is imperative that farmers have a fair opportunity to at least read and understand the full range of material risks they face before entering into company-dictated production contracts.

Despite the take-it-or-leave nature of the contracts, farmers are often persuaded to enter into them through promotional materials and oral statements of the companies' representatives touting the financial and lifestyle benefits to the farmers. Often these representations are not borne out in the contract provisions themselves.

For example, I once reviewed a contract for a farmer who was considering making a huge financial investment in barns to raise hogs under a production contract. The farmer provided me with the company's slick brochure which, among other things, touted the farmer's freedom to manage his own operation. However, when I reviewed the actual production contract, it would have required him to strictly follow the company's detailed management manual, leaving virtually no room for individual management decisions. The farmer, who was an experienced hog producer, was taken aback by this provision, having thought he would have management freedom. But even more disturbing to him was the contract provision that gave the company total discretion to declare that he was not properly caring for the animals or managing the operation, and giving the company the authority to kick him out of his own hog barns while the company hired someone else to run the facility and charged that cost to him. Incidentally, I recently provided legal advice on another hog production contract case in which the company had actually taken advantage of just such a provision and kicked the farmer out of his own hog barns while the company continued to raise animals in them using a company-hired manager. Clearly, contract terms relating to circumstances under which the contract may be terminated or the farmer may be required to turn over his facilities to the company are key factors of which the farmer must be aware when deciding whether to enter the contract.

In many instances, the farmers are also assured of the financial feasibility of the enterprise involved in the production contract by oral statements made by the company's representative or, in some cases, the lender who will finance the farmer's production contract enterprise. Often in the poultry sector, growers do not even see the production contract with the company until after they have taken out large loans to purchase a poultry farm or to build poultry houses on their existing property. Not long ago, I met with several growers who had made huge capital investments to purchase poultry farms based on the cash flow projections prepared by their lenders, who had relied, at least in part, on information from the companies. In reviewing those original projections, it became clear that there were many errors and that more accurate projections would have shown that the loans to purchase the farms could not have been paid off with the income received under the poultry contracts offered by the companies.

Though many oral representations are made to farmers to encourage them to enter into contracts, rarely would such representations be enforceable. Many court decisions disregard any oral promises that contract growers allege were made by company representatives because the contracts included "entirety clauses" stating that the entire agreement between the parties is included in the contract, and, consequently, refusing to enforce any oral promises not in the written contract. Farmers should be made aware that the oral representations or promises will not change the actual terms of the contract.

There are many terms in production contracts that pose substantial risks to the farmers by impacting the level of income they may receive, but which are rarely discussed or explained to the farmer. One significant example is a term that controls the number of animals that may be produced under the contract. For example, most poultry production contracts are written in such a way that it is left to the discretion of the company how many flocks will actually be delivered over any specific period of time. Some contracts are only for one flock and may provide for renewal as new flocks are delivered, but do not include any commitment to future flocks. Others may provide for a specified number of years in which the contract will apply, but do not establish how long the period between deliveries of flocks may be. This means that the company has the discretion as to when flocks will be delivered to the grower. When the companies choose to reduce their production levels due to market conditions or any other factors, they have the freedom to force longer periods between flocks. As the number of flocks per year decreases with the longer periods between flocks, growers' income is reduced dramatically, often causing them to default on loans and fail to pay their family living and farm operating expenses.

Other examples of poultry contract terms that may pose significant risks for farmers are those addressing equipment and facilities upgrades and those that relate to the company's provision of medication. Many contracts include provisions that explicitly or implicitly allow the company to require growers to make equipment and facilities upgrades as the companies see fit. Often it may cost growers thousands of dollars to install upgraded equipment. While some contracts may provide for sharing of the cost between the company and the grower or provide a small bonus on the payment of birds once the upgrades occur, these payments are often not sufficient to offset the cost for growers. Other contracts do not provide any additional payments to the grower, and it is often impossible for growers to recoup the costs of equipment upgrades merely through improved production efficiencies on which their payment per flock is based.

Many poultry contracts also set out that the company will provide the medication and veterinary services for the birds and often even prohibit growers giving the birds any medications not supplied by the company. Such a term may not on its face seem to have a huge impact on the grower's income. But it can be devastating. I recently met a grower whose chickens contracted a highly contagious disease. When informed, the company would only provide one type of treatment which failed, and refused to provide the medication a veterinarian suggested. The grower lost thousands of birds and eventually took the risk of purchasing the recommended medication in order to save at least enough birds to obtain a miniscule payment on that flock. Not only did the grower receive no payment for the birds that died, but because of the feed efficiency method of payment, the feed which the birds consumed before dying counted against the feed-to-weight gain efficiency of those that survived, essentially decreasing the payment received for the surviving birds as well.

As the size of livestock and poultry operations has increased, the public's concern over their potential environmental impact has also grown, resulting in more stringent review and regulatory requirements at all levels of government—local, state, and federal. Compliance with these more stringent standards can be quite expensive and many production contracts place compliance responsibility on the growers. This too can have a substantial impact on growers' net income from the contract.

Possibly the most significant risk to farmers under production contracts involves how much they can reasonably expect to be paid under a contract's payment formula. Yet under many poultry and livestock production contracts, the formula for calculating payment can be extremely complex and couched in technical language with no summary explanation provided. Even after some years of experience with production contracts, I once spent an entire afternoon trying to decipher the two-page payment formula on one turkey contract.

Despite their complexity, often involving many pages of technical and legal language, some contracts include a provision that requires the farmer to keep the contract confidential. This often prevents farmers from obtaining the necessary legal and financial advice that is absolutely essential to making an informed decision on whether to sign the agreement.

Current Packers and Stockyards Act (P&S Act) regulations state that poultry growers have the right to see their contracts, but there is nothing in current law to help ensure that they understand them. In workshops, growers are consistently surprised to learn that their right to even see the contract is protected by federal law. To be a meaningful right, growers must see and understand the contract before they take out a loan, purchase land, or begin building or upgrading facilities.

The first essential building block to ensure that livestock growers understand their contracts was added to the Packers and Stockyards Act in the 2002 Farm Bill—a provision protecting the right of growers to receive advice from attorneys, accountants, lenders, family members, and the government—by stating that any confidentiality clause in a contract is unenforceable, at least as to those parties. However, there is no similar legislation that applies to agricultural commodities not covered by the P&S Act.

2. Recommended Legislation

Congress should enact legislation that requires contracts for agricultural commodities to be in plain language understandable to growers and to disclose in a cover sheet the material risks associated with the contract. Requiring a cover sheet summarizing material risks the farmer faces would level somewhat the playing field for farmers in their dealings with companies that control contract terms, by improving the chances that growers understand the often technical provisions of the contract and giving them a better opportunity to evaluate their risks before signing. It would also create an incentive for companies to give farmers more accurate information in their promotional materials and recruitment discussions.

It is important that such legislation provide baseline requirements for what must be included in the cover sheet risk disclosure. The baseline risk disclosure provisions should require a summary explanation of terms that relate to the length of the contract, when and for what reasons it may be terminated, how renewal may occur, the factors to be used in determining payment, the minimum number of animals covered, the responsibility to obtain and comply with environmental regulations and liability for environmental damage, and identification of the state laws that will control disputes, as well as the venue for resolution of such disputes. In instances in which the level of grower pay is affected by factors outside the grower's control, an explanation of these factors should also be required in the risk disclosure statement. Examples of when such a disclosure would be required in the poultry context are when grower pay is affected by: (a) the quality of inputs provided by the integrator (such as chicks, feed, and medication); and (b) condemnations that may result from handling of the birds by company employees or agents. Other key risks which should be explained are the risk of termination of the contract before the grower's investment has been paid off, the risk of depopulation due to disease, the risk of a change in the timing, frequency, number, and size of flocks of chicks provided,[5] and the risk that the grower will be required to make substantial additional investments in the livestock operation in order to comply with facility and equipment requirements of the contractor. Any legislative description of the material risk factors that must be included in the cover sheet should be described in general enough terms to apply to all types of agricultural commodities but also

[5] One close review of poultry production contracts concluded that the short-term nature of the contracts is the critical element in the relationship between the parties. Neil D. Hamilton, *Broiler Contracting in the United States—A Current Contract Analysis Addressing Legal Issues and Grower Concerns*, 7 DRAKE J. AGRIC. L. 43, 84 (2002).

describe specific requirements for certain types of commodities such as poultry and other livestock where necessary.

As a corollary to the requirement that the company provide a material risks disclosure cover sheet, Congress should expressly prohibit companies from making false or misleading oral or written statements to farmers that are considering signing or have signed a contract with the company.

Legislation should also make void confidentiality clauses in production contracts to ensure that farmers are not deprived of the right to obtain the consultation and advice essential to making informed decisions on whether to enter into the contract or to how to address issues that arise during the contractual relationship.

C. Reduce Growers' Risks with Respect to Capital Investments

1. Background

The great imbalance of bargaining power between companies and farmers in production contract relationships is exemplified by the disparity in the level of the capital investments made. For example, in the hog and poultry sectors, farmers make capital investments of many hundreds of thousands of dollars in the buildings, equipment, and real estate in order to raise animals owned by the company. The companies, on the other hand, have very little invested in this infrastructure needed for the production of their animals. Sometimes these capital investments are directly required in the contract, with the company's building design and equipment specs being included. Though more often there is simply a tacit understanding that if farmers will purchase or build the facilities, the company will give them production contracts. As mentioned above, many livestock contracts also include provisions that allow the company to demand that the grower make equipment and facility upgrades as the company deems necessary. Thus, growers may also be required to spend tens thousands of dollars for capital improvements during the course of a production contract. Despite the large investments farmers make in order to obtain and retain the production contracts, the company-drafted contracts often are either for a very short duration or give the company the ability to terminate the contract at their discretion and with little or no notice to the farmer. Many poultry growers report that they have been told that their contracts will be cut off if they do not install equipment improvements such as tunnel ventilation.[6] These growers state that, as a result of complying with these capital demands, they are carrying greater debt loads after five, ten, or fifteen years as poultry growers than when they first purchased the farm. Growers also report that, even though they have installed expensive upgrades, the companies have cancelled their contracts. A grower's contract may be cut off, not because of any

[6] In a 1999 survey, 67% of respondent growers had implemented equipment upgrades costing at least $ 3,000 per chicken house. ASSESSING THE IMPACT, at Appendix 2-C, page 2. Half of growers agreed that their contracts would not be renewed unless they followed the company' recommendations about building new houses or making major improvements. *Id.* at page 4.

malfeasance on the grower's part, but because of the sale of a processing plant, a contraction in the industry, the company's desire to reduce production levels, or the desire of the company to save on transportation costs. Terminating a contract is often cost-free for the company, but devastating to the grower. Often, because of the concentration in the industry, there is no other company operating in the region for the grower to approach. And the barns are not readily converted to other uses.

2. Recommended Legislation

To address this problem, Congress should pass a law that would impose a duty on companies to compensate growers for the remaining useful life of buildings, machinery, equipment, and other capital investment items if a company terminates or fails to renew a production contract without good cause. Legislation should require that if a farmer has made capital investments of $100,000 or more in order to obtain a contract or at the direction of the company, before the company may terminate or fail to renew the contract, even for cause on the farmer's part, the company must provide the farmer with a written notice of the reasons for the intended action and give the farmer at least 180 days to take corrective action to prevent the loss of the contract. The concerns of integrators and contractors may be addressed by excepting situations where a grower abandons or breaches the contract if that breach reasonably threatens the farmer's substantial performance under the contract. Such a law would balance the right of the parties to enter into agreements, while preventing predatory behavior by companies. It is critical that such a provision address both termination and failure to renew a contract, because so many contracts are for much shorter terms than the time needed to recoup the farmers' investment in buildings and equipment made to produce the companies' animals.

D. Address Use of the Tournament System in Determining Grower Pay

1. Background

The "tournament" or "ranking" system for calculating payment under many poultry contracts described above is presented by the companies as a way to create incentives for hard work and skill. However, as implemented, the tournament system depends largely upon factors controlled by the companies rather than on the quality of the growers' work. In the 1999 survey cited previously, 78% of growers either agreed or strongly agreed with the statement, "My pay depends more on the quality of chicks and feed supplied by the company than on the quality of my work."[7] The health of chicks, the quality of feed, and the timeliness and effectiveness of the medications—all factors that vary greatly, and all of which the companies provide—control much of how efficiently birds put on weight. Thus, their distribution amongst growers is crucial to how much each grower will be paid under the contract. As such, the "tournament" or "ranking" system is rife with opportunities for companies to treat growers unfairly, discriminating against some while providing undue preferential treatment to others.

[7] ASSESSING THE IMPACT, at Appendix 2-C, page 4.

As an example of how such unfair and discriminatory treatment may occur, growers report being given sick chicks after speaking out about unfair treatment by the company. Other growers report being told by their field representatives that they were given sick chicks because the company hoped that as highly skilled growers, they would be able to nurse the chicks along.

2. Recommended Legislation

Many other pieces of recommended legislation discussed in my testimony will improve transparency and fairness in the negotiating process and may ameliorate some of the unfairness of the tournament system. But to address this problem, Congress should ban the tournament system of payment outright.

E. Binding Arbitration

1. Background

Clauses providing for arbitration are a standard feature of most agricultural production contracts. Arbitration clauses essentially provide that any dispute that arises under the contract will be addressed through arbitration without recourse to review or appeal by any court. Arbitration clauses have blocked numerous contract growers who sought to have their day in court.[8] Many more potential cases were never filed in court due to an arbitration clause. In addition, many disputes with the companies were never challenged even through arbitration, because a livestock producer or contract grower didn't have the price of admission—the often thousands of dollars necessary to pay the arbitration proceeding cost and the fee of the private arbitrator or arbitrator panel. The costs of arbitration are a prohibitive barrier for farmers, as they are not for multinational corporations.[9]

In one case, the swine contractor unlawfully sought to limit hog producers to binding arbitration as a remedy, while reserving to itself the right to go to court. *Tyson Foods, Inc. v. Stevens*, 2000 Ala. LEXIS 491 (Ala. 2000). Even where the contract binds both parties to arbitration, however, many arbitration provisions require producers to file arbitration requests within an unreasonably

[8] *See, e.g., Steed v. Sanderson Farms, Inc.*, 2006 U.S. Dist. LEXIS 71752 (S.D. Miss. 2006); *Schoenrock v. John Morell & Co.*, 2003 U.S. Dist. LEXIS 11733 (D. Minn. 2003).

[9] In a 1999 survey of 1424 contract poultry growers, the net cash flow from broiler production was negative for 9 % of respondent growers, and under $ 15,000 for another 36 % of respondents. ASSESSING THE IMPACT, at Appendix 2-C, page 6. For many growers, arbitration fees could equal or exceed their annual net income, as in the case of a grower who had lost her farm and was dependent upon social security, food stamps, and Medicaid to meet her own and her husband' needs, but would have had to pay over $ 27, 500 in arbitration fees in order for her legal claims regarding fraud, negligence, and wrongful termination of the contract to be heard. *Overstreet v. Contigroup Companies, Inc.*, 462 F.3d 409 (5th Cir. 2006). The court held the arbitration clause was not unconscionable.

short period of time—sometimes just days—after the dispute arises, or else waive the right to be heard. Moreover, there is little evidence of a need for companies to seek legal action against contract farmers; they simply terminate the contract and move on to the next farmer. In contrast, before the widespread use of arbitration clauses, poultry growers were more able to challenge egregious violations of the P&S Act through the courts, as in the case of *Braswell v. ConAgra*, 936 F.2d 1169 (11th Cir. 1991), where the jury awarded over $13 million in damages for purposeful misweighing of birds by the company resulting in underpayments to the growers for a period of more than eight years.

The inclusion of binding arbitration clauses in contracts is not a neutral tool to help both parties manage legal risk. Arbitration clauses are part and parcel of take-it-or-leave-it contracts presented by companies to farmers, and they compromise producers' ability to resolve disputes and ensure justice is served.

2. Recommended Legislation

Congress should prohibit the inclusion or enforcement of mandatory, binding arbitration provisions in contracts for the production and marketing of livestock and other agricultural commodities. Inclusion of an arbitration provision in these types of contracts should be lawful only if it provides that, after the dispute arises, all parties to the dispute agree in writing to submit to arbitration to resolve the dispute.

F. Require Good Faith Bargaining with Grower Associations

1. Background

As the poultry contacting situation demonstrates, there is a huge imbalance in the negotiating power between producers and companies. Growers are committed to one specific piece of real property in which they have made large capital investments, often including single-use buildings such as poultry houses, and on which their families reside. When, as is often the case in the poultry industry, growers have only one or a very few companies that serve their area, they are reluctant to enter into any disputes with the company for fear of losing their production contracts and only source of income from their single-use buildings. Companies, on the other hand, are not committed to any specific real estate on which to have their birds raised. They have not made large investments in the buildings housing their birds. As long as a company can find others to provide facilities and labor, the company is free to move. Companies contract with many growers in many regions of the country. A company does not "need" one particular grower in the way the grower needs the company. The physical asset specificity and the site specificity of livestock production mean that individual growers are vulnerable to a "holdup" by the company.[10]

[10] Physical asset specificity and site specificity are also present to varying degrees in other sectors of the agricultural economy. For example, sugar beet producers must invest in highly specialized harvesting equipment and seed beds, while transport costs and the rapid

The imbalance in negotiating power manifests itself in the grower's fear that the company will retaliate by terminating the contract if the farmer raises any significant issues.

I experienced an example of this recently in meeting with individual broiler growers in Arkansas. Their primary input expense is propane. The cost of propane had more than doubled over the last few years, significantly reducing any net earnings from their poultry operations. But the individual growers had no leverage to negotiate with the company for an increase in pay to cover their increasing operating costs. In the absence of collective bargaining, individual growers are forced to absorb those extra costs, while the companies remain unfairly insulated from the rising cost of producing birds they own. If there were a recognized bargaining association representing these growers, this issue would surely be addressed in negotiations with the company.

In fact, the companies are well aware of the weak bargaining posture of individual growers and exploit it to their advantage. For example, when a company closes a processing plant, it may offer a settlement to its growers in order to buy out the growers' contracts. To some extent, this may be a gesture of good will by a company, rather than forcing the growers to go to arbitration or litigation regarding any breach of contract. Yet the companies routinely insist on meeting with the growers individually to discuss the settlement terms. This serves to limit the bargaining power of the growers and to prevent them from joining together to negotiate collectively.

Collective bargaining rights are widely recognized throughout the economy as a necessary and lawful corrective to the harmful abuses found in an unregulated marketplace. The Agricultural Fair Practices Act (AFPA) establishes standards of fair practices required of handlers of agricultural products. 7 U.S.C. §§ 2301-2306. A "handler" includes any person who contracts or negotiates contracts, whether written or oral, with or on behalf of producers or associations of producers with respect to the production or marketing of any agricultural product. 7 U.S.C. § 2302(a). The Act prohibits handlers from knowingly coercing, intimidating, or discriminating against an individual grower because of the grower's decision to join or not join an association of growers.

However, the AFPA does not currently require that a handler deal with farmers who are members of an association, or with the association itself, so long as the stated reason for the decision not to deal with them is not based on membership in the association. This limitation in the Act greatly hinders its efficacy in promoting a stable and smoothly functioning marketplace for livestock production services. Companies may refuse to deal with grower associations, or with the leaders of emerging associations, and simply offer pretextual reasons for their refusal. More subtly, companies routinely discriminate against farmer leaders by manipulating input quality or picking up their birds a few days late in the production cycle, thus steering them toward failure in the ranking system. Broilers reach an optimum point of weight gain, after which they simply consume more food, but have little or no additional weight gain. It does not

conversion of sugar to starch once harvested also contribute to the vulnerability of sugar beet producers.

take many cycles of defeated leaders before growers do not want to take on leadership in the association, and before most growers even fear to have their trucks seen parked at known meetings of the association. The AFPA currently does little to halt such unfair and abusive practices.

2. Recommended Legislation

The Agricultural Fair Practices Act should be strengthened to affirmatively require companies to bargain in good faith with an association of growers, and to refrain from interfering with the formation or administration of any association of producers. Good faith requires that the companies honestly and sincerely bargain with an association of producers, that they do not refuse to deal with growers because of their exercise of the right to join, belong to, and participate in the leadership of an association of producers. But an effective law must reach much more subtle unfair practices than an outright refusal to deal with a grower. It must declare unlawful actions that interfere with the right of the grower to participate in an association. Legislation should declare it unlawful for the companies to discriminate in the quality, quantity, price, or timeliness of inputs such as chicks or other young livestock, feed, and medication required to be provided by the company under the terms of a contract, because of a grower's joining, belonging to, participating in, or providing leadership for, an association. An alternative legislative approach would affirmatively require companies that provide inputs under the contract to provide inputs that are of merchantable quality, and to distribute them randomly.

Strengthening the collective bargaining protections will help ensure that farmers are able to engage in true negotiations with the companies, thus resulting in more fair and balanced agreements, reducing the need for enforcement actions, and promoting the stability of the poultry and meat industries.

IV. Use of Captive Supply Procurement Methods in Red Meat Sectors

A. Background

A few meat packers overwhelming dominate the livestock industry today. Over the last 20 years, there has been an unprecedented increase in horizontal market consolidation in both the beef and pork packing sectors. In 1985, the top four beef packing firms slaughtered 50% of steer and heifers and 39% of all types of cattle nationally. By 2005, the top four firms slaughtered 80% of all steers and heifers and 71% of all types of cattle in the U.S.[11] Using the Herfindahl-Hirschman Index (HHI)—a measure used by the Department of Justice when weighing an industry's concentration level—the beef packing industry reached a level that is considered highly

[11] *Livestock Marketing and Competition Issues*, CRS Report to Congress, Geoffrey S. Becker, updated February 27, 2007, at 3 citing 2006 issues of *Cattle Buyers Weekly* and various USDA data sources.

concentrated (1,800 HHI) in the mid-1990s, and by 2004, its HHI was 1,900.[12] Between 1985 and 2005, the top four packing firms' percentage of the U.S. hog slaughter increased nearly two-fold, from 32% to 63%.[13] Such high levels of concentration in so few firms contribute to the packers' ability to exercise market power and control of the hog and cattle industries, reducing free market competition.

Compounding the problems for livestock producers associated with the horizontal consolidation in the meat packing sector is the rapid trend toward vertical integration. Packers and processors increasingly control their slaughter supplies through vertical coordination arrangements, such as production contracts with farmers who raise livestock owned by the packer; and marketing agreements and forward contracts in which the packer purchases livestock from producers, securing a commitment of supply weeks in advance of its slaughter.

A recent study indicated that, between October 2002 and March 2005, the largest 29 U.S. beef packing plants acquired over 38% of their cattle through vertically coordinated arrangements: 28.8% through marketing agreements; 4.5% through forward contracts; and 5% through packer ownership or other unknown methods.[14] In 2003, six large producers—Smithfield, Premium Standard Farms, Seaboard, Prestage, Cargill, and Iowa Select—together accounted for nearly 30% of the U.S. hog production.[15] The use of production contracts in the hog industry increased sharply from 29% of the production value in 1994-1995 to over 50% in 2003.[16] According to a recent study, vertically coordinated arrangements account for an estimated 89% of finished hog volume, of which 20% to 30% (depending on assumptions) was from packer-owned hogs.[17]

Because these vertically coordinated arrangements are individually negotiated outside any public market, they eliminate market transparency with regard to this rapidly increasing percentage of the total livestock slaughter in the U.S. In addition, packers tend to provide these individually negotiated contracts to larger livestock producers, excluding smaller producers who are then left to sell in the decreasingly competitive cash market that no longer reflects the price being paid for

[12] *Id.* at 3 citing Barkema; and USDA, Grain Inspection, Packers and Stockyards Administration (GIPSA), *Assessment of the Cattle, Hog, and Poultry Industries, 2005 Report,* March 2006.

[13] *Id.* at 4 citing *Cattle Buyers Weekly*; Barkema, and GIPSA.

[14] GIPSA, *Livestock and Meat Marketing Study*, Executive Summary and Overview, January 2007, at ES-5.

[15] *Id.* at 3 citing Informa Economic, *Special Report: The Changing U.S. Pork Industry*, November 1, 2004.

[16] *Id.* at 5 citing USDA/ERS, *Agricultural Contracting Update: Contracts in 2003,* Economic Information Bulletin No. 9, January 2006.

[17] GIPSA, *Livestock and Meat Marketing Study*, Executive Summary and Overview, January 2007, at ES-2.

a large volume of livestock being slaughtered. Research suggests that it is the large farms that the vertically integrated companies rely on for their supplies, and that they are much less willing to work with small- or medium-size farms.[18] Thus, packers' use of captive supply arrangements excludes small and independent livestock producers from much of the market for slaughter animals.

Meat packers' acquisition of slaughter supplies through vertically coordinated arrangements, such as packer-owned cattle or cattle committed through forward contracts and marketing agreements weeks in advance of slaughter, are often referred to as "captive supplies." Economic studies have repeatedly shown an association between increases in use of captive supplies to fill slaughter capacity and declines in cash market prices. Livestock producers' belief that the use of captive supplies causes declines in spot market prices has been borne out in empirical analyses, "which found a price reduction of between $1-2 a hundredweight for live cattle compared to a situation without captive supply practices."[19] Even small (three percent or less) reductions in price from the use of captive supply practices can have a significant impact on livestock producers as it represents between 12 and 25 percent of long-run cattle feeding profits.[20]

There is also evidence in an economic study conducted for GIPSA showing that packers act differently with regard to formula-priced and fixed-priced forward contracts, tending to slaughter more fixed-priced forward contract cattle when cash market prices are relatively high, and to slaughter more formula-priced forward contract cattle when cash market prices are lower. Because the formula used to set the base price often references the cash market prices, the packers' different practices with regard to fixed-priced and formula-priced cattle indicate a strategic use of these contracts to manipulate prices paid to producers.[21] Many economists have

[18] *Id.* at 11 citing Gebremedin, Tefsa G. and Christy, Ralph D., 1996; "Structural Changes in U.S. Agriculture: Implications for Small Farms," *Journal of Agricultural and Applied Economics*, 28, 57-66, General Accounting Office (1998). Changes in Nebraska's and Iowa's Counties with Large Meatpacking Plant Workforces. GAO/RCED-98-62.

[19] *Id.* at 11 citing Durham, C. (1998), Formula Pricing (Marketing Agreements) v. Fixed Pricing (Forward Contracts); Unpublished analysis commissioned by Western Organization of Resource Councils.

[20] *Id.* at 11 citing Lawrence, John (2004); Packer Concentration, Captive Supplies, and Fed Cattle Prices. Available online at http://www.econ.edu/classes/econ135/lawrence/captive%20Supplies %20and%20price.ppt.

[21] Durham, C. (1998), Formula Pricing (Marketing Agreements) v. Fixed Pricing (Forward Contracts); Unpublished analysis commissioned by Western Organization of Resource Councils.

emphasized that formula-priced contracts that are based on cash market prices distort buyer (packer) incentives in concentrated markets such as exist in the hog and cattle sectors today.[22]

Contract and packer-owned supplies have also been found to be associated with decreases in market prices. For example, a recent study conducted for GIPSA found that "the effect of both contract and packer-owned hog supplies on spot market prices . . . are negative and indicate that an increase in either contract or packer-owned hog sales decreases the spot price of hogs," and that increases in use of such supplies leads to packers buying fewer hogs on the spot market.[23]

The high concentration of market share in the top packing firms in both the hog and cattle sectors, coupled with the dramatic rise in the use of vertical coordination through packer ownership of livestock and formula-priced forward contracts, greatly reduces market transparency and creates an environment ripe for price manipulation and discrimination.

B. Recommended Legislation

Any legislative solution to the problems many livestock producers face in highly consolidated and vertically integrated hog and cattle sectors must ensure transparency in slaughter livestock transactions and remove the mechanism by which packers have an incentive and ability to manipulate prices and discriminate against smaller producers.

1. Requirements for forward contracts

To meet these goals, a legislative solution should require that all forward contracts for a purchase of livestock for slaughter—contracts in which the livestock is committed more than seven days in advance of slaughter: (1) include a fixed-base price that can be equated to a fixed dollar amount on the day the contract is entered into; and (2) be traded in an open and public manner which allows sellers and buyers generally to participate in the market, solicits blind bids (without identifying the bidder) that can be witnessed generally by buyers and sellers as the bids are made and accepted.

This captive supply provision would help restore competition by requiring packers to bid against each other to acquire forward-contracted slaughter supplies, preventing packers from unjustly

[22] See, Taylor, Robert C., *Testimony to the United States House of Representatives Committee on Agriculture, Subcommittee on Livestock, Dairy and Poultry* (April 17, 2007), citing in footnote 5 statements of several economists at the Public Forum on Captive Supplies held by the United States Department of Agriculture, Denver, CO, September 21, 2000.

[23] *GIPSA Livestock and Meat Marketing Study*, Executive Summary and Overview, January 2007, at ES-10. This study has been roundly—and I believe appropriately--criticized for the methodologies used to attempt to explain away its findings regarding the impact of vertical coordination agreements' impacts on livestock markets and prices. See, Taylor, Robert C., *Testimony to the United States House of Representatives Committee on Agriculture, Subcommittee on Livestock, Dairy and Poultry* (April 17, 2007).

discriminating against smaller independent livestock producers when acquiring forward contracted livestock. It would remove the market-distorting incentives and ability of packers to use forward-contracted slaughter supplies to manipulate and control prices paid to producers, by eliminating formula prices that are based on cash market prices that occur after the contract is entered into. It would make all forward contract transactions transparent by requiring that they be conducted in an open and public manner. In addition, such a provision ensures that packers retain the alleged benefits of forward contracting: (1) the ability to coordinate supplies to keep packing plants operating at peak efficiency; and (2) the ability to pay premiums for specific traits and quality characteristics they desire by providing such premiums above the fixed-base price. Livestock producers would also retain the benefits they claim from selling through forward contracts—obtaining premium prices for higher quality livestock and improving supply management.

2. Packer-owned livestock

A legislative solution to address the declines in prices paid to producers associated with packer-ownership of livestock being raised for slaughter is to prohibit the large packing companies from owning or feeding livestock directly or through an arrangement in which the packer maintains the operational, managerial, or supervisory control of the livestock for longer than seven days in advance of slaughter.

Such a legislative provision would eliminate the packers' incentive and ability to strategically slaughter livestock it owns to keep prices paid to independent livestock producers relatively low. It would also prevent packers from freezing independent producers out of a significant percentage of the slaughter market which is now met with packer-owned livestock.

V. Enforcement of the Packers and Stockyards Act

A. Background

The Packers and Stockyards Act (P&S Act), was enacted in the 1920s as the "Big Five" packing firms were forced to divest their interest in companies by which they had vertically integrated the markets. It was intended to be the "most comprehensive measure and extend farther than any previous law in the regulation of private business, in the time of peace, except possibly the interstate commerce act."[24] The Conference report on the Act states, "Congress intends to exercise, in the bill, the fullest control of the packers and stockyards which the Constitution permits."[25] It was intended to go further than the anti-trust statutes and the Federal Trade Commission Act by not just restricting unfair competition between competitors on the same

[24] House Report No. 77, 67th Congress, 1st Sess. at 2 (1921).

[25] Conference Report, H.R. Report No. 324, 67th Congr. 1st Sess., at 3 and 5-6. Statement of the Managers on the Part of the House; 61 Congr. Rec. 4778, 4779 (1921).

plane, but also "unfair practice[s] as between the packer and the general public, the packer and the producer, or the packer and any other agency connected with the marketing of livestock."[26]

The primary manner in which Congress intended to regulate unfair practices between packers and producers, as well as consumers and the general public, was through § 202 of the P&S Act (7 U.S.C. § 192) which makes it unlawful for packers, swine contractors, and live poultry dealers[27] to engage in any of the enumerated practices. The prohibited practices include, among other things: (1) engaging in or using any unfair, unjustly discriminatory, or deceptive practice or device; (2) making or giving undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subjecting any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever; or (3) engaging in any course of business or doing any act for the purpose or with the effect of manipulating or controlling prices.

Under the P&S Act, the Secretary of Agriculture was granted extraordinarily comprehensive regulatory powers, including the authority to issue substantive regulations, as well as procedural and advisory regulations necessary to carry out the Act.[28] Congress intended that USDA use its broad regulatory powers to monitor the packing industry and adjust regulatory controls to ensure compliance with the purposes of the Act as industry structure and practices changed over time.[29] USDA, however, has failed to keep pace with the changing structure of the livestock and poultry industries. It has failed to issue regulations that help to define the types of practices that are unfair, deceptive, or unjustly discriminatory, or that have the purpose or effect of manipulating or controlling prices as the packers and processors have moved to strengthen their power over producers through vertical coordination practices such as production contracts and captive supply procurement methods. USDA has issued some minimal regulations addressing poultry

[26] 61 Cong. Rec.1805 (1921).

[27] The P&S Act was amended in 1935, making this provision apply to the sale of live poultry, while in 1987, the definition of "live poultry dealer" in the Act was amended to include companies that arranged for growers to raise and care for live poultry that the company continued to own. The Act was again amended in 2002 to include swine contractors.

[28] 7 U.S.C. §§ 228(a) and 222.

[29] Congressman Anderson of Minnesota, then a member of the House Committee on Agriculture and a sponsor of one of the bills that led to the act, stated during debates in the House that: "[I]ndustry is progressive. The methods of industry and the manufacture and distribution change from day to day, and no positive iron-clad rule of law can be written upon the statute books which will keep pace with the progress of industry. So we have not sought to write into this bill arbitrary and iron-clad rules of law. We have rather chosen to lay down certain more or less definite rules, rules which are sufficiently flexible to enable the administrative authority to keep pace with the changes in methods of distribution and manufacture and industry in this country." 61 Cong. Rec. 1887 (1921).

production contracts, but has failed to revise these for many years as retaliatory and other unfair practices persist in the industry.[30] It has not issued any regulations addressing practices regarding swine contractors in the five years since these entities were made subject to § 202 of the Act.

This failure to provide effective regulatory guidance on the types of packer, poultry dealer, and swine contractor practices that fall within the prohibitions of § 202 of the P&S Act has greatly contributed to the loss of one the key original purposes of the Act: to prohibit unfair, unjustly discriminatory, deceptive, and price manipulative practices that cause injury to livestock producers without regard to the effect on competition between packers or processors or their alleged business justification for taking such action. Despite USDA's recent assertion in the *London* case discussed below that it interprets the purposes and intent of § 202 this way, a few courts have failed to enforce the Act in this manner.

Two recent court cases highlight the serious problem with how the P&S Act is currently being enforced without regard to this original purpose. These cases demonstrate how it has become extremely difficult for livestock producers to effectively enforce § 202 of the P&S Act. In *London v. Fieldale Farm Corp.*, 410 F.3d 1295 (11th Cir. 2005), a poultry grower sued the integrator, Fieldale Farms, for violations of § 202 of the P&S Act, asserting that the company retaliated against him for providing a deposition in a racial discrimination lawsuit against the company. The alleged retaliation involved terminating the poultry growing contract without economic justification, improperly adjusting weight of birds on which the grower's pay was based, and providing settlement sheets calculating the grower's payment that contained inaccurate weights. Despite a friend of the court brief filed by the USDA, arguing that the § 202 of the P&S Act does not require proof that the challenged action had an adverse affect on competition, the Court ruled that the grower was required to prove that such targeted practice or practices "adversely affects or is likely to adversely affect competition." The Court refused to give deference to USDA's interpretation of the P&S Act because, though the agency has the authority to adjudicate violations of the Act with regard to packers, it does not have the authority to adjudicate violations with regard to live poultry dealers.

In a class action lawsuit, *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272 (11th Cir. 2005), cattle producers sued a packer claiming that the use of marketing agreements with formula prices used to purchase slaughter supplies was unlawful under § 202 of the P&SA, because it was a practice that was unfair and had the purpose or effect of manipulating or controlling prices. The jury found that the packer's use of marketing agreements "damaged the cash market price" between 1994 and 2002, and awarded a total of $1.28 billion in damages to the class of cattle producers. The Eleventh Circuit Court of Appeals, in affirming the district court's decision to set aside the jury verdict, found that there was evidence to support the jury's finding that the packer's use of marketing agreements resulted in lower prices for cattle, both on the cash market and the market as a whole. However, the Court held that, in addition, the cattle producers were

[30] *See, e.g.* 9 C.F.R. § 201.43, 201.49, 201.100.

required to prove that the use of marketing agreements that resulted in reduced prices had an adverse effect on competition. The Court accepted the packer's proffered business justifications for the use of marketing agreements.

In addition to its rulemaking authorities, USDA has the authority to bring an administrative enforcement action against any packer or swine contractor it has reason to believe has violated or is violating any provision of the P&S Act. 7 U.S.C. § 193. If in such an administrative adjudication a violation of the Act is found, USDA may issue an order to cease and desist and for penalties against the violator. This authority does not apply to poultry dealers. USDA's failure to aggressively pursue such administrative enforcement actions in the red meat sectors in a manner demonstrating its interpretation that the intent and purpose of § 202, does not require proof of an injury to competition, has also significantly contributed to the loss of enforcement of the original intent and purpose of the Act to protect producers from unfair, deceptive, unjustly discriminatory, unduly preferential, or price manipulative actions by packers.

It is difficult for farmers to pay for the resource-intensive legal assistance needed for cases challenging violations of the P&S Act.. These cases tend to require economic as well as legal expertise. For years, USDA's Office of General Counsel has itself balked at the expense and difficulty of these cases, leaving a vacuum in which farmers must take action in their own and the public's interest.

B. Recommended Legislation

To ensure that the provisions of the P&S Act are enforced in a manner consistent with the original intent and purpose to prevent packers, swine contractors, and poultry dealers from using unfair, deceptive, and unjustly discriminatory or price manipulating practices in their dealings with producers, the Act should be amended as follows:

- Giving the USDA the same authority to administratively adjudicate violations and enforce provisions of the P&S Act as to live poultry dealers, as it currently has with regard to packers and swine contractors;
- Expressly providing that practices that are unfair, unjustly discriminatory or deceptive, or which have the purpose or effect of manipulating or controlling prices may be held unlawful without regard to whether the practices cause competitive injury or have an adverse effect on competition and without regard to alleged business justifications for the practice; and
- Authorizing livestock and poultry producers who are successful in bringing actions to enforce the P&S Act to recover litigation costs and reasonable attorneys' fees. (Such a provision makes it much more likely that producers who have legitimate claims against packers or poultry dealers for violations of the Act will be able to find lawyers willing to represent them. Such private suits will encourage more comprehensive enforcement of the Act.)

VI. Consolidation and Vertical Integration in Non-Livestock Commodity Markets

A. Background

Markets for crops, dairy, and other agricultural commodities are also undergoing rapid horizontal consolidation and vertical integration similar to that seen in the poultry, hog, and cattle markets. Producers of these other agricultural commodities need the same kind of protections from unfair trade practices and anti-competitive actions by buyers, processors, and handlers as those that have been afforded poultry and livestock producers under the P&S Act. Producers of these other agricultural commodities should also be afforded the same type of regulatory and enforcement assistance to protect their interests as is afforded livestock producers under the P&S Act.

B. Recommended Legislation

Legislation should be enacted prohibiting handlers, processors, and buyers of non-livestock agricultural commodities from participating in the same types of both unfair trade practices and anti-competitive actions prohibited in § 202 of the P&S Act. Such legislation should also grant USDA the authority to issue both substantive and procedural rules to implement such provisions relating to non-livestock agricultural commodities. USDA should also be authorized to bring administrative enforcement actions, including the ability to issue cease and desist orders and assess penalties against violators. The legislation should also authorize USDA to bring civil actions in the United States district courts against alleged violators of the these provisions seeking injunctive and other preventive relief. Individuals aggrieved by alleged violations of these prohibited practices should also be allowed to bring enforcement actions in U.S. district courts seeking both injunctive relief, compensatory damages, and penalties. In order to encourage enforcement of these provisions, legislation should also provide for the award of reasonable attorneys' fees and costs of litigation to producers of non-livestock agricultural commodities in successful civil actions.

VII. Other Federal Laws that Affect Production Contract Growers

In addition to laws that govern relationships between farmers and companies, a variety of other federal laws could be utilized to ensure fair treatment of farmers under production contracts.

A. Farm Service Agency Guaranteed Loans

1. Background

FLAG has previously testified on the need for more aggressive review and oversight by the Farm Service Agency (FSA) of loans it guarantees under the Guaranteed Loan Program for farmers.[31] In this context, the urgency of the need is highlighted by the severe financial distress that hundreds of Hmong and other Southeast Asian American contract poultry growers in Arkansas, Missouri, and Oklahoma are experiencing within just a couple of years of receiving loans that FSA guaranteed. In many of these cases, FSA had guaranteed loans to these growers based on unrealistic cash flow plans and exaggeratedly high real estate appraisals developed by or for the

[31] *See* Testimony of Karen R. Krub, Farmers' Legal Action Group, Inc. (FLAG), before the Senate Committee on Agriculture, Nutrition, and Forestry, June 13, 2006.

lenders. Several Hmong poultry growers have been forced into bankruptcy as a result of these loans. Many more are unable to feed their families and keep their operations running. Significant loan restructuring and servicing are needed on these loans that were made based on suspect determinations by the lenders that they were adequately secured and financially feasible.

2. Recommended Legislation

To preserve the integrity of the FSA Guaranteed Loan Program and to ensure that contract poultry growers do not lose their farms due to inaccurate financial feasibility and adequacy of security determinations made by commercial lenders who obtained FSA guarantees, Congress should take action to: (1) appropriate funds making the Interest Assistance Program available to these growers in restructuring real estate secured loans with the commercial lenders that received FSA guarantees; and (2) authorize and appropriate funding to allow FSA direct loan refinancing of these guaranteed loans, when restructuring with the commercial lenders cannot be accomplished.

B. Disaster and Contagious Disease Assistance for Contract Livestock Producers

As Congress reexamines federal disaster assistance for farmers in an effort to make it more consistent and fair, it should be mindful of the predominance of contract growing arrangements in many sectors of the agricultural economy. In some instances in recent years, Congress has included disaster assistance for contract growers. This should be continued and systematized, so that whenever assistance is provided to livestock owners for livestock mortality, illness and injury, pasture losses, increased feed and heating fuel costs, and lost production, contract growers receive assistance on an equitable basis. Perhaps it goes without saying that the assistance should be provided directly to the growers, and not through the companies, due to the sometimes strained or adversarial relationship between the parties.

Whenever Congress deals with laws addressing forced depopulation of livestock and poultry to prevent the spread of infectious disease such as Ayian Influenza, or compensation for the destruction of livestock and poultry, it should ensure that the losses suffered by contract growers are covered. In addition to any compensation for livestock and poultry owners in the case of forced destruction of animals, the contract growers who were raising those animals should also receive fair compensation for their losses under the contract, including income that they would have received had the animals been slaughtered for market, and the cost to sterilize their barns and equipment and for any added downtime between placement of animals in their facilities due to sterilization requirements.

In general, when drafting legislative language intended to provide assistance to livestock producers, Congress should consider the unique aspects of their contractual arrangements, since terms such as "owners" or "buyers" and "sellers" or "sales" will tend to exclude contract growers.

Congress should seize the opportunity to address these serious issues related to agricultural market consolidation and vertical integration in order to ensure the economic health and viability of our country's farming and rural communities. Thank you for the opportunity to present this testimony.

Sincerely,

FARMERS' LEGAL ACTION GROUP, INC.

s/Lynn A. Hayes

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LAH/rgc

Statement of

Burdell Johnson

President of the
American Sheep Industry Association

Before the

Committee on Agriculture, Nutrition and Forestry

United States Senate

April 18, 2007
Washington, D.C.

Economic Challenges and Opportunities Facing American Agricultural Producers Today

On behalf of the more than 69,000 family farms and ranches that produce sheep in America, I am very appreciative of this opportunity to discuss our nation's agricultural policy with the agriculture leadership of the United States Senate.

I am Burdell Johnson and currently serve as president of the American Sheep Industry Association (ASI), the national trade organization of the nation's sheep industry. I am a fourth-generation sheep producer from Tuttle, North Dakota.

The sheep industry produces lamb and wool in every state. The industry provides half a billion dollars to the American economy and is a mainstay of many rural communities in which sheep are a key use for grazing and pasture land.

Sheep producers have been aggressive and creative in their approach to national initiatives that strengthen the domestic industry.

In 2005, the sheep industry approved a national referendum to continue our American Lamb Board checkoff program. This lamb promotion program is entirely funded by the industry and I am pleased to say that of those who voted, 80 percent voted in favor of the referendum. We collect over $2 million annually from sheep sales with producers, feeders and lamb companies all paying a share of the checkoff.

We are the first livestock industry to use the standing authority for checkoff programs as was authorized in the 1996 Farm Bill and can report to you the system does work.

The American Wool Council launched a wool production, information and marketing program for American wool in early 2001. Our international initiatives have improved competition for American wool. International marketing programs have exposed U.S. wools to the world and exports have grown rapidly to over 60 percent of our annual production. Total exports represented less than a third of production prior to these programs. We now sell into eight or more international markets each year.

In addition to expanding market opportunities for producers, the Wool Council has developed new fabrics and treatments for textiles with U.S. companies and America's armed services. We are proud to help provide clothing and uniforms for the men and women of our military. Nearly one-fourth of our wool production is consumed by the U.S. military.

2004 marked the first growth in the U.S. sheep inventory since 1990. We grew our industry again in 2005, the first year-on-year increase in sheep numbers since 1987 – 1988. Industry growth improves competitiveness for all segments of the industry from lamb feeders to lamb meat companies, wool warehouses to wool mills, feed suppliers, trucking firms and shearing companies. Inventory declined slightly in 2006 which analysts contribute to severe drought conditions, impacting lamb survival and ewe lamb retention.

Additionally, the sheep industry recognized that Livestock Risk Protection programs (LRP), as authorized by Congress, would be of assistance to sheep farmers and ranchers. I am pleased to state that the Federal Crop Insurance Corporation approved a twenty-seven state pilot project for LRP-Lamb expected to be available this summer. Currently, there are no price risk management tools available to sheep producers, so a successful pilot with this price insurance product is important.

I am pleased to comment on the positive impact of the current Farm Bill as it included the new Wool Loan Deficiency (LDP) program which provides the only safety net for wool producers in our business. **I encourage the Committee to re-authorize the wool LDP at a base loan rate of $1.20 per pound in order to provide the benefit of the program as intended.** While nine loan rates are available, essentially all wool LDP applications are in one non-graded rate category. The research provided in 2002 by the Food and Agriculture Policy Research Institute (FAPRI) supported a $1.20 per pound base loan rate, however, the legislation lowered the base to a $1 per pound with a budget score of $20 million annually. The total payments for each of the 2002 through 2006 crop years was $7.8 million, $7 million, $7.3 million, $6.1 million and $7.5 million respectively.

The significant difference between the annual cost estimate and the actual payment total each year combined with the fact that nearly all participation has been in only one loan rate category out of nine, supports the request that the program be authorized at the base rate of $1.20 per pound rather than $1 in the current legislation. With a loan rate of $1.20 per pound, total payments are projected to remain under $20 million annually.

I urge the Committee to support re-authorization of the National Sheep Industry Improvement Center.

As established in the 1996 Farm Bill in the Rural Development program of USDA, the National Sheep Industry Improvement Center provided loans and grants to business ventures for financing programs where normal commercial credit or funds were not available. The authorization for this program expired in the fall of 2006.

The program would not provide funds for individual producers or for the purchase of sheep or land, but rather for projects to strengthen the sheep business including loans to wool warehouses, lamb slaughter and processing ventures, and wool. During the ten years of operation, the Center provided 56 loans to 38 entities in 21 states. The total volume of dollars that have been loaned since 2000 totals approximately $15.5 million. The Center made 58 grants equaling $20,754,529 plus the final investment this year of nearly $6 million to help deliver Livestock Risk Program-Lamb coverage to the U.S. Sheep Industry.

Re-authorization of the Center for the life of the next Farm Bill is crucial to the efforts to continue re-building the U.S. sheep inventory and infrastructure. $20 million of funding would complete the $50 million authorization of the 1996 legislation.

Additionally, the sheep industry actively participates in the USDA Foreign Market Development, Market Access Program and Quality Samples Program and we encourage inclusion of these in the Farm Bill.

The United States has no barriers to lamb meat imports and as such has become the market of choice for lamb exporters from around the world. Lamb was never part of the Meat Import Act so other than the brief period of temporary restrictions in late 1999 – 2001, lamb meat has and is freely traded. However, the playing field is not equitable for U.S. sheep producers. The European Union continues to provide over $2 billion annually in government price support and subsidies to their sheep producers. The European Union maintains strict and effective tariff rate quotas on lamb imports. Our industry looks to both the Agriculture Committee's role in industry programs in the next Farm Bill and the Committee's role in pushing for aggressive reform of Europe's agriculture programs and barriers to assist the domestic sheep business.

Our industry supports enhancement of the conservation title of the next Farm Bill with support of prescriptive grazing with sheep.

Weed invasion into rangeland communities often results in reduced biodiversity, increased soil erosion, degradation of wildlife habitat and water quality and reduced carrying capacity for livestock.

Due to the fact there are many challenges when controlling invasive plants on rangeland, including vast roadless areas that limit access for weed control and lands of low economic value that make chemical and mechanical control impractical, these challenges favor biological control methods. One biological control method that is an underexploited, readily available tool is prescribed livestock grazing, which is quickly proving to be very effective for weed control.

Prescribed grazing is the application of livestock grazing at a specified season, duration and intensity to accomplish specific vegetation management goals. Scientific studies and on-the-ground experiences have clearly demonstrated that livestock are a promising tool in the battle against weeds in pastures, rangeland and forests.

We believe the conservation title should address programs and direction to support prescriptive grazing with sheep both for invasive species and noxious weed control.

Cost-share programs could be directed to prescriptive grazing projects to provide financial and technical assistance through our industry to promote grazing contracts with federal, state, municipal, tribal or private lands for prescribed grazing. I add that our industry believes prescribed grazing can be expanded to become a revenue option for farmers and ranchers which in turn strengthen the economies of rural areas of the country.

As evident in the listening sessions on the Farm Bill that USDA Secretary Johanns conducted last year, a number of comments were provided by producers in support of a **retained ewe lamb program** in the next Farm Bill. The growth of the U.S. sheep industry can in part be credited to the USDA retained ewe lamb program that was in effect for 2002 - 2004. The incentive payment to producers to keep ewe lambs in their breeding herd rather than sell them for slaughter encouraged producers to expand breeding herds which, in the longer term, will provide increased market lambs to help U.S. producers maintain and increase their share of the American meat case.

As requested by the Committee, I provide comments on competition related issues of the sheep industry.

Mandatory Price Reporting for Livestock made a positive impact on the U.S. Sheep Industry and is in a large part credited for less price volatility in the lamb market of recent years. Mandatory reporting implementation came at a great cost to the industry however in April 2001 through the end of that year, neither a voluntary nor a mandatory reporting system was in place and the live lamb market price suffered. 2002 through October 2005 proved successful for the new reporting system but unfortunately, compliance has now been voluntary for nearly eighteen months. The Department of Agriculture announced last fall following the re-authorization by Congress that rulemaking was required so we await the publishing of regulations. Over 40 percent of wholesale lamb cut prices are not reported, the retail price series for lamb is still not available and some lamb companies refuse to participate voluntarily.

I add that during the congressional consideration of the legislation in 2006, the American Sheep Industry did not find producer interest in the various proposals to change the mandatory price reporting system.

ASI strongly supports the interstate movement of state inspected meat as a way for sheep producers to compete with additional opportunities for lamb slaughter and processing.

We ask the 110th Congress to approve legislation this year allowing interstate movement of state inspected meat.

The sheep industry opposes the use of USDA quality and yield grades of lamb on imported lamb. The U.S. industry has invested heavily in the grading system including the coupling of quality and yield grades in 1992. Nearly 90 percent of American lambs are federally graded and in some years, imported graded lamb exceeds 100,000 carcasses.

The American Sheep Industry Association board of directors two years ago, voted to delete the organizations' long standing policy opposing packer ownership of livestock.

Country of Origin Labeling is of course supported by the American sheep industry. Product mixing of domestic and imported lamb in boxes can allow price discounting against domestic product and only mandatory labeling would require disclosure. Regarding the implementation date of labeling in 2007 versus the existing statutory date of 2008, the rulemaking situation at the Department of Agriculture with Mandatory Price Reporting would cast doubt on official rules being available for labeling this year anyway.

Two issues of international competition for the sheep industry include the need to address the tremendous subsidies and import protections afforded the European sheep industry that create serious disadvantage to American producers. Our industry believes sheep meat trade reform should be included as a priority in the negotiations of the World Trade Organization. Sheep meat trade reform would provide a more equal footing for trade around the world and equity for domestic agriculture producers.

The Centre for International Economics of Canberra, Australia, provided an extensive report on the global benefits of Sheep Meat Trade Report dated January 11, 2006, and we provide that report as supporting documentation in development of the United States trade policy with the WTO.

Secondly, American producers' ability to compete is hampered by the lack of pharmaceuticals and biologics for sheep health care that are licensed for use overseas but not in the United States. The American Sheep Industry Association strongly supports a tax credit for pharmaceutical firms to conduct the required research and testing to label sheep health products in this country particularly those that they already make available to our international sheep producing competitors.

Thank you for the opportunity to provide the sheep industry priorities for the next Farm Bill.

Prepared remarks
of
Mary K. Muth, Ph.D.

Director, Food and Agricultural Policy Research Program
RTI International
before the
United States Senate Committee on Agriculture, Nutrition and Forestry

regarding

"Economic Challenges and Opportunities Facing
American Agricultural Producers Today"

April 18, 2007

RTI
INTERNATIONAL

Good morning Chairman Harkin and members of the committee. My name is Mary Muth, and I am director of the Food and Agricultural Policy Research Program at RTI International, an independent not-for-profit research institute in Research Triangle Park, North Carolina. I was the project manager for the congressionally funded GIPSA Livestock and Meat Marketing Study that was completed earlier this year. I am an agricultural economist by training and have a PhD in economics from North Carolina State University. I have been conducting analyses of the livestock and meat industries for almost 15 years. In addition, my husband's family owns a cow-calf operation in western Kentucky. I am pleased to be here and thank you for the opportunity to provide an overview of the findings of the Livestock and Meat Marketing Study.

The study was conducted from July 2004 through January 2007 by a team of researchers at RTI International, Iowa State University, North Carolina State University, Montana State University, Colorado State University, and the Wharton School at the University of Pennsylvania. The team conducted a large number and range of analyses for the study to meet the requirements of the Performance Work Statement for the contract with GIPSA.

The study addresses the economic effects that alternative marketing arrangements have on the livestock and meat industries. As you know, the cash (or spot) market includes auctions, direct trade, and use of dealers and brokers. In contrast, alternative marketing arrangements include all other marketing methods such as marketing agreements, marketing and production contracts, packer ownership, and forward contracts. The final report comprises six volumes covering the various aspects of the analysis. It follows publication of an interim report in August 2005 that described marketing arrangements used in the livestock and meat industries and qualitatively the reasons why they are used.

In the final report for the study, we analyzed (1) the extent of use of alternative marketing arrangements, price differences across marketing arrangements, and the effects of using marketing arrangements on cash market prices; (2) the costs and benefits of various marketing arrangements, particularly as they relate to quality, costs of production, and risk; and (3) the implications of using marketing arrangements on livestock producers, meat packers, and consumers. We used state-of-the-art economic modeling and statistical analysis methods to address the requirements of the study with the following types of data:

- an industry survey of livestock producers, meat packers, meat processors, retailers, wholesaler, food service operators, and exporters;
- purchase and sales transactions data collected from meat packers and meat processors (2.5 years of data, from October 2002 through March 2005);
- profit and loss data from meat packers (also 2.5 years of data)
- results of industry interviews with producers, packers, and meat buyers;
- Mandatory Price Reporting (MPR) data; and
- other publicly available data.

Note that the industry survey was a statistically designed sample and included responses from 293 beef producers, 229 hog producers, and 302 lamb producers. The transactions data for beef represented 58 million head of fed cattle purchased by 29 beef plants, and the transactions data for pork represented 190 million head of finished hogs purchased by 29 pork plants.

In general, the study found that use of alternative marketing arrangements in the livestock and meat industries provides benefits not only to meat packers but also to livestock producers and meat consumers. Therefore, restricting their use would have negative economic consequences on most segments of the industry. Next, I would like to give a broad overview of the specific results of the study organized along the six central questions for the study.

The first question concerned what types of marketing arrangements are used and the extent of their use. Based on the data available for the study, we estimated that alternative marketing arrangements represent 38% of the volume for fed cattle, 89% of the volume for finished hogs, and 44% of the volume for fed lambs sold to packers. Furthermore, we estimated that packer ownership volumes represent less than 5% of fed cattle and fed lamb volumes and 20 to 30% for finished hogs.

In the beef industry, fed cattle are sold primarily through the cash market (specifically, direct trade) and marketing agreements. Based on the industry survey and interviews we conducted, we expect alternative marketing arrangement use in the beef industry to remain at similar levels in the near term. In the pork industry, finished hogs are sold using a large number of methods, including direct trade, marketing contracts (highest), marketing agreements, and packer ownership (packer-owned farms and production contracts with packers). Based on the industry survey and interviews we conducted, we expect alternative marketing arrangement use in the pork industry to remain at similar levels in the near term. Finally, in the lamb industry, fed lambs are sold primarily through auctions and marketing agreements, but custom feeding and/or slaughter is also significant. Based on the industry survey and interviews we conducted, we expect a moderate increase in the use of alternative marketing arrangements in the lamb industry in the near term. Note that, across all species, most packers and many producers use portfolios, or combinations, of marketing arrangements rather than a single type.

In discussing the next five key study questions, I will focus primarily on beef and pork, but I will say a few words about the lamb industry at the end.

The second question concerned the price differences across marketing arrangements, and whether the use of alternative marketing arrangements affects cash market prices. In the beef industry, prices for fed cattle (for a given level of quality and controlling for seasonality) are similar for direct trade and marketing agreements, higher for the small percentage of auction barn cattle, and lower for the small percentage of forward contract cattle. We found that a 10% reduction in the volume of spot market transactions, assuming that volume is shifted into alternative marketing arrangements, results in an extremely small decrease in the spot market price of 0.1%. In the pork industry, prices for finished hogs (when controlling for differences in quality and seasonality) are higher for marketing contracts and lower for packer-owned hogs relative to the cash market. We found a relatively large effect of using alternative marketing arrangements on cash market prices for hogs. A 1% increase in hogs under contract is associated with almost a 0.9% decrease in cash market prices. We believe this estimate is this high because alternative marketing arrangements already comprise 89% of the volume of finished hogs sold; thus, a further increase from this high percentage causes a large effect on the cash market price. In addition, we found that a 1% increase in hogs under packer ownership is associated with a 0.3% decrease in cash market prices.

The third question concerned the effects of alternative marketing arrangements on costs of production at the packer level, that is, on costs other than the cost of purchasing livestock. In the beef industry, procurement of cattle through alternative marketing arrangements is associated with lower production costs per head than through cash markets, but this result does not hold for all packing plants. The estimated average cost savings are $6.50 per head, compared with an average processing cost of about $138 per head (or about 5%). In the pork industry, procurement of hogs through alternative marketing arrangements is associated with an extremely small decrease in production costs. Specifically, a 1% increase in alternative marketing arrangement use is associated with an extremely small decrease in marginal costs at the sample means because alternative marketing arrangement use is already extremely high.

The fourth question we analyzed was whether and how the quality of livestock and meat varies across marketing arrangements. In the beef industry, we found that cattle sold through marketing agreements, the primary alternative marketing arrangement, were higher quality and had less variation in quality than cattle sold through direct trade. Specifically, the increase in quality for marketing agreement cattle relative to direct trade cattle is equivalent to a 57 cent per cwt increase in value. It is also notable that the small percentage of sales through auctions was associated not only with the highest quality but also the highest variation in quality; this is likely due to specialty sales in particular regions of the country. In the pork industry, we found that hogs sold through marketing contracts, the primary alternative marketing arrangement, were higher quality than hogs sold through direct trade. Marketing contract hogs ranked higher across multiple quality measures, such as average lean percentage, loin-eye area, and average loin depth, compared with other types of marketing arrangements.

The fifth question we analyzed was how risk, particularly market access risk and price risk, varies across marketing arrangements Across all species, alternative marketing arrangements offer some guarantee of market access, for both livestock producers and meat packers. That is, alternative marketing arrangements ensure that producers can sell livestock and meat packers can purchase livestock when they need to for their business operations. In the beef industry, prices for cattle sold through marketing agreements, the primary alternative marketing arrangement, were less variable than for cattle sold through direct trade. Specifically, the variance of prices for marketing-agreement cattle was 18 to 20% less than for direct-trade cattle when controlling for differences in quality. Auction barn and forward contract cattle were associated with the highest levels of price risk for fed cattle. In the pork industry, prices for hogs sold through marketing contracts, the primary alternative marketing arrangement, had lower variance than hogs sold through direct trade. The variance of prices for hogs sold through marketing contracts was 5 to 45% less than for hogs sold through direct trade (but not controlled for differences in quality). Furthermore, in the pork industry, use of production contracts for hog producers eliminates about 94% of the producer income volatility compared with independent hog producers. Risk-averse producers, in particular, benefit from the availability of production contracts.

The final question we analyzed concerned the potential effects of restricting alternative marketing arrangements on livestock producers, meat packers, and consumers. We conducted simulations of various hypothetical scenarios in which alternative marketing arrangements were restricted. In general, these simulations indicate losses to livestock producers and consumers due to losses in efficiencies in the market. These losses in efficiencies translate into higher prices for consumers purchasing meat and lower prices for producers selling livestock. Specifically, in the beef industry, eliminating alternative marketing arrangements would cause livestock producers and feeders, beef packers, and consumers to lose economic surplus. Our beef industry model indicates that over 10 years, eliminating alternative marketing arrangements in the beef industry would reduce economic surplus by 5 to 16% for each sector of the industry. Even if you assume some level of market power exists in the industry, and that elimination of alternative marketing arrangements would eliminate the market power, all sectors of the industry still lose economic surplus, but the losses are slightly smaller. In the pork industry, one of the scenarios we considered was increasing the cash market share to 25%, from its current 11%. Our pork industry model indicates that this restriction would cause hog producers and pork consumers to lose economic surplus, but that pork packers would be affected very little. Our specific estimates are that, over 10 years, increasing the cash market share to 25% would reduce economic surplus by 3 to 5% for hog producers and pork consumers, but slightly increase economic surplus for pork packers. Reducing alternative marketing arrangement use benefits producers to some degree because of a reduction in market power by pork packers, but the loss in cost efficiencies offsets the effects of reduced market power.

To return to the results for the lamb industry, we found the results of analyses to be relatively similar to the results for the beef industry described above with a couple of notable differences. Specifically, we found that prices of fed lambs sold on the cash market are slightly higher than other methods, and use of alternative marketing arrangements does not appear to reduce price risk. However, procurement of lambs through alternative marketing arrangements is associated with lower production costs and higher quality.

In conclusion, use of alternative marketing arrangements in the livestock and meat industries provides benefits not only to meat packers but also to livestock producers and meat consumers. Restricting their use would have negative economic consequences on most segments of the industry. Across the scenarios analyzed, livestock producers would have greater economic losses due to restrictions than packers. However, it is also important to note that the cash market serves an important role in the industry, particularly for smaller producers and packers. Reported cash prices are frequently used as the base for formula pricing under, and thus are important for, any type of marketing arrangement that uses formula pricing.

Mr. Chairman, I would like to enter into the record Volume 1 of the report for the Livestock and Meat Marketing Study. This volume contains the executive summary and overview for the study. Thank you.

Economic Challenges and Opportunities Facing American Agricultural Producers Today

Testimony

of the

Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (R-CALF USA)

Before the

United States Senate Committee on Agriculture, Nutrition, and Forestry

Hearing on Livestock, Poultry, and Competition Issues in the 2007 Farm Bill

April 18, 2007

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Good morning Chairman Harkin, Ranking Member Chambliss, and Members of the Committee. I appreciate the opportunity to testify about including livestock and competition issues in the 2007 Farm Bill. I am Eric Nelson and along with my wife, Carol, and our five children, we own and operate a beef feedlot and a cow/calf and farming operation near Moville, Iowa, in Woodbury County. I am also a Board of Director of R-CALF USA.

R-CALF USA is a non-profit cattle-producer association that represents thousands of U.S. cattle producers in 47 states, along with over 60 state and local affiliates. R-CALF USA's mission is to ensure the continued profitability and viability of independent U.S. cattle producers. The demographics of R-CALF USA's membership are reflective of the demographics of the entire U.S. cattle industry, with membership ranging from the largest of U.S. cattle producers to the smallest. R-CALF USA's membership consists primarily of cow-calf operators, cattle backgrounders, and feedlot owners. Various main street businesses are associate members of R-CALF USA. The 2007 Farm Bill presents an important opportunity to strengthen the cattle sector and create a competitive playing field at home and abroad for United States cattle producers.

I. INTRODUCTION

Ensuring a market framework that provides participants in the U.S. live cattle industry with the opportunity to remain profitable should be a central focus of the 2007 Farm Bill. A profitable and vibrant U.S. cattle industry is vitally important to the health of our citizens and the overall welfare of Rural America. Today's production agriculture, which, in addition to its principal role of producing an abundance of safe, wholesome, and high-quality food, now includes the development of bio fuels and a heightened emphasis on international trade. This makes for a highly complex and dynamic industry that has created many overlapping and interconnected relationships.

To effectively address the new complexities that were brought about by changes in national policy, we must adhere to sound market principles. For example, R-CALF USA believes that each segment of U.S. agriculture should have the opportunity to prosper at the same time, without pitting one against another. This belief is based on our knowledge that competitive markets have long assimilated increased production costs without rendering entire industry segments unprofitable. When applying this principle to the nation's current policy of achieving more energy independence through alternative energy promotion, R-CALF USA does not join critics who claim the government's ethanol incentives are inappropriate. Instead, R-CALF USA believes the proper response by the U.S. cattle industry to this national energy policy is to work aggressively to remove the barriers that currently prevent the U.S. cattle market from assimilating necessary increases in productions costs. If appropriate reforms are made to enable U.S. cattle producers to begin receiving their competitive share of the consumers' beef dollar and their competitive share of the consumer beef market, then they will be able to recover increased production costs from the competitive marketplace.

The removal of current market-competition barriers from the U.S. cattle market would generate another benefit for the U.S. cattle industry, besides that of accommodating the nation's desire to achieve energy independence. Production agriculture is a capital intensive endeavor, making it very difficult for young people to gain entrance. For generations, livestock production has served as the means by which young entrepreneurs have gained entry into agriculture.

In 1930, my grandfather and great grandfather built a barn that still stands on our home farm. It took a lot of faith to build a barn in 1930, right after the stock market crash of 1929. But they were livestock producers, and less than 10 years before building their barn the Packers and Stockyards Act had reestablished a competitive livestock market, which provided hard working entrepreneurs with a genuine opportunity to prosper in the livestock industry. The 2007 Farm Bill could, again, reestablish competitive livestock markets that would afford that same opportunity to a whole new generation of livestock producers.

The core problem facing the cattle industry today that the 2007 Farm Bill can help to correct is that the overall framework that defines how our cattle industry operates is no longer adequate to ensure a balanced and properly functioning competitive marketplace. The present industry framework comprised of the statutes, regulations, and policies that govern contracts and market competition, consumer information and information disclosure, heath and safety, and trade have evolved under the considerable influence of the nation's largest meatpackers; and without sufficient counterbalance from producers. As a result, the balance of power within the present industry framework is tilted in favor of the meatpackers, resulting in a pricing advantage for them and an erosion of competition for livestock producers.

Independent livestock producers cannot match the economic or political power held by the nation's largest meatpackers – we cannot expect to level the playing field by correcting the deficiencies within our industry's framework through negotiations with the meatpacking sector. Ironically, we are in an intense competition to win back competition. Therefore, our success in winning back our competitiveness will depend on you, the Congress. I would like to take this time to identify the specific areas in which congressional reforms are needed to properly rebalance the framework that defines the operation of the U.S. cattle industry.

II. CONTRACTS AND COMPETITION

The ongoing erosion of competition within the domestic livestock market is a threat to present and future generations of U.S. livestock producers. This Committee has heard convincing arguments over the past several years in support of the conclusion that competition has been significantly reduced in the domestic cattle market. These arguments have highlighted the radical changes that occurred to the structure of the U.S. cattle market over the past few decades. These unfavorable structural changes include:

A. UNFAVORABLE STRUCTURAL CHANGES

1. Unprecedented Consolidation of the U.S. Meatpacking Industry

Concentration in the meatpacking industry has tripled since the late 70s, and today just four meatpackers control over 83 percent of nation's steer and heifer slaughter.[1] By the mid-90s, a single packer – Tyson (then IBP) – purchased about 35 percent of slaughter cattle.[2] The General Accountability Office (GAO) reported in 2002 that "no other manufacturing industry showed as large an increase in concentration since the U.S. Bureau of the Census began regularly publishing concentration data in 1947. . ."[3] Such a high level of concentration is indicative of a severe lack of competitiveness in the industry, given that most economists believe competitive conditions begin to deteriorate once the four-firm concentration level exceeds 40 percent.[4]

2. Introduction and Increased Use of Non-traditional Contracting and Marketing Methods that Further Erode the Selling Power of Cattle Producers

While the meatpacking industry has become more integrated horizontally (through consolidation), it has also been increasing its vertical coordination through its contracting practices. Such methods include purchasing cattle more than 14 days before slaughter (packer-fed cattle), forward contracts, and exclusive marketing and purchasing agreements. Together, the four largest packing companies employed such forms of "captive supply" contracting methods for a full 44.4 percent of all cattle they slaughtered in 2002.[5] And use of these captive supply methods has been increasing rapidly, rising 37 percent from 1999 to 2002.[6] Captive supply practices push risks of price instability on to cattle producers and hold down cattle prices.[7] As prices for cattle are artificially depressed and become more volatile, it is cattle producers who pay the price, even when broader demand and supply trends should be increasing returns to producers.

B. NEGATIVE EFFECTS OF PACKER CONCENTRATION AND ABUSIVE CONTRACTING PRACTICES ON PRODUCERS AND CONSUMERS

1. Producers' Share of the Consumers' Beef Dollar has Shrunk and the Spread Between Farm to Retail has Widened.

[1] J. McDonald et al., "Consolidation in U.S, Meatpacking," Food and Rural Economics Division, Economic Research Service, U.S. Department of Agriculture, Agricultural Economic Report No. 785, February 2000 at 7 and M. Hendrickson and W. Heffernan, "Concentration of Agricultural Markets," University of Missouri Department of Rural Sociology, February 2005, available on-line at http://www.foodcircles.missouri.edu/CRJanuary05.pdf.

[2] C. Robert Taylor, *Legal and Economic Issues with the Court's Ruling in Pickett v. Tyson Fresh Meats, Inc., a Buyer Power Case,* The American Antitrust Institute, Working Paper No. 07-08, at 6, available at http://www.antitrustinstitute.org/archives/files/AAI_Taylor_WP07-08_033020070955.pdf.

[3] U.S. General Accounting Office, *Economic Models of Cattle Prices: How USDA Can Act to Improve Models to Explain Cattle Prices*, GAO-02-246, March 2002.

[4] "Economic Concentration and Structural Change in the Food and Agriculture Sector: Trends, Consequences and Policy Options," Report Prepared by the Democratic Staff of the Committee on Agriculture, Nutrition, and Forestry, United States Senate, Oct. 29, 2004 at 4 – 5.

[5] RTI International, "Spot and Alternative Marketing Arrangements in the Livestock and Meat Industries: Interim Report," Report Prepared for the Grain Inspection, Packers, and Stockyard Administration, U.S. Department of Agriculture, July 2005 at 3-15.

[6] *Id.* at 3-17.

[7] *Id.* at 3-18 – 3-22 and John M. Connor, "The Changing Structure of Global Food markets: Dimensions, Effects, and Policy Implications," Paper Presented to The Conference on Changing Dimensions of the Food Economy: Exploring the Policy Issues, The Hague, Netherlands, Feb. 6 - 7, 2003 at 8.

The impact of packer concentration and abusive contracting practices is evident in the declining share of each beef retail dollar that actually reaches cattle producers. The producers' share of each retail dollar earned on beef was 47 cents in 2006, down from 60 cents in 1990.[8] Looking the opposite direction along the food chain reveals that consumers have likewise not benefited from packer concentration and abusive contracting practices. The price spread between what the cattle producer receives per pound of beef sold and what consumers pay per pound of beef purchased has widened dramatically, with the spread nearly doubling from $1.13 per pound in 1990 to $2.10 per pound in 2006.[9] In fact, the retail carcass value paid by consumers in 2006 was $580 more than they paid in 1990, while cattle producers received only $89 more for their live cattle in 2006 than they did in 1990.[10]

As clearly revealed in Figure 1 below, the spread between the farm gate price of beef and the retail price of beef widened dramatically beginning in the early 90s. It is important to note that this chart depicts the value of carcasses based on fresh cuts of beef sold at the meat case, which are relatively low value-added cuts.[11] The U.S. Department of Agriculture, Economic Research Service warns, "Analysts who cite increasing value-added as a factor in pork and beef price spreads misunderstand how these are calculated."[12] The enlarged gap between the farm-gate price and retail price suggests that the meatpacking and retailing sectors have become less efficient at processing and/or selling beef, or they have acquired sufficient buying power to leverage down the price of live cattle, or both.

As a full-time cattle producer who feeds cattle to finish, I find it hard to imagine how a competitive market would dictate that consumers would pay nearly twice the value for beef derived from the finished cattle I sell. I spent 16 months caring for and feeding each of the 1,200 pound steers that I sold in 2006 for approximately $1,033. After I sold the steers to a meatpacker, and within a matter of days or a few weeks, the fresh cuts of beef from each of my steers was sold to consumers for approximately $1,985, a mark-up of approximately $950.

But in 1990, my 1,200 pound steer sold for $944 after I cared for and fed it for 16 months. The consumer at that time paid $1,405 for the beef from my steer after the meatpacker and retailer handled the beef for days or a few weeks, a mark-up of $461. If the meatpackers' claims are true – that consumers benefit from increased efficiency attributed to horizontal consolidation and vertical integration – it is certainly not revealed by the more than two-fold mark-up on beef that occurred since 1990 after the live cattle producer sells his or her cattle. A competitive market would not have predicted this result and these facts reveal that the current market structure, from the early 90s on, is breeding inefficiency and windfalls for intermediaries at the expense of both producers and consumers.

[8] USDA Economic Research Service, "Beef Values and Price Spreads," available on-line at http://www.ers.usda.gov/briefing/foodpricespreads/meatpricespreads/.

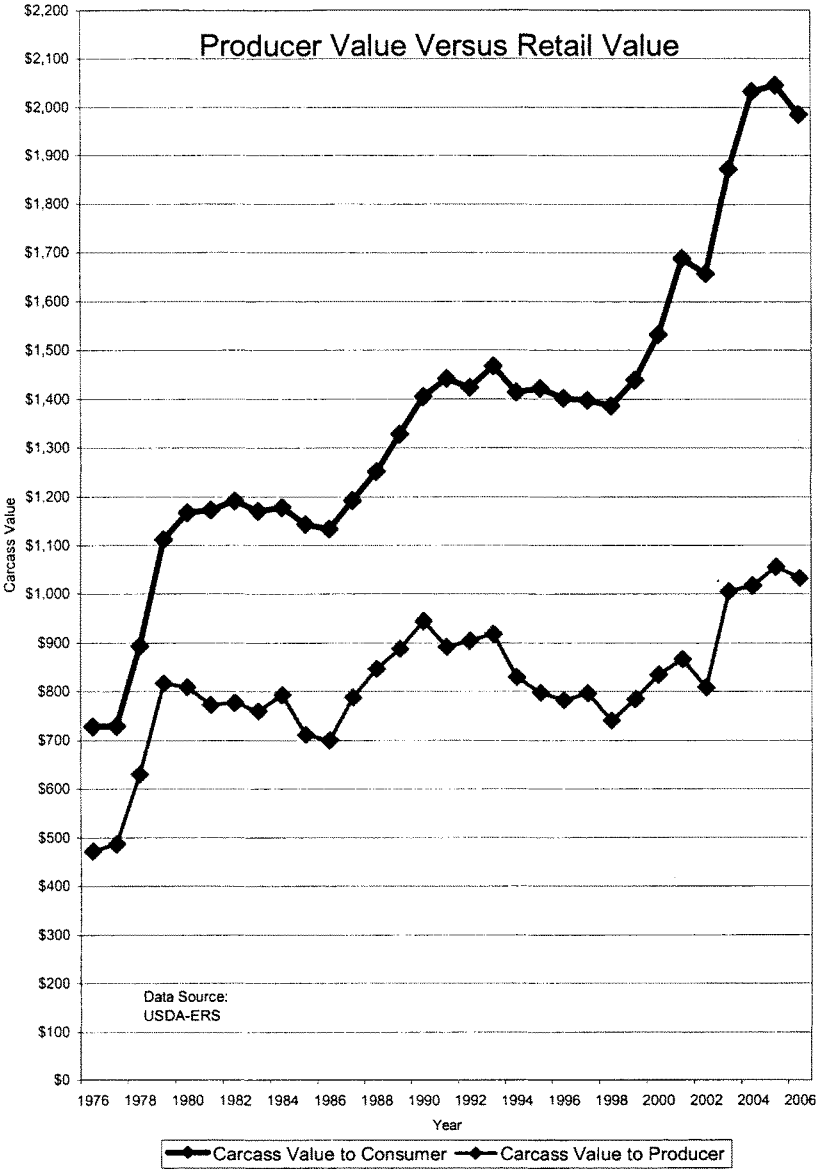
[9] *Id.*

[10] *See id.*

[11] Beef and Pork Price Spreads Explained, U.S. Department of Agriculture, Economic Research Service, LDP-M-118-01, at 4, available at http://www.ers.usda.gov/publications/ldp/APR04/ldpm11801/ldpm11801r.pdf.

[12] *Id.* at 2.

Figure 1



Data Source:
USDA-ERS

2. Packers Have Gained a Significant Pricing Advantage in the Cattle Market

Since the early 90s, the largest meatpackers have perfected their exercise of buying power attained through consolidation and abusive contracting practices. The meatpackers' exposure to the cash market is now so limited that the current bidding practice involves an offer by the meatpacker once per week, and within only about a fifteen minute timeframe. If the meatpackers are short bought, this fifteen minute window may occur on a Thursday, or perhaps even on a Wednesday. However, if the meatpacker is long-bought, the fifteen minute marketing opportunity may not occur until late Friday afternoon, after the close of the future markets. This extremely narrow window of opportunity to market cattle places cattle feeders at a distinct disadvantage as there is insufficient time to make calls to other meatpackers after an offer is made – it is essentially a take-it or leave-it offer that, if refused, means you must continue feeding for another week, even if the cattle are finished, in hopes of a more realistic offer the next week. This limited and infrequent bid window affords the meatpackers with market power that gives them a distinct pricing advantage in the market.

It is notable as well that a single meatpacker will consistently offer a bid for my cattle that is slighter higher than the one or two other packers that may also offer a bid; and I mean consistently for an entire year. As a result, a single packer buys all of my cattle for about a one-year period. But this has rotated over the years. The next year a different packer will consistently offer the slightly higher bid, and the one or two other packers will consistently offer a low bid.

The meatpacker's use of captive supply cattle is akin to insider trading. With captive supply cattle, the packers know how much of their slaughter capacity is filled each week and at what price before they enter the cash market; they also know how many captive supply cattle are available at a known price to fill their slaughter needs in the event the cash market is not low enough to achieve their pricing objectives. This information is not reported to the public, and certainly not to the cattle feeder. It is time for the cattle market to follow the long-established principle of transparency that facilitates competitive Wall Street-like trading.

The fact that meatpackers are using their buying power and abusive contracting practices to gain a distinct pricing advantage in the market is revealed by a combination of industry acknowledgments, academic studies, and empirical evidence.

i. Industry Acknowledgements

The concentrated meatpacking industry has acknowledged the profound impact their contracting practices have on the domestic live cattle market. Such acknowledgments began in 1988 when Bob Peterson, then Chairman of IBP (now Tyson) was quoted as saying:[13]

[13] Affidavit of Lee Isaac, *Pickett v. Tyson,* July 26, 2002, containing the transcript of Bob Peterson's July 26, 2002, containing the transcript of Bob Peterson's July 1998 speech to the Kansas Livestock Association, pp. 7-8.

> Procurement practices are changing and this concerns me. There is a quiet trend towards packer feeding and it is much, much bigger than you think it is. We cannot stand by if the competitive playing field is unlevel. Our competitors are promoting contracts and seeking more. These forward contracts coupled with packer feeding could represent a significant percent of fed cattle at certain times of the year. Do you think this has any impact on the price of the cash market? You bet! We believe a significant impact.
>
> ...we believe that some of those who are feeding cattle and using forward contracting are creating aberrations within the market place by coming in and out of the market; that is not reflecting the true value of the cash market.
>
> But with the packers in the feeding business and forward contracting, there's going to be a major, major shift against the leverage system.
>
> In my opinion the feeder can't win against the packer in the real fair play if we go into the feeding and the hedging program.

In written testimony before the July 16, 2002, United States Senate Agriculture Committee hearing on packer ownership of livestock, the meatpacking industry's trade association, the American Meat Institute (AMI), testified: "Demand for consistent quality product has led many firms to exert greater control over the supply chain." While AMI did not specifically state that firms were exerting control over livestock prices, a study commissioned by the National Cattlemen's Beef Association (NCBA) provides insightful documentation regarding the true nature of this industry control.

In its written testimony before the same July 16, 2002, Senate hearing, the NCBA attached the executive summery of the Sparks Study to its testimony. Specifically, the NCBA commissioned Sparks Study states the following:

> Packers use ownership of livestock to help control unit costs in a variety of ways. If this management tool is restricted, unit costs can be expected to increase (without increasing the value of the final product).[14]

Based on this Sparks Study finding, it is readily apparent that the "control" mentioned by AMI included control over the packers' unit costs. While the cost of live cattle is the single largest unit cost incurred by packers, this finding lacks specificity as to the exact nature of the "unit costs" that are being controlled by the packers. The Sparks Study, however, provides even greater clarity as to exactly what "unit costs" were being controlled by packers. The Sparks Study asserts that direct ownership of livestock limits the packers' market risk, arguing that the futures market is insufficient for this purpose. Therefore, according to the Sparks Study, one of the few tools available to packers to offset the smaller margins associated with higher livestock prices is through direct ownership of raw production materials, i.e., livestock, which enables

[14] *See* Sparks Companies Inc., "Potential Impacts of the Proposed Ban on Packer Ownership and Feeding of Livestock", A Special Study, (March 18, 2002) at 40.

them to reduce their margin risk. The Sparks Study states, "The pressure to reduce costs force the search for low-cost livestock supplies (often at the expense of producer returns)."[15]

Thus, it is readily apparent that the unit costs the Sparks Study finding referenced as among the unit costs controlled by packers through packer ownership of livestock is the cost of livestock itself. The Sparks Study adds additional insight into the packing industry's rational for supporting packer ownership of livestock as well as other means that contribute to vertical integration of their industry. The Sparks Study acknowledges:

> For many meat packers, integration between the packing and feeding stages of livestock production is seen as an effective vehicle to reduce market risk exposure and loss of such a valuable tool increases their costs . . .[16] and,
>
> Vertical integration often attracts investors because of the negative correlation between profit margins at the packing stage and the feeding stage.[17]

It is clear that the current market structure affords meatpackers with a distinct pricing advantage over the U.S. cattle market, and this pricing advantage is disrupting the competitiveness of the U.S. cattle industry. Also obvious is the inherent disadvantage faced by domestic cattle feeders that must first compete against the same meatpackers when purchasing feeder cattle that they must later sell to when their cattle are finished.

ii. Academic Studies

In a report completed in 2002, the Grain Inspection Packers and Stockyards Administration (GIPSA) cited numerous studies indicating a correlation between captive supply volumes, including packer-owned cattle, and cash cattle prices. The report indicated that economists Schroeder, Mintert, Barkley, and Jones found a negative statistical relationship between fed cattle prices and captive supplies in 1992; that same year economist Elam found a negative statistical relationship between captive supplies and monthly average fed cattle prices; GIPSA's 1992 study found that packers use captive supplies, including packer owned cattle, strategically; economists Parcell, Schroeder, and Dhuyvetter found that a one percent increase in captive supply shipments was associated with a reduction in basis in Colorado and Texas in 1997; and GIPSA, in cooperation with economists Schroeter and Azzam, found a negative statistical relationship between weekly captive supply and the weekly average spot market price in 1999.[18]

These studies, beginning in 1992, are uncontested with respect to showing a negative statistical relationship between levels of captive supply and spot market prices, though GIPSA has not taken any enforcement action to reduce captive supply use. It is important to note that a March 2002 report completed by the General Accountability Office (GAO) had revealed that the USDA was without the analytical tools needed to accurately evaluate the effects of captive

[15] Id. at 22.
[16] Id. at 24.
[17] Id. at 24.
[18] Captive Supply Report, GIPSA-USDA, January 18, 2002.

supplies during the time that GIPSA completed its 2002 captive supply report. The GAO report reminded us that over 10 years ago, in 1996, the Packers and Stockyards Administration could not conclude that the U.S. cattle industry was competitive. The 2002 GAO report further reveals that USDA has not properly maintained and updated the economic models used by it for evaluating the U.S. live cattle industry. The GAO stated that the USDA has not properly re-estimated, documented, or validated its models, and much of the data used in the original estimation was from the 1960s and 1970s.[19]

Even in the preliminary stages of study, the authors of GIPSA's $4.5 million interim captive supply report found that meatpackers were accruing the benefits of vertical integration, though they found the impacts on the cash market to be "elusive." The report states: "While the empirical research, on balance, suggests an inverse relationship between captive supplies and cash market prices, establishing a causal link has been elusive." [20]

iii. Empirical Evidence

Unlike the meatpacking industry, the live cattle industry was in a serious state of decline and suffered through a dozen years of depressed prices from 1991 through 2002, beginning first with the decline in fed cattle prices and followed by the decline in feeder cattle prices. During the 12-year period from 1991 to 2002, the U.S. live cattle industry suffered staggering losses measured in the billions of dollars, with the value of cattle and calf production falling from $30.1 billion in 1990 to $26.9 billion in 2002.[21] U.S. cattle feeders lost approximately $3 billion just during the period from March 2001 through May 2002.[22] For the period from 1992 to 2001, the average return to U.S. cow/calf producers was a negative $30.40 per bred cow per year for each of those 10 years.[23] Consequently, the U.S. cattle industry has lost over 127,000 beef cattle operations since 1994.[24] This includes the estimated loss of over 8,500 U.S. feedlots just since 1995.[25] As revealed by Figure 2, the production capacity of the U.S. cattle industry has been shrinking since the late 70s.

[19] U.S. General Accounting Office, *Economic Models of Cattle Prices: How USDA Can Act to Improve Models to Explain Cattle Prices*, GAO-02-246, March 2002.

[20] RTI International, "Spot and Alternative Marketing Arrangements in the Livestock and Meat Industries: Interim Report," Report Prepared for the Grain Inspection, Packers, and Stockyard Administration, U.S. Department of Agriculture, July 2005 at 3-17.

[21] *See Meat Animals Production, Disposition, and Income*, United States Department of Agriculture National Agricultural Statistics Service, 1990 and 2002 summaries, available at http://usda.mannlib.cornell.edu/reports/nassr/livestock/zma-bb/ .

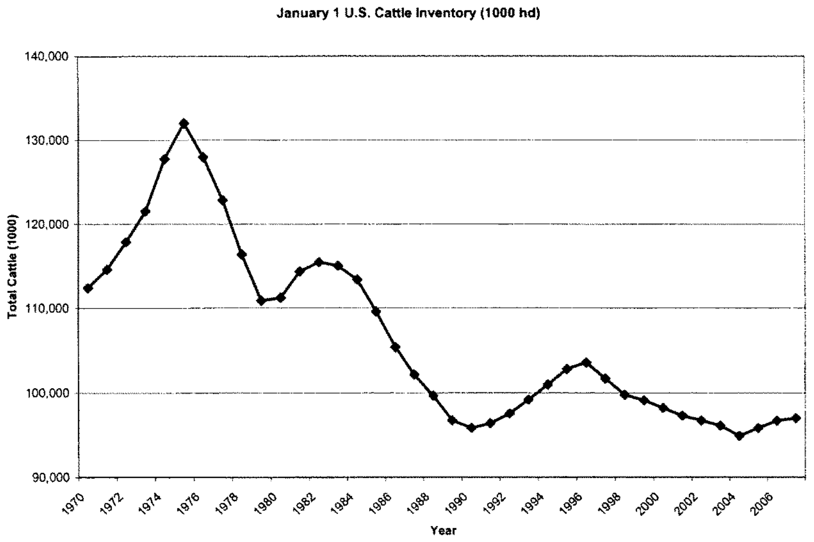
[22] Figures based on USDA's Great Plains cattle feedlot estimated returns data. *See Current State of the United States Live Cattle Industry (Revised), Presented at the 2002 Business Forum of the Free Trade Area of the Americas, Quito, Ecuador,* October 29-31, 2002, R-CALF USA, Figure 2, available at http://www.r-calfusa.com/FTAA-TPA/current_state_of_the_u_s__live_cattle_industry.htm .

[23] *U.S. Cow-Calf Production Cash Costs and Returns, 1990-95; 1996-99; 2000-2001*, Economic Research Service/USDA, available at http://www.ers.usda.gov/data/farmincome/CAR/DATA/Appendix/Cowcalf/US9095.xls; http://www.ers.usda.gov/data/farmincome/CAR/DATA/History/CowCalf/US9699.xls; and http://www.ers.usda.gov/data/CostsAndReturns/data/current/C-Cowc.xls , retrieved from the internet on October 18, 2002.

[24] *See* U.S. Department of Agriculture, National Agricultural Statistics Service Agricultural Statistics Database, *U.S. and All State Data, Cattle and Calves, Cattle Operations – Numbers,* 1994-2005, available at http://www.nass.usda.gov:8080/QuickStats/PullData_US.jsp .

[25] "Economist Sees Gradual Price Decline Next Two Years," *Livestock Weekly*, March 9, 2006.

Figure 2



Despite the fact that domestic beef consumption increased by nearly 3.8 billion pounds from 1993 to 2002,[26] no recovery to the protracted depression in live cattle prices occurred until 2003, the year the Canadian border was temporarily closed to imports of Canadian beef and cattle.

Beginning in 2003, U.S. cattle prices hit historic highs, and these higher prices were sustained through 2006, albeit not without considerable price volatility. The rise in prices afforded a four-year healing period, at least for cow/calf producers that experienced less price volatility than their cattle feeding counterparts.

But the gains in live cattle prices during this period were perhaps less than they might have otherwise been due to the continued decline in the producer's share of each consumer's beef retail dollar over the same period. The spread between producer prices and retail prices in each of the years of 2003, 2004, 2005, and 2006 was wider than at any time in the industry's recent history.[27] Furthermore, for the period June through August 2005, after USDA warned that

[26] *See* U.S. Department of Agriculture, Foreign Agricultural Statistics Database, *Production, Supply and Distribution Online*, available at http://www.fas.usda.gov/psd/complete_files/LP-0111000.csv.

[27] *See* U.S. Department of Agriculture, Economic Research Service, *Beef Values and Price Spreads*, available at http://www.ers.usda.gov/briefing/foodpricespreads/meatpricespreads/. *See also* U.S. Department of Agriculture, Economic Research Service, *Retail Price Spreads, Red Meat Yearbook*, available at http://usda.mannlib.cornell.edu/data-sets/livestock/94006/.

beef prices were too high,[28] the producer's share of the consumer's beef dollar fell below the historical low annual average of only 44 percent received in 2002,[29] when live cattle prices were seriously depressed and selling for $11.52 per cwt. less than producers received a dozen years earlier in 1990.[30] Live cattle prices fell to a 17-month low during the month immediately following USDA's public statement that beef prices were too.[31]

Thus, despite the relief associated with higher cattle prices that resulted from the closure of the Canadian border, it was the beef processing and retailing sectors that increasingly captured the lion's share of the record high beef prices experienced in 2003, 2004, 2005, and 2006, not U.S. cattle producers.

While USDA reports issued as recently as December of 2005 continued to predict bullish prices for domestic cattle prices,[32] something went terribly wrong beginning in January 2006 and live cattle prices fell precipitously. Fed cattle prices that were averaging $96.50 per cwt. in December of 2005 nosed downward in January 2006 and continued to decline for a full five months, hitting a low of $79.10 per cwt. in May of 2006.[33] This substantial decline more than ate up the entire increase in cattle prices experienced between the years 2002 and 2003.[34] U.S. cattle feeders again experienced staggering losses during the period of February through June of 2006. As revealed in Figure 3 below, U.S. cattle feeders lost over 3/4 of a billion dollars just from the sales of fed steers during the early months of 2006.

[28] Associated Press, *USDA Secretary Johanns: Beef Prices Too High*, Emily Johns, June 10, 2005.

[29] *Ibid.*

[30] U.S. Department of Agriculture, Economic Research Service, *Table 59, Slaughter Steer Price, Choice 2-4, Nebraska Direct, 1100-1300 lbs., Red Meat Yearbook*, available at http://usda.mannlib.cornell.edu/data-sets/livestock/94006/livestocklprices.xls.

[31] *Ibid.*

[32] *See* U.S. Department of Agriculture, Economic Research Service, *Livestock Dairy and Outlook Report LDP-M-138*, December 16, 2005, available at http://www.ers.usda.gov/Publications/LDP/Dec05/LDPM138T.pdf. "Interruptions in cattle moving to packing houses due to weather markets, such as the one observed last week in the Northern and Central Plains, will occur from now until April, briefly boosting prices with each occurrence."

[33] *See* U.S. Department of Agriculture, Economic Research Service, *Beef Values and Price Spreads*, available at http://www.ers.usda.gov/briefing/foodpricespreads/meatpricespreads/.

[34] *Ibid.*

Figure 3

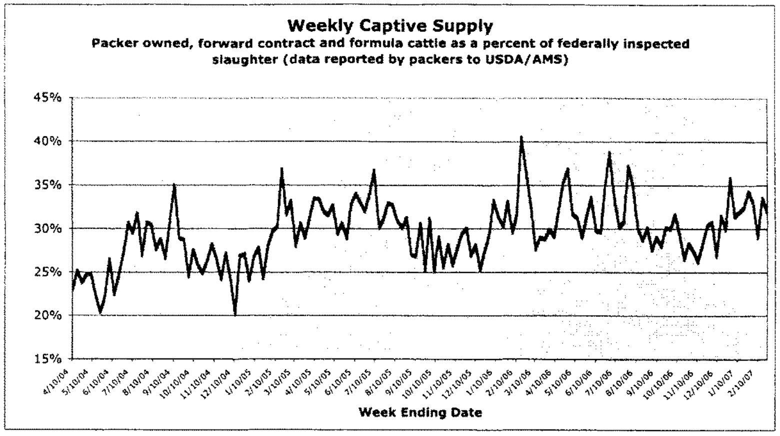
Month	**Great Plains Estimated Losses per Pound**[35]	**Estimated Live Weight**[36]	**Estimated per Head Loss**	**Number of Steers Slaughtered**[37]	**Total Loss to U.S. Cattle Feeders**
February 2006	(.0408)	1,200	($48.96)	1,189,000	($58,213,440)
March 2006	(.0983)	1,200	($117.96)	1,481,000	($175,052,640)
April 2006	(.1043)	1,200	($125.16)	1,400,000	($175,224,000)
May 2006	(.1293)	1,200	($155.16)	1,674,000	($259,737,840)
June 2006	(.0451)	1,200	($54.12)	1,752,000	($94,818,240)
Total 5-Month Loss on Steers				7,496,000	**($763,046,160)**

Based on these large financial losses associated with only fed steers, it can be conservatively estimated that U.S. cattle producers lost more than $1 billion during this 5-month period, given that comparable losses were experienced by feeders who fed the over 4.2 million fed heifers that were also marketed during this timeframe.[38] The circumstances surrounding the unexpected drop in cattle prices warrant careful review.

As revealed in Figure 4 below, weekly captive supply numbers increased significantly beginning in late 2005 and early 2006. In February 2006, all four major meatpackers – Tyson, Cargill, Swift & Co., and the National Beef Packing Co. – withdrew from the cash market in the southern plains for an unprecedented period of two weeks. The packers made minimal to no purchases on the cash market, relying on captive supplies of cattle to keep their plants running for two weeks and cutting production rather than participating in the cash market. As a result of the packers shunning the cash market, cash prices fell for fed cattle, replacement cattle, and in futures markets. Only with falling prices did packers reenter the cash market.

[35] *See* U.S. Department of Agriculture, Economic Research Service, *Production Indicators, Livestock Dairy and Outlook Reports,* January 2006 – June 2006, available at http://www.ers.usda.gov/Publications/LDP/.
[36] *See* U.S. Department of Agriculture, Economic Research Service, *High Plains Cattle Feeding Simulator, Livestock, Dairy and Poultry Outlook Tables*, at fn. 2, Updated May 22, 2006, available at http://www.ers.usda.gov/Publications/LDP/xlstables/High%20Plains%20Cattle%20Feeding%20Simulator%20May06%20F.xls. The USDA simulator is based on 1100 – 1300 pound steers, or an average of 1200 lbs.
[37] *See* U.S. Department of Agriculture, Economic Research Service, *Meat Statistics, Livestock Dairy and Outlook Reports*, January 2006 – June 2006, available at http://www.ers.usda.gov/Publications/LDP/.
[38] *Ibid.*

Figure 4



It is important to note that the abandonment of the cash market in February of 2006 occurred after the Livestock Mandatory Price Reporting (MPR) program expired. Thus, much less information regarding the incident is available than would be if the program had still been in effect. The episode may have lasted for much longer than the two weeks we can verify through public sources, possibly dragging on for as long as three or four weeks. Yet, without the benefit of the market transparency provided by the MPR program, we are only able to rely on other public sources of information documenting that the withdrawal from cash markets lasted for at least two weeks. The simultaneous abandonment of the cash market for cattle began in early February and continued through February 17. On February 13, 2006, market analysts reported that no cattle had sold in Kansas or Texas in the previous week.[39] No cash trade occurred on the southern plains through Thursday of the next week, marking, as one trade publication noted, "one of the few times in recent memory when the region sold no cattle in a non-holiday week."[40] Market analysts noted that "[n]o sales for the second week in a row would be unprecedented in the modern history of the market."[41] During the week of February 13 through 17, there were no significant trades in Kansas, western Oklahoma, and Texas for the second week in a row.[42] R-CALF USA members are convinced that the meatpackers' strategic timing and use of their captive supply cattle was the principal force that drove cattle prices down in the first half of 2006.

During the 2006 summer, fed cattle prices remained in the low $80s. By September cattle prices began to recover and were in the low $90s. Then, during the week that ended October 13, the meatpackers cast a negative psychology upon the market: three of the nation's four largest beef packers announced they would all reduce cattle slaughter. Even though they

[39] "Packers Finally Seriously Cut Kills," *Cattle Buyers Weekly* (Feb. 13, 2006).
[40] "Classic Standoff Continues Through Thursday," *Cattle Buyers Weekly* (Feb. 20, 2006).
[41] *Id.*
[42] Curt Thacker, "Cash Cattle Quiet 2-20," *Dow Jones Newswires* (Feb. 20, 2006).

had bought very few cattle in the south and were short supplied, they cited high cattle prices, tight supplies, weak beef demand, and limited export access as the reasons they were cutting back. During that week, the packers reportedly slaughtered an estimated 10,000 fewer cattle than the previous week, but 16,000 more cattle than they did the year before. Fed cattle prices still fell $2 to $3 and feeder prices fell $3 to $10.

By Friday of the next week, October 20, the packers slaughtered 14,000 more cattle than they did the week before and 18,000 more cattle than the year before – obviously they didn't cut back slaughter like they said they would. But live cattle prices kept falling, with fed cattle prices down another $1 to $2 and feeder cattle down another $4 to $12. Following this October episode, fed cattle prices were pushed back to the mid to high $80s for the next five months.

To those of us whose livelihoods depend on a properly functioning, competitive market, the events that took place in 2006 clearly show that the meatpackers are using their buying power to manage the price of domestic cattle. Using techniques such as negative market psychology, minimal market transparency, and increased captive supplies, the meatpackers gained significant control over the price of domestic cattle, to the financial detriment of us producers.

In the 2007 Farm Bill, steps must be taken to guard aggressively against anticompetitive practices and protect producers from the abuse of market power. There are two key components to this strategy: 1) strengthening tools to combat excessive concentration in the meatpacking industry; and 2) improving regulation to prohibit unfair contracting practices that deny market transparency and reduce producer bargaining power in open markets.

C. NEEDED REFORMS

The Farm Bill should ensure that antitrust and competition laws are effectively and vigorously enforced. The Farm Bill should provide additional funding for antitrust enforcement and ensure that the various government agencies entrusted with enforcement better coordinate their work to make the most of limited resources. Numerous studies have criticized the failure of the USDA's Grain Inspection, Packers, and Stockyards Administration, the Department of Justice, and Fair Trade Commission to work together more aggressively to scrutinize mergers and acquisitions in the industry and to pursue a proactive strategy for preempting and remedying anticompetitive practices.[43] Steps to consider include additional dedicated funding for the agencies to enforce antitrust rules in the meatpacking industry; regular reporting to Congress on cases referred, pursued, and prosecuted; and the establishment of market consolidation thresholds that trigger enforcement action. R-CALF USA supports the creation of an Office of Special Counsel at USDA to oversee both investigations under, and enforcement of the Packers and Stockyards Act (P&S Act).

Early last year, the Office of Inspector General (OIG) found that GIPSA's investigative tracking system for violations of the Packers and Stockyards Act was inaccurate and incomplete,

[43] *See, e.g.*, General Accounting Office, *Packers and Stockyards Programs: Actions Needed to Improve Investigations of Competitive Practices*, GAO/RCED-00-242, Sept. 2000 and General Accounting Office, *Justice's Antitrust Division: Better Management Information Is Needed on Agriculture-Related Matters*, GAO-01-188, April 2001.

that GIPSA's process for managing investigations was inadequate, that GIPSA left important policy decisions unmade for months and even years, and that previous recommendations from the OIG and the GAO to strengthen GIPSA had not been fully implemented. As a consequence of these failures, GIPSA has referred only one competition investigation to the USDA's Office of General Counsel (OGC) for follow-up since the end of 2002, and the OGC has not filed any administrative complaints against the meatpacking industry since 1999.[44]

R-CALF USA believes that (1) Congress should amend the P&S Act to prevent unfair or deceptive practices, to define "unreasonable preference or advantage," and to correct a recent misinterpretation by the U.S. appellant court system: a meatpacker should not be allowed to avoid the P&S Act's jurisdiction by claiming it engaged in unfair market practices (that are harmful to the economic wellbeing of producers) in order to maintain competitiveness with other meatpackers, that are likewise engaged in the same unfair practices. (3) Congress should take steps to reduce the volume of captive supplies. Limiting packer ownership of livestock and requiring a certain percentage of daily slaughter to be purchased from the cash market would minimize the negative effects of current captive supply use. (4) Congress should take steps to prohibit the use of certain anti-competitive, forward contracts that are not transparent and that do not contain a firm base price. In addition, the law should require processors to bargain in good faith and prohibit other unfair contract practices by (5) requiring a fixed base price in formula contracts; (6) ensuring cattle purchase contracts include a clear disclosure of producer risks; (7) requiring contracts to be traded in open, public markets and prohibit confidentiality clauses; and (8) Improving termination and arbitration provisions to protect producers' rights. Many of these important reforms are presently included in S. 622, S. 305, S. 786, and S. 1017.

Importantly, Congress should also remove the present deterrent against the expansion of state inspected meat processing plants. This deterrent is the result of restrictions that prohibit state inspected meat plants from engaging in interstate commerce. This deterrent can be lifted by allowing the interstate shipment of state inspected beef.

III. CONSUMER INFORMATION AND INFORMATION DISCLOSURE

A. MANDATORY COUNTRY OF ORIGIN LABELING

Congress passed mandatory Country of Origin Labeling (COOL) for beef and other perishable agricultural products in 2002. The American people in poll after poll support knowing what country their food comes from, and domestic producers believe that labeling provides an excellent opportunity for promoting high-quality U.S agriculture products.[45] Due to historical anomalies in country-of-origin marking rules and the marking practices of the Bureau of Customs and Border Patrol, beef and other perishable products are some of the few items

[44] Audit Report, Grain Inspection, Packers and Stockyards Administration's Management and Oversight of the Packers and Stockyards Program, U.S. Department of Agriculture Office of Inspector General, Report No. 30601-01-Hy, January 2006.

[45] *See, e.g.,* John VanSickle et al., "Country of Origin Labeling: A Legal and Economic Analysis," University of Florida Institute of Food and Agricultural Science, May 2003. (Hereinafter VanSickle).

consumers purchase in the U.S. that lack country of origin information.[46] The vast majority of other developed countries have already implemented country-of-origin labeling programs for such products, including beef.[47] The positive track record with seafood country of origin labeling proves that such labeling can be implemented to the benefit of both consumers and industry in the U.S. Unfortunately, despite broad public support and the proven success of similar programs, COOL implementation was recently delayed until 2008 due to widespread misunderstandings about the costs and benefits of COOL.

Congress should restore COOL by moving its implementation date to September 30, 2007, as provided in S. 404. In addition, Congress should outline an implementation approach that ensures COOL is administrated in the most simple and cost-effective manner for producers while providing the full scope of information to consumers contemplated in the original COOL law. The GAO and independent analysts have expressed concern that initial plans for COOL implementation outlined by USDA are unnecessarily burdensome and expensive, and could be simplified significantly.[48] Packers should be capable of identifying those animals exclusively born and raised in the U.S., whose meat qualifies for a "U.S." label of origin under COOL, without passing along undue additional costs and legal liabilities to producers. Current marking and sealed conveyance requirements for cattle imported from Canada and Mexico due to health and safety concerns, together with any necessary modifications to marking law and regulations which exempt imported cattle from regular import marking requirements, should be sufficient to ensure that packers have all of the information they need to comply with COOL without imposing additional burdens on cattle producers. Finally, the Farm Bill should establish technology grants for COOL-related or other meat traceability programs to facilitate their implementation.

B. PRICE TRANSPARENCY

The 2007 Farm Bill should help promote transparency in the market by extending and strengthening Livestock Mandatory Price Reporting. Recently the GAO recommended a number of ways in which the current price reporting program could be improved to ensure that more accurate and complete data are available, and the Farm Bill should adopt and build upon these recommendations.[49]

IV. HEALTH AND SAFETY

A. PREVENTING DISEASE INTRODUCTION

[46] *See, e.g.*, General Accounting Office, *Country-of-Origin Labeling: Opportunities for USDA and Industry to Implement Challenging Aspects of New Law*, GAO-03-780, Aug. 2000. (Hereinafter GAO-03-780).
[47] *Id.*
[48] *See, e.g.*, GAO-03-780 and VanSickle.
[49] Government Accountability Office, *Livestock Market Reporting: USDA Has Taken Some Steps to Ensure Quality, but Additional Efforts Are Needed*, GAO-06-202, Dec. 2005.

Congress should take steps to counteract the radical policy shift recently initiated by the USDA to abandon longstanding U.S. import restrictions established to prevent the introduction of foreign animal diseases in favor of attempting to mitigate disease spread after it is introduced. Unfortunately, the Animal Health Protection Act does not contain standards with which to measure the USDA's performance in preventing the introduction of foreign animal diseases; nor does it expressly state under what conditions the USDA is to impose import restrictions for this purpose. Congress should provide clearer direction to the USDA in this regard by amending the Animal Health Protection Act in the 2007 Farm Bill. Meanwhile, Congress should pass a Resolution of Disapproval to force the withdrawal of the USDA's proposed rule to allow the importation of cattle over 30 months of age and beef products from cattle over 30 months of age from Canada, a country that has detected multiple cases of BSE born years after the implementation of its feed ban.

In addition, Congress should take immediate steps to (1) prevent the USDA from continually relaxing BSE-related import standards for both Canada and Japan as this action subjects the U.S. cattle industry to increased exposure to BSE. (2) Prevent the USDA from relaxing our foot and mouth disease (FMD) disease protections via its proposal to allow a region of FMD-affected Argentina to begin importing fresh and chilled beef into the United States. (3) Require the USDA to impose more effective restrictions on the importation of cattle from Mexico in light of recent testimony by the USDA Office of Inspector General that indicates that approximately 75 percent of all bovine tuberculosis cases detected under U.S. slaughter surveillance originated in Mexico.[50]

Following the discovery of a Canadian cow with bovine spongiform encephalopathy (BSE) in Washington State in 2003, more than 50 countries banned U.S. cattle and beef imports, costing the U.S. industry billions of dollars. Though some key export markets, such as Japan, have begun to loosen their import bans on U.S. beef, it is unlikely that this partial market opening will allow for the full resumption of previous export volumes. While the U.S. has struggled to negotiate even limited access for U.S. cattle and beef exports to foreign markets, the domestic market has been thrown open to a much broader range of imports from abroad. As a result, cattle and beef imports into the U.S. face lower standards than U.S. exports must meet overseas, giving foreign countries an excuse to keep their markets closed due to the potential risks posed by the lower health and safety standards the U.S. applies to its imports.

In the case of Japan, for example, USDA agreed to allow imports of Japanese beef with no age limits while securing access to Japan only for U.S. beef from animals aged 20 months or younger. The broad opening to Japanese beef makes the U.S. the only major beef-consuming country in the world to accept beef from a BSE-infected cattle herd – regardless of the scope of the disease problem in that country and without requiring the more stringent BSE risk mitigation measures recommended by the OIE (World Organization for Animal Health). This lack of a coherent BSE protection policy presents a major obstacle to United States cattle producers who seek to protect their herds from disease and market their high-quality product around the world.

[50] Statement of the Honorable Phyllis K. Fong, Inspector General, before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies, Committee on Appropriations, U.S. House of Representatives, March 1, 2007, at 9.

The Farm Bill should lay out an aggressive, comprehensive global strategy for protecting the integrity of the United States cattle and beef supply. Ultimately, global markets for U.S. products will not re-open fully if U.S. health and safety standards, particularly import standards, are perceived as inadequate. The Farm Bill should direct USDA to engage with other countries to upwardly harmonize global import standards for beef. These standards must provide the highest level of protection for animal health and food safety and rely on sound science. The Farm Bill can ensure that USDA makes health and safety a top priority as it works to restore global export markets for U.S. beef by:

- Closing loopholes in the U.S. feed ban that were identified by an international scientific panel convened by USDA more than two years ago;
- Instructing USDA to adopt the most stringent BSE risk mitigation measures recommended for both imports and exports by the OIE pending an international agreement on BSE standards;
- Employing more FSIS meat inspectors to work the lines in the large processing plants rather than using HACCP inspection so that Specified Risk Materials (SRMs) and other prohibited cow parts are not entering the food system;
- Allowing voluntary BSE testing by U.S. packers; and
- Directing USDA to take the lead in bringing countries together to upwardly harmonize BSE standards that would allow trade of safe cattle and beef products to resume and prevent any further global spread of the disease.

A coherent, global approach to health and safety in the cattle and beef sector will protect livestock health, ensure that products coming into the U.S. face standards as high as U.S. exports face overseas, provide producers with certainty and predictability, and confirm for consumers at home and abroad that U.S. beef is among the safest, highest-quality product in the world.

B. IMPROVING ANIMAL DISEASE TRACE-BACK CAPABILITIES

The 2007 Farm Bill should be used to prohibit the USDA from imposing a costly and onerous mandatory animal identification system on the U.S. cattle industry. Congress, instead, should take steps to strengthen and expand the time-proven Brucellosis surveillance and vaccination program, which involves the placement of a permanent metal ear tag in breeding females. This current disease trace-back system, if strengthened and combined with the state brand laws in 17 states, would significantly improve the United States' current disease trace-back capabilities as desired by U.S. animal health officials.

V. TRADE

While the Farm Bill does not typically address U.S. trade policy, these policies have significant impacts on U.S. cattle producers, and it is therefore important that the Farm Bill examine whether U.S. trade policies are consistent with broader policy goals for the cattle and beef sector. The U.S. has not enjoyed a trade surplus in cattle and beef trade since 1997 in dollar terms, and the deficit in the sector has exploded over the past six years, hitting more than $3.3 billion in 2004. Given the supply-sensitive nature of the market for U.S. cattle, the growing trade deficit in both cattle and beef has a profound impact on the U.S. cattle industry. The lack of harmonization of health and safety standards outlined in Section III, above, plays a large role in the loss of U.S. export markets. United States' competitiveness is also undermined by large subsidies and high tariffs on cattle and beef in other countries, while the U.S. market is one of the most open in the world and U.S. cattle producers receive no trade-distorting subsidies. It will also be important that USDA become more engaged in researching how exchange rates play into agricultural trade flows and monitoring the manipulation of exchange rates.

Congress outlined a number of steps that should be taken to eliminate the gross distortions plaguing global cattle and beef trade in the Trade Act of 2002.[51] There have been varying degrees of progress in meeting these objectives in ongoing negotiations at the World Trade Organization (WTO). In the Trade Act of 2002, Congress called for reduction of foreign tariff levels to meet U.S. levels,[52] which would require substantial reductions in beef tariffs by trading partners such as Japan and Korea. It is too early to tell whether this goal will be met in the Doha Round because of on-going discussions around the scope of carve-outs for sensitive products and the extent of tariff reductions, though negotiators have agreed in principle to a formula that would cut higher tariffs more steeply than low tariffs. Congress also called for the elimination of "subsidies that decrease market opportunities for U.S. exports or unfairly distort agriculture markets" in the Trade Act of 2002.[53] Significant progress has been made on this objective, as WTO negotiators have agreed in principle to eliminate export subsidies in agriculture by 2013 and called for substantial reductions in trade-distorting domestic support.

Finally, because of the limited time periods in which perishable products can be marketed, Congress also called for the creation of special rules on perishable and cyclical agricultural products such as cattle and beef and timely access for growers of such products to import relief mechanisms.[54] R-CALF USA is troubled by the possibility that the special safeguard for agriculture that currently exists for beef could be given up by the U.S. at the WTO without the establishment of special rules for perishable and cyclical agriculture as directed by Congress. Preserving the right of developing countries to employ the special safeguard for agriculture while eliminating the right to do so for developed countries such as the U.S. could result in a mismatch of market opportunities that puts U.S. cattle producers at a competitive disadvantage. While the U.S. has tabled an initial paper flagging the need to discuss the creation of special rules for perishable and cyclical agriculture within the Doha Rules negotiations, it does not appear that this issue has been developed any further within the negotiating group.

There is no doubt that further trade liberalization without special safeguards will erode the market for the U.S. cattle industry. This could happen even in the absence of unfair trade practices. The U.S. Trade Deficit Review Commission noted, "Easy availability of imports can limit price increases either by expanding available supply or reducing the ability of businesses to raise prices in order to pass on increases in their costs."[55] This dynamic is particularly apparent

[51] 19 U.S.C. § 3802.
[52] 19 U.S.C. § 3802(b)(10)(A)(ii).
[53] 19 U.S.C. § 3802(b)(10)(A)(iii).
[54] 19 U.S.C. § 3802(b)(10)(A)(ix) – (x) and (B)(i).
[55] "The U.S. Trade Deficit: Causes, Consequences and Recommendations for Action," Final Report of the U.S. Trade Deficit Review Commission, Nov. 14, 2000 at 26.

in the cattle and beef industry, where, as former U.S. International Trade Commission Chairwoman Lynn Bragg observed, "The concentration of packers increases the packers' leverage relative to cattle producers, thus providing packers the ability to use imports to reduce domestic live cattle prices and/or prevent price increases."[56]

In addition, the Farm Bill should create a global marketing information program – building upon existing data sources such as the FAO – to provide regularly updated information by country on commodity prices, supply and consumption trends, exchange rate impacts, and the dominant market shares of trading companies in order to help U.S. producers better target potential export markets. This need for better trade information was highlighted in the report of the bipartisan U.S. Trade Deficit Review Commission, which noted, "The growing importance of trade in our economy and the needs of government and businesses for information to be able to make good decisions make it essential that data on international trade in goods and services be relevant, accurate, and timely."[57]

VI. SUPPORT A STRONGER, MORE COMPETITIVE CATTLE AND BEEF SECTOR

The 2007 Farm Bill is the ideal vehicle to make needed reforms to the current beef check-off program. Amendments are needed to this current program to (1) allow U.S. cattle producers to use their check-off contributions to promote beef that is exclusively born, raised, and slaughtered in the U.S., rather than to promote generic beef regardless of its origin; (2) provide for a periodic referendum every five years; (3) allow direct contracting of the program with vendors to avoid possible conflicts of interest; (4) limit representation by any one national policy organization on the Cattlemen's Beef Board to no more than 40 percent; (5) expand the definition of eligible program contractors to include organizations formed after the implementation of the program; and (6) limit contract awards to prevent any recipient from receiving more than 30 percent of annual award amounts.

VII. CONCLUSION

The 2007 Farm Bill presents an important opportunity to reform U.S. agriculture policy to level the playing field for U.S. cattle producers. A dedicated competition title in the 2007 Farm Bill should guarantee a competitive domestic market for cattle and beef, improve consumer information and information disclosure, strengthen safeguards for health and safety, address global distortions in cattle and beef markets, and strengthen programs to support the continued vitality of the largest sector of United States agriculture.

Thank you, again, for allowing me the opportunity to provide input at this important hearing. I welcome any questions that Members of the Committee may have.

[56] *Live Cattle from Canada*, Inv. No. 731-TA-812 (Final), USITC Pub. 3255, Nov. 1999 at 50.
[57] "The U.S. Trade Deficit: Causes, Consequences and Recommendations for Action," Final Report of the U.S. Trade Deficit Review Commission, Nov. 14, 2000, at ch. 7.

Testimony of
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Pork Producer
Bruning, Neb.

On behalf of

National Pork Producers Council
for the
United States Senate Committee on Agriculture

April 18, 2007
Washington, D.C.

INTRODUCTION

The National Pork Producers Council is an association of 43 state pork producer organizations. NPPC is the voice in Washington for the nation's pork producers. Joy Philippi is immediate past president of NPPC.

The U.S. pork industry represents a significant value-added activity in the agriculture economy and the overall U.S. economy. Nationwide, more than 67,000 pork producers marketed more than 103 million hogs in 2005, and those animals provided total gross receipts of $15 billion. Overall, an estimated $20.7 billion of personal income and $34.5 billion of gross national product are supported by the U.S. hog industry. Economists Dan Otto and John Lawrence at Iowa State University estimate that the U.S. pork industry is directly responsible for the creation of 34,720 full-time equivalent jobs and generates 127,492 jobs in the rest of agriculture. It is responsible for 110,665 jobs in the manufacturing sector, mostly in the packing industry, and 65,224 jobs in professional services such as veterinarians, real estate agents and bankers. All told, the U.S. pork industry is responsible for 550,221 mostly rural jobs in the U.S.

The hog industry in the United States has seen rapid structural changes in recent years, yet total hog numbers have trended up since 1990. In 1990, inventories were 54.5 million head; data from December 2006 showed inventories over 62 million head. And in 2006 2.74 billion pounds of pork and pork variety meats were exported; U.S. consumers purchased 18.8 billion pounds of U.S.-produced pork. Domestic consumption of pork in 2006 was 3 billion pounds higher than it was in 1990; exports were 2.2 billion pounds higher than they were in 1990.

The U.S. pork industry today provides 21 billion pounds of safe, wholesome and nutritious meat protein to consumers worldwide. In fact, 2006 will be the fifth consecutive year of record pork production in the United States, and all indicators point to another record in 2007.

Exports of pork also continue to grow. New technologies have been adopted and productivity has been increased to maintain the U.S. pork industry's international competitiveness. As a result, pork exports have hit new records for the past 15 years. In 2006, exports represented nearly 15 percent of production.

2007 FARM BILL

Pork producers have a keen interest in the next Farm Bill. NPPC formed a 2007 Farm Bill Policy Task Force to gather input from producers from around the country. The task force has held a number of meetings over the past year and a half, reviewing and evaluating many of the Farm Bill issues that will affect our industry. Pork producers have participated in several congressional field hearings on the Farm Bill and attended USDA Secretary Mike Johanns' Farm Bill listening sessions. NPPC is committed to working with Congress to craft a new Farm Bill.

As the next Farm Bill is written, we hope Congress will consider the needs of the nation's pork producers: 1) maintain the U.S. pork industry's competitive advantage globally; 2) strengthen the industry's competitiveness; 3) defend the industry's competitiveness by opposing unwarranted and costly provisions and regulations.

RENEWABLE ENERGY

Pork producers support the development and use of renewable and alternative energy as a way to reduce the country's dependence on foreign oil. But the U.S. pork industry continues to have the jitters over the rapid expansion of the corn-based ethanol industry and the challenges that expansion presents to maintaining our competitiveness with domestic and international meat protein competitors. Additionally, we are concerned about not having an adequate transition period to adjust to the rapid expansion of the ethanol industry. Primarily, though, we are concerned about the availability of corn to feed our pigs and about corn prices. That is why pork producers support expansion of alternative fuels that are not corn based.

Of immediate concern is the availability of corn next summer. Economist Bob Wisner at Iowa State projects, based on data available as of April 1, an end-of-year corn carryover of only 788 million bushels for 2007. This is less than four weeks' worth of utilization. The last time there was this small a level of carryover was in the fall of 1996 when supplies got down to about two and a half weeks' worth. Corn was so scarce in Iowa that it had to be shipped in from Texas.

Wisner's forecast assumes that corn exports this year will increase by 3.9 percent. However, corn export sales to date are running 11 percent above the same period last year. If this pace of export sales continues, some parts of the country in livestock-dense areas could face significant corn pressures.

Projections are that about 26 million acres of corn will be needed to supply the 4 billion bushels of corn that will be used by the ethanol industry by 2008. (It is estimated that we will plant about 90.5 million acres of corn this year, a 15 percent increase over last year and an amount that may alleviate some of the supply pressures.) The huge demand for corn for all uses, reflected in the prices of corn futures contracts for delivery in 2008, is providing strong incentive for farmers to plant more acres to corn. But that same demand may mean there will be significant challenges to meeting the country's food, fuel *and* feed needs.

Current corn supply pressures coupled with high demand mean rising prices. The surge in corn demand already has resulted in higher corn prices, with Omaha cash corn prices passing $4 per bushel in February and remaining near $3.50 today. Those prices compare with about $2 per bushel last summer. And higher corn prices have resulted in higher soybean prices – and therefore higher soybean meal prices – as acres are being shifted from soybean production to corn production. The net result is that producer feed costs have risen dramatically, from about $35 a pig last year to about $65 dollars now. In an industry that has seen average margins of $2 to $3 per hog since 1992, a $30 per head cost increase is a disaster.

Iowa State economist Dermot Hayes says the ethanol industry is expanding at such a rapid pace mainly because of two factors: it is selling an energy product that is priced relative to gasoline and, ultimately, crude oil, and it is subsidized. As long as OPEC is successful at maintaining crude oil at the current $60 per barrel target, ethanol will enjoy a high price floor. The ethanol industry's 51-cent per gallon blender's tax credit will be added to this ethanol value. The tax credit, which was put in place when crude oil prices were much lower, alone adds $1.40 per bushel to the price of corn.

In addition to the blender's credit, the ethanol plants benefit from a 10-cent per gallon income tax credit and a host of additional state and federal incentives. Ethanol prices are protected from imports by a 54-cent tariff. It is estimated that the total value of these subsidies is approximately $2 per bushel of corn. It will be difficult for pork producers to compete against ethanol for corn as long as the ethanol industry receives the subsidies it does. The combination of high oil prices and generous subsidies gives the ethanol industry incentive to grow, and that growth will continue to put pressure on corn supplies.

The latest study of the impact of the ethanol industry on U.S. agriculture conducted by Iowa State University's Center for Agricultural and Rural Development (CARD) shows that by early 2010 the ethanol industry will use slightly more than 5 billion bushels of corn. (Should crude oil prices increase by $10 a barrel, that amount could more than double.) To give some perspective to that number, in 2006 corn farmers produced 10.535 billion bushels, and the livestock industry alone is projected to use nearly 6 billion bushels of that this year. Exports will account for 2.23 billion bushels, and another 1.4 billion bushels will be for food, seed and industrial uses.

Certainly, the pork industry will adjust to changing costs and supply challenges as it always has. High production costs will reduce profitability and, initially, many producers will try to ride it out, hoping that other producers will reduce output first. We know that there are diversified producers who will consider retirement of their livestock operations if corn and bean prices remain high and they can turn a profit in their farming operation without livestock production.

Production will eventually fall enough to bring the hog market to a new level. According to CARD, pork production will need to contract by 4.6 percent, under a scenario where corn goes to just $3.16 a bushel, to allow the industry to recoup the higher production costs, and retail pork prices would rise by 4.2 percent. Under a less-favorable scenario, where corn goes to $4.42 per bushel, pork production falls another 4.6 percent and retail pork prices rise another 4.2 percent. These hikes also would occur in beef, dairy and broiler prices. We will end up with a smaller livestock industry in the U.S. and with higher retail prices and food price inflation.

For pork producers the question remains: Who ultimately benefits from subsidized ethanol production? Ethanol plant owners have benefited greatly to date. Corn growers will certainly gain from higher corn prices this year and possibly in 2008, and soybean growers will benefit as well during that period. Eventually, though, higher corn and soybean profits will be bid into higher cash rents for crop acres thus driving up production costs for corn and soybeans and reducing profits. Higher rents will drive up land prices, and the eventual beneficiaries will be landowners.

It is uncertain what effect the surge in ethanol production will have on rural America. Economist John Lawrence at Iowa State has calculated that a 100 million gallon ethanol plant creates about 80 jobs. But if the bushels of corn required to produce that much ethanol are diverted from use in pork production, rural America will lose 800 direct on-farm jobs. Given the multiplier calculated for the pork industry, that would mean an estimated 12,000 lost jobs economy wide.

It has been suggested that all of the feed problems created by using a substantial portion of the nation's corn supply for ethanol production are irrelevant because of distillers grains, a major co-product of the ethanol production process that can be fed to livestock. But, as we told this committee in testimony Jan. 10 of this year, distillers dried grains with solubles, or DDGS, do little to allay the concerns of pork producers regarding the future cost and availability of feedstuffs and, consequently, the well-being of our animals and the cost of pork to U.S. consumers. Pork producers have several issues with regard to feeding DDGS to pigs, including the consistency of DDGS's nutrient content from ethanol plant to ethanol plant and even within a plant, flowabililty problems of DDGS at the feed mill as well as in the complete feed in the feed bin and problems with digestibility and palatability.

Finally, DDGS are so much more useful in ruminant – beef and dairy – rations than in hog rations that the ruminant market virtually will always bid it away from hogs. It will typically sell at a small discount to corn so that hog producers chose corn and ruminant producers chose DDGS.

Pork producers believe that to maintain a healthy rural economy – indeed a healthy economy in general – market-based energy policies and regulations must ensure a balance between the food, fuel and feed needs of the country. That is why we have communicated our concerns to Congress, USDA and our counterparts in agriculture. And that is why pork producer delegates – most of whom also raise corn and soybeans – participating in NPPC's recently concluded National Pork Industry Forum approved the following resolutions that call for:

- Allowing the 51-cent per gallon ethanol blender's tax credit and the 54-cent tariff on imported ethanol to expire.
- Developing – should the blender's credit be extended – a countercyclical blender's credit system based on the price of oil.
- Increasing the use of bio-diesel as a renewable fuel source.
- Seeking incentives for capturing and digesting methane from swine farms as an alternative energy source.
- Urging the federal government to appropriate funds for research on the use of bio-fuels co-products for swine feed rations and for research on swine utilization of DDGs and their impact on meat quality and animal health.
- Considering the findings of a Center for Agricultural and Rural Development study on the impact of corn-based ethanol production on the livestock industry during formulation of the 2007 Farm Bill.
- Releasing early and incrementally – without penalty –Conservation Reserve Program acres back into crop production.

Further research and development are needed to find other energy alternatives, such as using animal manure and fat and biomass, including lignocellulose, switchgrass and corn stover. NPPC has established a Renewable Fuels working group to evaluate this issue further. The right balance is needed to meet the needs of fuel *and* feed security.

Pork producers are hard at work implementing an ambitious program to improve the environment and create new sources of renewable energy from our operations. One option allows us to accomplish this through the construction of manure lagoon covers that will reduce odors and capture methane that can be turned into energy. Although the technology to do this exists, until now it has not been economical to do so.

Two things have changed, though, that give us hope. One is the emergence of a viable market for greenhouse gas emission credits that will enable us to realize a significant value for manure incorporation and/or for methane utilization as other industries look to offset their carbon emissions. The other is the renewed attention focused on the need for increased production of renewable energy. And we are now working hard to take down the regulatory hurdles that have stood in the way of our ability to receive a fair price for the energy our methane can create.

Producers feel that they can contribute to the efforts to ensure fuel security for our country by ramping up our efforts in the area of methane production. By providing another source of energy, we are doing our part to bring balance to the country's fuel, food and feed needs.

It is the U.S. pork industry's belief that as the bio-fuels and alternative fuels industries continue to expand, our concerns as livestock producers must be recognized and respected in the legislative and regulatory decision-making processes. The U.S. pork industry supports a market-based bio-fuels policy that:

- Helps reduce our nation's dependence on foreign oil.
- Ensures a balance between the fuel, food and feed needs of our country.
- Takes into account the livestock industry's need for a transition period to adjust to the rapid expansion of the corn-based ethanol industry.
- Maintains the competitiveness of the livestock producers who feed our country and the world.

CONSERVATION AND THE ENVIRONMENT

Pork producers would like to see dismantled the regulatory hurdles they face in trying to incorporate conservation planning into their production operations. We suggest streamlining the Natural Resources Conservation Service approval process for financial assistance, reducing duplicative processes and providing more flexibility to producers in contracting with technical service providers and in adopting conservation practices. We also support expansion of the Conservation Security Program (CSP) program to make it national in scope while at the same time ensuring that the program is easier for producers to understand and manage. It should also be responsive to producers and provide some level of guidance on participation within a short, set time frame to allow producers to develop more effective and precise long-term plans.

Pork producers have reduced the environmental footprint of their operations on the country's natural resources and landscape through the adoption of sound and advanced manure management and utilization practices. The vast majority of the resources pork producers have invested in these practices have been provided by producers themselves – without public assistance. But pork producers remain very interested in participating in USDA's working-lands conservation programs, such as the Environmental Quality Incentive Program (EQIP), to raise the level of their environmental performance and to address any remaining critical conservation and environmental needs on their operations. During debate on the 2002 Farm Bill, U.S. pork producers took a lead role with other livestock groups to advance major funding increases for EQIP. So we are quite disappointed in how little assistance EQIP has provided pork producers over the 2003 to 2005 program years.

After a thorough review of several hog-producing states' EQIP programs, NPPC presented its findings to the Natural Resources Conservation Service. Despite what we believe to have been sincere efforts by NRCS to correct the program's problems, EQIP continues to fail pork producers. Using NRCS data and our own estimates, we calculated that approximately $1.98 billion in cost-share assistance was provided by the EQIP program to both crop and livestock producers from 2003 through 2005. Of this amount, approximately $1.26 billion or 63 percent was provided to livestock producers. This percentage is consistent with the 2002 Farm Bill recommendation that 60 percent of funds go to livestock and poultry. Looking at the 2003 data, pork producers received just 3 percent of the cost-share assistance provided to all livestock producers that year – less than goats, emus, ostriches, elk and bison received. After reviewing the data from 2004 and 2005, we found similar results.

EQIP spending under the 2002 Farm Bill on all livestock, 2003 to 2005 and total over that period, by species

Species	2003-2005 $	‘03-‘05 %	2005 $	‘05 %	2004 $	‘04 %	2003 $	‘03 %
Horses	$7,147,193	1 %	$0	0 %	$4,421,244	1 %	$2,725,949	1 %
Sheep	$16,858,540	1 %	$8,883,826	2 %	$4,522,929	1 %	$3,451,785	1 %
Swine	$43,061,095	3 %	$17,582,432	4 %	$14,569,213	3 %	$10,909,450	3 %
Other	$46,002,475	4 %	$18,867,510	4 %	$15,459,060	3 %	$11,675,905	4 %
Poultry	$73,275,499	6 %	$32,524,429	7 %	$25,645,002	6 %	$15,106,068	5 %
Dairy	$248,745,439	20 %	$91,143,643	18 %	$88,806,934	20 %	$68,794,862	22 %
Beef	$825,055,530	65 %	$327,827,898	66 %	$296,134,316	66 %	$201,093,316	64 %
Total	$1,260,145,771		$496,829,738		$449,558,698		$313,757,335	

Even in the eight states (Iowa, North Carolina, Minnesota, Indiana, Illinois, Missouri, Nebraska, and Oklahoma) that account for 78 percent of the nation's pork output, producers received only 11 percent of the EQIP cost-share assistance funds provided to all livestock producers from 2003 through 2005. While an improvement, it still indicates a significant under-investment in the environmental practices of pork producers. NPPC would like this imbalance corrected and would like EQIP funds to be allocated for specific on-farm practices that have a clear environmental benefit, such as development of comprehensive nutrient management plans and the use of technical service providers; odor and emissions reduction practices; and manure storage, transfer and field application technologies.

Pork producers believe the marketplace should decide how to meet the demand for renewable energy, which could mean crop-producing acres currently in the Conservation Reserve Program (CRP) be placed back into production between now and 2010. Without these additional acres being made available for crop production, producers are facing run-ups in feed prices in years to come. Pork producers remain committed to leaving in the CRP, even among its current corn acres, those portions of fields that are planted to filter strips, buffer strips, grass waterways and other partial field enrollments that provide extremely high environmental benefits. Pork producers also support returning CRP land to crop production in a manner that preserves CRP-developed organic matter and minimizes erosion through the use of practices such as conservation and no-till techniques. But the bottom line, in our view, is that much more crop land must be made available to ensure there is an adequate feed supply to meet demand. (We applaud USDA's recent announcement that 4.6 million acres will come out of CRP between now and 2010.)

We also hope lawmakers and regulators will recognize livestock producers as valuable contributors to meeting the nation's renewable energy needs and that the various projects implemented by producers are recognized for their environmental value and are supported equally along with other renewable energy projects.

ANIMAL CARE, HOUSING AND TRANSPORTATION

America's pork producers established the world-class Pork Quality Assurance (PQA) program to provide responsible animal care through the application of scientifically sound practices. That means proper care and handling at each stage of the production process, with no tolerance for mistreatment of animals, and it means well-kept facilities to allow for the safe and humane movement of each animal and development of herd health programs with veterinary advice. Further, we enhanced our commitment to animal care through the Pork Quality Assurance Plus program. This is a first-of-its-kind animal well-being program in the U.S. livestock sector that combines producer education and on-farm assessments, verified by third-party audits, to ensure the highest levels of animal care. Furthermore, we have a Trucker Quality Assurance (TQA) program that addresses animal care and handling issues during transport. For producers, there is no higher priority than maintaining the well-being of their animals, and they have shown their commitment by funding PQA (and PQA Plus) and TQA through their check-off dollars.

While the pork industry has invested hundreds of millions of dollars in research and practical applications to enhance swine well-being, our industry is under attack by those who would legislate how farmers raise livestock and poultry for food. We are faced with provocative ad campaigns used to sway public opinion, lawsuits that seek to halt our production practices and scare tactics that question the safety of our product. In the next Farm Bill, we expect so-called animal-rights groups to push for a number of provisions that, if adopted, would be very detrimental to the viability of the U.S. pork industry. Among those provisions, all of which pork producers oppose, are:

- Extension of an 1870s law known as the "28-hour rule" to the transportation of all livestock to all destinations. The law was enacted to deal with the movement by train of cattle to slaughterhouses. Applying the rule to livestock transported by truck would raise a number of problems, including lack of off-loading facilities, biosecurity risks at off-loading facilities and increased stress of animals during the additional off-loading and loading. The pork industry already has a Trucker Quality Assurance program that addresses animal care and handling issues during transport. TQA has become the *de facto* industry practice because it's the right thing to do.

- A ban on non-ambulatory or fatigued hogs from the food supply. Several animal-rights groups tried in the last three Congresses – including an effort during the 2002 Farm Bill – to include such a ban. For pork producers, this would be particularly devastating given that previous versions of federal legislation called for the euthanasia at auction markets and slaughterhouses of any animal that, for whatever reason, does not get up and move under its own power at delivery. The physiological makeup of the pig often prompts it to lie down, particularly after transport because of stress or weather conditions. Under the strict conditions of pending legislation to ban such non-ambulatory animals, these pigs would be killed without regard to their health, the ownership of the animals or cost to the producer and with no chance for testing and surveillance for disease. All non-ambulatory or fatigued hogs are inspected by Food Safety Inspection Service inspectors and veterinarians regarding their fitness for processing and entering the human food supply.

- A ban on the use of certain antibiotics. Pork producers use antibiotics judiciously and responsibly. The pork industry, through the National Pork Board, has developed an animal-health program – Take Care – that includes responsible-use principles on and guidelines for antibiotic use. All antibiotics used by pork producers are approved by the U.S. Food and Drug Administration after they undergo rigorous review for safety to animals, humans and the environment. FDA sets withdraw periods that require animals to be off antibiotics for certain times prior to going to market. Pork producers use antibiotics to treat illness, prevent disease and control disease. Producers and their veterinarians use their experience and knowledge in combination with scientific information to decide when to use antibiotics in pigs. A ban on antibiotics ignores all of the work done by scientific and regulatory agencies, sends the wrong message to consumers and says USDA and FDA don't know about these issues but Congress does. Proponents of a ban suggest that producers are overusing antibiotics and that such overuse is causing antibiotic resistance in humans. Antibiotic-resistant bacteria develop from many factors, including human use of antibiotics and routine household use of disinfectants such as antibacterial soap. A 2006 report from the international scientific society Institute of Food Technologists said "eliminating antibiotic drugs from food animal production may have little positive effect on resistant bacteria that threaten human health."

- A mandate on production practices, including a ban on the use of sow stalls, on farms that produce food animals that are purchased by the federal government for school lunches, prisons and the military. We oppose such legislation for several reasons: cost to the American taxpayer, practicality and because no one production practice has a better animal well-being record than any other. Pork producers use various production systems today. All of them are based on the well-being of the pigs. The pork industry has for many years supported programs that promote animal well-being, including:

1. Swine Welfare Assurance Program (SWAP) – An on-farm assessment tool that ensures that farms comply with animal care guidelines and good management and production practices.
2. Pork Quality Assurance Plus (PQA Plus) – Built on the success of the Pork Quality Assurance (PQA) and SWAP programs, PQA Plus, which debuts this June, addresses food safety and animal welfare priorities. USDA-inspected slaughter facilities are

required to ensure that producers participate in the PQA Plus program as part of company HACCP programs.

3. Take Care Program – A program supporting producers' responsible use of antibiotics.
4. Trucker Quality Assurance Program – A program certifying truckers to incorporate humane care and handling when transporting pigs.

Another issue that will have an adverse affect on the pork industry is mandatory country of origin labeling (MCOOL). The provision, which was included in the 2002 Farm Bill ostensibly to assure consumers that meat products are safe, is set to take effect September 30, 2008. Congress twice delayed MCOOL implementation because the provision has serious flaws. We are confident that MCOOL:

- Will reduce U.S. pork exports by creating comparative advantages for our export competitors such as Canada.
- Will place U.S. pork producers at great financial peril due to the need to indemnify their customers for damages that a producer error might cause.
- Will favor vertically integrated pork production systems in both the U.S. and Canada.
- Will impose onerous requirements and additional costs on U.S. pork producers if administered as Congress intended.
- Will create a permanent cost advantage for chicken and turkey, even if those species were to be covered by the law. (They are exempt.)
- Will not result in long-term higher hog prices for U.S. pork producers.
- Will not provide additional food-safety assurances to U.S. consumers.
- Will not provide adequate traceback to handle a foreign animal disease emergency.

MCOOL is NOT a food-safety law. It is a trade-protectionist law designed to restrict the access of imported meat and meat from imported animals to U.S. retail meat cases. It will not enhance the U.S. government's ability to address food-safety emergencies or foreign animal disease outbreaks, such as foot-and-mouth disease, nor will it provide additional food-safety assurances to U.S. consumers. The law enables consumers to determine the country-of-origin for fresh pork sold only through retail meat cases – not for pork that is either sold by food service establishments or further processed. This excludes more than 50 percent of the pork consumed in the U.S. today! The information required by this law is not sufficient to find the state, let alone the county or farm of origin to identify and respond to a food-safety emergency or a foreign animal disease outbreak. In fact, the law actually prohibits the Secretary of Agriculture from requiring an animal identification system, a key element for any workable food-safety traceback system. USDA already has the authority to require animal identification to protect U.S. consumers from the threat of illegal residues and food-borne pathogens.

If implementation of MCOOL does move forward, USDA will need to reissue the 2003 proposed rule. Additionally, we believe that any effective MCOOL system must include a mandatory animal identification system for all relevant species.

ANIMAL IDENTIFICATION

The U.S. pork industry already is moving forward with implementing a swine ID system to ensure herd health – and that means ensuring the safety and wholesomeness of pork products. Bio-security remains a cornerstone in our production facilities so that absolute confidence in the safety and wholesomeness of pork can be maintained by domestic and international consumers. U.S. pork producers believe in the establishment of a mandatory National Animal Identification System and are committed to an industry-wide approach to identifying our animals. We believe animal ID enables state and federal animal health officials to address existing diseases, foreign animal diseases and emerging diseases. An ID system will allow for monitoring and establishing efforts to control and eradicate these diseases, and a surveillance system will facilitate tracking and containing the spread of disease. Pork producers believe that the ability to rapidly identify animals and detect, contain and eliminate disease is an essential food security tool that will preserve the domestic and international marketability of U.S. livestock.

NPPC and the National Pork Board formed an identification implementation task force made up of producers and other industry stakeholders to enhance the existing swine ID system, which was set up in 1988 and used successfully to eradicate pseudorabies from the commercial herd. The organizations are calling for:

- Mandatory premises registration, which includes owner and location data, by Dec. 31, 2007.
- Mandatory animal IDs for groups/lots by Dec. 31, 2008.
- Mandatory individual animal IDs for market breeding swine and show pigs by Dec. 31, 2008.

More than 50 percent of swine premises already have been registered, and NPPC and the Pork Board are working diligently to get the remaining premises registered as soon as possible.

MARKET STRUCTURE AND INFORMATION

The U.S. pork industry has enjoyed unparalleled prosperity over the past three years. Average farrow-to-finish producers in Iowa – the nation's No. 1 pork producing state – completed their 35th consecutive profitable month in December – the longest string of such months since Iowa State University's Estimated Costs and Returns series was started in 1973. While the string of profitable months was broken in January, new ISU estimates based on modern technology and production coefficients indicate that these operations have remained profitable through March of this year in spite of near-record feed costs.

Pork cutout values reached record levels in 2004, and Iowa-Minnesota cash hog prices have been near-record high on several occasions since that time. Iowa-Minnesota hog prices have broken the downtrend of the 1990s and established a new, higher trend over the past four years. This new trend was started by a surge in domestic and export demand in 2004, with domestic demand bolstered by the popularity of low-carb, high-protein diets and export demand driven by better market access for U.S. products, a weaker U.S. dollar and U.S. products better tailored for export markets.

The success of the pork producers has come while the structures of the U.S. industry and of U.S. pork and hog markets have changed. So, we urge Congress to focus not on structural issues but on the more important market efficiency measures of conduct and performance as it deliberates the wisdom of government intervention in these matters. While the 1990s were a difficult time for U.S. pork producers, policy should based on the realities of today, not the past. This industry went through a major restructuring in the '90s, changes driven by new consumer demands, new technology and rationalizations of both old-line packing and old-line production capacity. Such sweeping changes are always painful and should not be forgotten, but they also must be kept in context and not used to forever drive a desire for the "way things used to be."

The focus of most debates regarding competition has been the number and market shares of the various participants. That is, many try to use industry structure to draw direct conclusions that firms behave in certain ways and that prices and quantities are moved away from their competitive optimums.

The pork production and packing sectors are more concentrated than they once were. Some areas have only one or two packers bidding for hogs. Some producers now control substantial shares of the live hog supply. But that does not mean that market power is being exerted on hog or pork prices. The key is whether sufficient competitive pressure exists to make the fewer packers and fewer producers behave in a way that approaches competitive norms and yields competitive prices and quantities. This can only be measured by looking at actual transactions to determine how firms act and what the results of those actions are.

Congress has invested significant taxpayer resources in researching the current situation in livestock markets, including the recently released Grain Inspection, Packers, and Stockyards Administration (GIPSA) Livestock and Meat Marketing Study. Much of that research is relatively new, and the pork industry has had little time to consider what it tells us. We would urge Congress to move slowly as USDA and the industry digest new knowledge and apply the findings.

Although the process of restructuring is ongoing, and the merits of this industry restructuring are still being debated, the net result is that the U.S. pork industry has held its ground domestically and has made major inroads in export markets. The U.S. now has one of the most competitive pork industries in the world but still faces challenges both from other meat sources and from other countries, such as Canada and Brazil. The pork industry has done well because of the variety of marketing options available to pork producers. Open and transparent hog markets are working well for the pork industry. U.S. hog and pork markets work because pork producers and packers are able to use any of several methods to market and price pigs. These include spot market transactions, cooperatives, bargaining associations and contractual arrangements. We support the right of all producers of any size or type of production system to market access, and we are opposed to anything that hinders that access. Furthermore, we do not believe that U.S. pork producers will be well-served by eliminating or requiring any particular marketing or pricing mechanism.

Pork producers also continue to need accurate and complete price and quantity information such as that found in the reports created by the Livestock Mandatory Price Reporting Act of 1999, which last year was reauthorized and enhanced with additional swine reporting requirements for the pork industry. We will say that USDA is being a little slow in getting out a proposed rule for the reauthorized Price Reporting law.

TRADE

Pork producers are the most ardent promoters of free trade agreements, which have prompted rapid growth in pork exports and record profitability. We realize that as an industry we must continue to work to remove trade distortions that impinge on the free market. There is a considerable global demand for pork and pork products. Pork represents 44 percent of global meat protein intake, far more than beef and poultry. The extent of any increase in global pork trade in the future hinges heavily on continued efforts to bring about further agricultural trade liberalization. We support the Market Access Program (MAP) and the Foreign Market Development Program (FMD), which help expand export opportunities for U.S. pork, and we urge continued funding for these programs, which have long-term market benefits. NPPC is part of the broad Coalition to Promote U.S. Agricultural Exports seeking an increase in MAP funding to $325 million annually and an increase in FMD funding to $50 million annually. It is important to emphasize the need to strengthen the ability of U.S. agriculture to compete in the global marketplace. American agriculture is among the most competitive industries in the world, but it should not be expected to compete alone in the export markets against foreign governments. Reductions of MAP and FMD funding would put American farmers at a substantial competitive disadvantage. Congress should pass trade agreements negotiated with Peru, Colombia, Panama, and South Korea and extend Trade Promotion Authority. Implementation of these trade agreements and extension of TPA will strengthen the ability of U.S. agriculture to compete efficiently in the global and domestic marketplaces.

RISK MANAGEMENT

U.S. pork exports in 2006 accounted for nearly 15 percent of production, up from 12 percent in 2005. The U.S. pork industry enjoyed its 15th straight record year of pork exports in 2006. Our success in expanding exports has created a new market environment. The downside of growing exports is a larger adverse economic impact should there be any trade disruption. Pork producers understand this dynamic, and Congress must recognize that a trade disruption would be devastating to the U.S pork sector. Iowa State economist Dermot Hayes estimates a $3.6 billion loss for the industry if export markets are lost.

Given that potentially significant shock to the U.S. pork industry – and to the U.S. economy – NPPC supports programs to minimize the economic impact of any trade disruptions. We understand that a USDA Livestock Risk Protection program and an Iowa program were placed in the 2002 Farm Bill. Pork producers are evaluating these futures market-based programs and the reasons for their limited success among producers. NPPC is looking at federal revenue-based assurance options that would assist producers should export markets ever be interrupted.

RESEARCH

USDA's research is critical to the pork industry, be it improving swine genetics by completing the mapping of the swine genome; testing and deploying new and improved animal vaccines; improving the usefulness of energy production by-products, such as distillers dried grains; further increasing animal productivity; or the development of new environmental management and mitigation technologies. Research also can assist in monitoring diseases and preventing a disease outbreak.

A significant amount of research has been devoted to other animal genomes. It is time for USDA to do the same for the swine genome. Genome sequencing is only the first step to unlocking key genetic information. Annotation is the identification of the functional genes associated within the sequence of the genome and will provide the industry with tools to quickly and efficiently improve production efficiencies in nutrition, swine health, reproductive physiology, animal welfare, nutrient management and pork quality. In addition, the pig is an excellent model for human research in health and nutritional disciplines. Annotation of the swine genome will assist in the development of research models in human nutrition, physiology and medicine.

We also support pending legislation to establish within USDA the National Institute of Food and Agriculture, which would conduct research and studies to "ensure that the agricultural innovation that has been so successful in the past continues in the future."

CONCLUSION

As Congress begins to craft the 2007 Farm Bill, please keep in mind that pork producers are working to maintain, strengthen and defend their competitive advantage both domestically and internationally.

The National Pork Producers Council and the many pork producers we represent, thank you for holding this hearing and allowing us to share the U.S. pork industry's thoughts on this critical legislation. We respectfully request your continued and focused attention on the matters we have brought to you today, and we look forward to working with the committee.

Testimony

on behalf of the

National Cattlemen's Beef Association

with regard to

Economic Challenges and Opportunities Facing American Agricultural Producers Today

submitted to the

United States Senate - Committee on Agriculture, Nutrition, and Forestry

Senator Tom Harkin, Chairman

submitted by

Mr. John Queen

President
National Cattlemen's Beef Association

April 18th, 2007
Washington, DC

BEEF USA **National Cattlemen's Beef Association**

Mr. Chairman, members of the Committee, my name is John Queen and I am a cattle producer and livestock market operator from Waynesville, North Carolina. I am President of the National Cattlemen's Beef Association (NCBA) and am pleased to be with you today.

As with most agricultural producers in the country, we have been anxious for work to begin on crafting the 2007 Farm Bill. As cattle producers, our livelihood is tied to many other agricultural commodities. Livestock consumes three out of four bushels of the major feed grains like corn, sorghum, and barley. Cattle in feedlots account for nearly one-fourth of the total grain consuming animal units, and all beef cattle account for nearly 30 percent. We are dependent upon this nation's agricultural system and infrastructure to feed, transport, market our cattle, and provide beef for America's table; and as such, we are interested in seeing this segment remain healthy and viable.

Unlike other agricultural commodity groups, however, we tend to take a different look at portions of U.S. agriculture policy. Our industry is made up of over 800,000 ranchers in all 50 states, and we have over 95 million head of cattle in this country. Cash receipts from cattle and calves in 2005 were over 48 billion dollars, and those sales account for nearly 40 percent of all livestock sales and nearly half of all farm receipts. Ranchers are an independent lot who want the opportunity to run their operations as they see fit with minimal intrusion from the government. As the nation's largest segment of agriculture, the cattle industry is focused on continuing to work towards agricultural policy which minimizes direct federal involvement; achieves a reduction in federal spending; preserves the right of individual choice in the management of land, water, and other resources; provides an opportunity to compete in foreign markets; and does not favor one producer or commodity over another.

The open and free market is powerful, and as beef producers, we understand and embrace that fact. The cyclical ups and downs of the market can be harsh, but the system works, and we remain steadfastly committed to a free, private enterprise, competitive market system. It is not in the nation's farmers or ranchers' best interest for the government to implement policy that sets prices; underwrites inefficient production; or manipulates domestic supply, demand, cost, or price.

Conservation and the Environment

There are portions of Federal agriculture policy that we can work on together to truly ensure the future of the cattle business in the United States. Conservation and environmental issues are two such areas. Some of the cattle industry's biggest challenges and threats come from the loss of natural resources and burdensome environmental regulations. Ranchers are a partner in conservation. Our livelihood is made on the land, so being good stewards of the land not only makes good environmental sense, it is fundamental for our industry to remain strong. Our industry is threatened every day by urban encroachment, natural disasters, and misinterpretation and misapplication of environmental laws. We strive to operate as environmentally friendly as possible, and it is here where we can see a partnership with the government.

The goal of conservation and environmental programs is to achieve the greatest environmental benefit with the resources available. One such program that achieves this is the Environmental Quality Incentive Program or EQIP. Cattle producers across the country participate in this program, but arbitrarily setting numerical caps that render some producers eligible and others ineligible limits the success of the program. Addressing environmental solutions is not a large versus small operation issue. All producers have the responsibility to take care of the environment and their land, and should have the ability to participate in programs to assist them establish and reach achievable environmental goals. Accordingly, all producers should be afforded equal access to cost share dollars under programs such as EQIP.

Secondly, many producers would like to enroll in various USDA conservation programs such as the Conservation Reserve Program (CRP) to reach environmental goals. However, to enroll in these programs requires the producer to stop productive economic activity on the land enrolled. We believe economic activity and conservation can go hand in hand. As such, we support the addition of provisions in the next farm bill that will better allow managed grazing on land enrolled in CRP. This will have tangible benefits on environmental quality - for example, helping to improve lands threatened by invasive plant species.

USDA's conservation programs are a great asset to cattle producers. We want to see programs such as EQIP, GRP, and CSP continued and refined to make them more producer friendly and more effective in protecting the environment in a sensible way.

Environmental issues are also a huge challenge for our industry. We understand the need for environmental regulations to protect resources downstream, and we believe those producers that knowingly and willingly pollute and violate the Clear Air and Clear Water Acts should be prosecuted to the fullest extent of the law. However, the use of other vehicles, such as EPA's Superfund, to sue agricultural producers in an attempt to get larger settlements is egregious and it threatens the future of ag producers both large and small. This, combined with EPA's talk of regulating agricultural dust, animal emissions, and other naturally occurring substances, makes us all concerned for our industry. Although these items are not addressed in the Farm Bill, we ask that the members of the Committee step in and help ag producers in their fight to have effective and sensible environmental regulations.

Activism

In addition to dealing with the misapplication of environmental regulations, our industry is also becoming more at risk from attacks by environmental and animal activist and terrorist groups. Activist groups such as PETA and the Humane Society of the U.S. (HSUS), along with extremist groups such as the Animal Liberation Front and Earth Liberation Front, use heavy-handed measures to try and force their views of vegetarianism and extreme environmentalism on others. Every person has a right to their own views, but to force their views on others using scare tactics, arson, and terrorism is unacceptable. It's not just the extremists, however, that threaten animal agriculture. All we have to do is look at the issue of processing horses for human consumption. All it took was a few celebrities, horse racing groups, and misinformed politicians to pass a law that banned the use of USDA funds to inspect horse processing facilities. The processing of horses is a regulated and viable management option that helps take care of unwanted or unmanageable horses. It would be preferable if there were plenty of people willing to pay for these animals and take care of them, but there are not. Instead, a group of activists have pushed their emotional views on others, and in return are running the risk of allowing more horses to starve or be mistreated, as well as putting companies out of business. This win gives activist and extremist groups a foothold to come after other species. It's no secret that groups, such as PETA, want to put the U.S. cattle industry out of business. It may seem far-fetched, but in today's society, the rural voice is quickly being lost. The Farm Bill should not be a platform for these activist groups.

Trade

Outside of conservation, environmental, and activist issues, there are several other issues that have the potential to impact the long-term health of the beef industry. One such area is trade. U.S. cattlemen have been and continue to be strong believers in international trade. We support aggressive negotiating positions to open markets and to remove unfair trade barriers to our product. We support government programs such as the Market Access Program and the Foreign Market Development Program which help expand opportunities for U.S. beef, and we urge sustained funding for these long-term market development efforts.

We also support Congressional and regulatory action to address unfair international trade barriers that hinder the exportation of U.S. beef. We appreciate the Committee's help in working to reopen foreign markets that were closed to U.S. beef after the discovery of BSE on December 23, 2003, in a Canadian cow in Washington State. As you are aware, we continue to fight to recover the market share we once had in countries such as Korea and Japan. We ask that you continue to support the effort to see that sound science is being followed in bringing down these artificial trade barriers. To grow our business, we have to look outside of the U.S. borders to find 96 percent of the world's consumers. We encourage the Committee's continued strong and vigilant oversight of the enforcement of any trade pact to which American agriculture is a party.

Research

In regards to animal health emergencies, we see a need to keep a strong agricultural research component to the Farm Bill. USDA's research is critical in all aspects of our business. Their research and extension activities help to find new and improved cattle production methods to help make our business more efficient and effective. Animal health research helps to control and eradicate animal diseases; develop better methods to keep foreign animal diseases out; and to identify, control, and preempt new diseases. These activities keep our national herd healthy and make it easier to export our beef and cattle. In addition, nutrition research is important to show that beef is a healthy part of America's diet and plays an important role in USDA's "My Pyramid" and food guidelines.

Energy

Research is also needed to identify and develop alternative methods of producing energy. Renewable energy is an increasingly important part of our country's energy supply and there are many ways that cattle producers can contribute and benefit. Research and development is needed to find cost-effective methods of utilizing manure and animal waste as a fuel supply. Gasification, biodiesel, and other methods hold a lot of promise for our industry. When looking at ethanol, however, we must be careful not to act in a way that is detrimental to the livestock industry. Livestock consume the majority of U.S. corn. As ethanol continues to grow, we must make sure we find ways for all of us to be successful. All we want is to be able to compete on a level playing field with ethanol for that bushel of corn. We must take all opportunities to look at ways to balance feed demand, price, and the benefit of renewable fuels.

Property Rights

In turning to business matters, one of the biggest concerns to cattlemen right now is their private property rights. The Supreme Court's ruling in Kelo versus The City of New London sent a shockwave through the cattle community. The thought that our ranches could be taken by municipal governments and turned over to private developers in the name of economic development is disturbing. Our country is great for many reasons, but one of them is the ability to own property, use it how you see fit, and not worry about it being taken from you on someone else's terms. We believe in the rights of cattlemen to keep their property and applaud the Committee's efforts to protect those rights.

Taxes

Reducing the tax burden on ranchers has always been a top priority for our industry. We continue to support permanent repeal of the Death Tax. Regardless of how many or how few are effected, if even one rancher has to sell off part of their operation to pay this tax, it is unacceptable to us. Cattlemen pay their fair share of taxes, and resent the fact that many are being penalized for wanting to pass their operations on to future generations. Our priority is to keep families in agriculture, and this tax works against that goal. We do not see this as a tax cut for the rich. The rich can afford high priced attorneys and accountants to protect their money now. Ranchers operate in an asset rich but cash poor business environment. Ranchers must spend money that would otherwise be reinvested in their businesses to hire the resources necessary to protect their assets and pass their operations on to their children. At the same time, however, they may have several hundred acres of land whose value has been driven up by urban sprawl and the unintended consequences of Federal crop supports. We also support keeping the Capital

Gains Tax at a lower rate, repeal of the Alternative Minimum tax, and full 100 percent deductibility of health insurance premiums for the self-employed.

Marketing Issues

When it comes to market structure and competition issues, NCBA's position is simple – we ask that the government not tell us how we can or cannot market our cattle. The way we market cattle has changed significantly over the years, and it has come from a recognition within our industry that we are not just cattle producers, but beef producers, and must be in tune with what our consumers prefer to purchase from their local retail meat case. This focus on consumer preferences has led to many innovative marketing programs that have improved the quality of beef, given the consumer what they are asking for, and made many of America's ranchers more profitable and efficient. Some of these innovations have come in the form of alternative marketing arrangements (AMAs) such as forward contracting, marketing alliances, and packer ownership. These marketing arrangements offer producers the opportunity to get paid for the value that they add to the animal.

Historically, cattle were marketed in lots or pens with every animal in the lot receiving the same average price. Since producers did not benefit from providing higher quality beef, they had no incentive to supply a higher quality product or meet consumer demands. As our industry struggled through the 1970s, 80s, and early 90s with decreasing demand, we did not see any market driven signals to produce the leaner, more consistent beef the consumer demanded. Many producers, however, took significant steps to produce high quality lean beef by making investments in genetics, management, and herd health to meet the demand we began to recognize. To pay for this investment, producers demanded a premium. This demand for premiums has manifested itself today into a system of value-based marketing that is reflected in the multitude of premiums, discounts, grids, contracts, formulas, and alliances that have become commonplace in the beef industry. Some of the marketing programs that producers participate in are:

- Certified Angus Beef
- U.S. Premium Beef, Ltd.
- Ranchers' Renaissance
- Harris Ranch

These are just a handful of the innovative marketing programs available. Many of the country's ranchers have made the choice to participate in a program that will offer them an opportunity for a larger share of the consumer's dollar. These arrangements are market and consumer driven, and in many cases, led by producers themselves. There are many more, particularly in areas where producers are teaming with other segments of the industry to take advantage of national, regional, and even niche market opportunities ranging from breed or genetics programs to natural and organic production. Process and source verified programs are utilizing today's technology, such as electronic identification of animals, allowing producers to become more efficient at raising high quality animals that yield the beef products that consumers will pay a premium for.

This growing number of innovators are ranchers who came together in a proactive way to address their desire for a growing, viable beef industry by developing bold new marketing strategies. Not only are ranchers, feeders, and packers working together in these programs to market cattle, but this innovation is also visible in the meat case. Consumers not only demand leaner, tender, more consistent products, but they demand convenience as well. The meat case is beginning to be filled more and more not by fresh beef, but by products that are pre-prepared and ready for the microwave.

In addition to being responsive to our consumers, participation in these marketing arrangements provide the producer with several tools that help improve their operations and herd management in an effort to capture the premiums I mentioned above. The ability to manage price risk is probably one of the most valuable of these tools. Taking advantage of marketing arrangements such as forward contracting allows producers to make a price that allows them to be profitable. If the price does not fit their needs, they can walk away and find another buyer. Being a "price maker" rather than a "price taker" puts ranchers in control of their business. Traditional routes of cattle marketing do not always offer that flexibility. Knowing that you have a guaranteed buyer and a price you can live with makes it easier to manage your day-to-day business and focus on operational improvements instead of always worrying where your money will come from.

Along those same lines, many producers rely on operating loans from their local bank to get the financing needed to run their operation from year to year. If a producer can go to their banker and show that they have secured a buyer for their cattle and can obtain a premium for those cattle, the banker is much more inclined to approve that loan than if he were dealing with a producer with no marketing plan.

Entering into these marketing agreements also has the added bonus of being able to pick up on operational efficiencies that make the most of your cattle, streamline your operation, and potentially save money. Many ranchers who participate in these programs get information back from the feedlots that tell them how their cattle performed while being fed. Information also comes back from the packer in the form of yield and quality grades. This information is critical in managing the herd to ensure that the traits which provide the higher quality animals and beef are the ones in which you focus on.

The benefits of alternative marketing arrangements are being seen everyday in the cattle business, and they were recently supported by the results of the Grain Inspection Packers and Stockyards Administration's (GIPSA) Livestock and Meat Marketing study conducted by RTI International and released in February. This three and a half year study was funded by four and a half million taxpayer dollars and was billed as the "definitive answer" on these issues. The study supports what many ranchers across the country have known all along – a market-driven system works. This study was based on over half a million transactions representing more than fifty-eight million head of cattle[1]. The overwhelming conclusion of this study is that overall, alternative marketing arrangements help all sectors of the industry, not just those that participate.

[1] RTI International, *GIPSA Livestock and Meat Marketing Study,* Vol. 1, Executive Summary, page 4

With all of the taxpayer money and time invested in this project, I think the livestock industry and Congress need to give serious consideration to its conclusions. The report states that the leading reasons producers participate in alternative marketing arrangements are the ability to buy or sell higher quality cattle, improve supply chain management, and obtain better prices[2]. All three of these tie into the topics we discussed above – higher quality cattle produce the beef products that the consumers desire. Providing this consumer preferred product allows us to capture more of that consumer dollar in the form of a premium. That bigger share of the consumer dollar is being passed down to the producer. The producer is getting a better price for their cattle and can use that money to continue to improve their operation.

When talking about improved supply management, we have to once again go back to the consumer. The consumer does not come into their local Safeway looking for "Rancher's Reserve" beef only on Tuesdays. The consumer demands the convenience of picking up a package of "Rancher's Reserve" beef any day of the week. To meet that demand, the retailer and packer need a steady and consistent supply of cattle that meet the qualifications of the store-branded program. This allows them to ensure this product is available daily. If the packer is limited in its ability to source these cattle, they cannot ensure that there will be a steady supply of cattle entering their processing plants. In turn, they cannot supply "Rancher's Reserve" beef everyday, and the consumer chooses another source of protein for the center of the plate.

Thus far, I have only talked about alternative marketing arrangements and the benefits they have provided to our industry. One of the conclusions in the study, however, was that only a minority of the cattle marketed to the twenty nine largest packers was done so with AMAs. RTI International's results show that approximately twenty nine percent of cattle are marketed through marketing agreements, almost five percent through forward contracting, and only five percent were packer owned. Approximately sixty two percent of cattle marketed were done so through the cash or spot market[3].

Auction markets are a critically important part of the U.S. cattle industry. They have been the primary arena for marketing cattle for over a hundred years. In this method, a willing seller takes the highest bid for his cattle when he decides it is the right time to bring them to the auction barn. Ranchers who market this way cite several reasons for their choice. One reason is independence. By using the cash or spot market, you have no restrictions or cattle quality concerns that would keep you from selling your cattle – unlike marketing arrangements that require certain criteria be met before cattle qualify for filling the contract. Flexibility is also important to these producers. Selling on the spot market gives ranchers the opportunity to participate in market rallies whereas those who have already contracted their cattle lose that opportunity because they are already locked into a price agreement. We must remember, however, that this only gives

[2] RTI International, *GIPSA Livestock and Meat Marketing Study,* Vol. 1, Executive Summary, page 4

[3] RTI International, *GIPSA Livestock and Meat Marketing Study,* Vol. 1, Executive Summary, page 5

them the opportunity to catch the rally. Timing the market is always a difficult task and adds to your price risk.

Even with traditional means of marketing, we have seen innovations and improvements that have been market-driven. One of these innovations is video livestock auctions. With this method, ranchers can auction their animals by video and reach customers across the country and not just those that come to the sale barn that week. This style of spot market stemmed once again from ranchers who produce a higher quality product and want to make sure they are getting paid for the value they are adding to their cattle.

It is always a bonus when both the consumer and rancher can benefit from innovations in the cattle industry. Many of these new marketing methods and tools are great successes. The consumer is getting the beef products they prefer and ranchers are getting paid for that added value. The results are quantifiable as shown by the Livestock and Meat Marketing Study and by the numbers. Demand for beef has grown substantially over the past decade – twenty percent since 1998. Consumer expenditures on beef are at record levels of seventy-one billion dollars for 2006. More importantly, consumer confidence in beef is at ninety-one percent. This is greater than it was in September of 2003 (before the December 23rd BSE case in Washington state) when it was eighty-eight percent. All of this has translated into profitable market conditions for ranchers. In 1980, the average price for a 650 pound feeder steer was $73.11 per hundredweight. That price dropped to $65 per hundredweight in 1996. We saw tremendous improvement in the market over the next ten years resulting in an average price of $117.73 per hundredweight in 2005 and only a slight drop from that in 2006. This price increase was affected by many things, but one of those factors was meeting consumer demands with alternative marketing arrangements.

Demand is high, prices are at more profitable levels, and the market-driven innovations our industry has put in place are proving successful. Yet today, we continue to discuss legislation that would interfere with a market-driven structure. In today's marketplace, producers need the freedom and flexibility to market their cattle in ways that provide the best return on their investment. As I have already mentioned, ranchers can market their cattle in different ways and see additional economic benefits – all while maintaining a strong and viable cash market. The study shows that government-enacted restrictions on the market-driven system would be detrimental to all sectors of our industry[4].

The study concludes that reductions or restrictions on alternative marketing arrangements would cause a decrease in the supply of cattle, a decrease in the supply and quality of beef, and an increase in retail beef prices[5]. These are all results that would set our industry back rather than move it forward. The study continues by concluding that feeder cattle prices would decrease because of higher operating costs resulting from

[4] RTI International, *GIPSA Livestock and Meat Marketing Study,* Vol. 1, Executive Summary, page 3

[5] RTI International, *GIPSA Livestock and Meat Marketing Study,* Vol. 1, Executive Summary, page 8

restrictions on alternative marketing arrangements[6]. That means that in the end, it is the individual cow/calf producers across this country that will bear the brunt of government restrictions. At the same time, we continue to see an increase in feed costs due to competition with ethanol for corn, and an increase in fuel costs. In a time of these additional costs and strains on the bottom line, the last thing we need to do is think about adding more burdens to our ranchers. On the surface, these restrictions and bans on alternative marketing arrangements, including a ban on packer ownership of cattle, look appealing, but in both the short and long-term, they will unintentionally hurt those it was intended to protect.

Rather than talk about restrictions on innovation, NCBA would prefer to talk about ways we can partner with Congress to keep the marketplace working fairly and efficiently. One program that has proven useful in making the marketplace more transparent and fair is mandatory livestock price reporting (MPR). Mandatory price reporting has been in place since 2001, and since then we have seen increased and more readily understandable information regarding pricing, contracting for purchase, and supply and demand conditions for livestock. This user-friendly information is essential to ranchers as they evaluate the marketplace and determine when and how to sell their cattle.

Fortunately we were able to work with Congress to get mandatory price reporting reauthorized last year after more than a year of the program being voluntary. As of today, however, we have still not seen the final rule from USDA that will once again require mandatory reporting. Although we appreciate the beef packers' continued voluntary reporting, we would like to see the rule to re-implement the program expedited and put back in place. We also thoroughly studied the Government Accountability Office's (GAO) report on mandatory price reporting. We thought the program was thoroughly studied and that the GAO's recommendations were productive. We let the Agricultural Marketing Service (AMS) at USDA know of our support of the recommendations and have urged them to implement those changes as quick as possible. They already have several in place and we will continue to monitor their progress. Mandatory price reporting needs to remain an effective, viable, and reliable tool for producers to utilize when making their marketing decisions.

NCBA continues to look at additional legislation and programs that will help foster more competition in our industry. One of those priorities is the ability for small, state-inspected beef packers to ship their product across state lines. Smaller plants that currently operate under state-inspected programs are precluded from taking advantage of market expansion because they cannot ship across state lines. In order to take advantage of interstate shipment of their products, they must first make the necessary, and often expensive, steps to become federally inspected. NCBA recommends that meat inspected under state programs be accorded the same freedom of movement in interstate commerce that is accorded foreign-inspected imported meat.

[6] RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 1, Executive Summary, page 8

This change would provide smaller packers with the ability to expand their trade area and open new markets. Accessing new markets always provides economic benefit, and it will allow these packers to stay viable, grow, and provide more competition in the fed cattle market. These packers will also have the opportunity to develop local, state, or regionally branded beef products, which, in turn, will allow them to benefit from alternative marketing arrangements and help build a niche demand for their products.

Probably the most effective way for industry and Congress to ensure that the marketplace stays fair and competitive is to just ensure that the laws already on the books are readily enforced. The Packers and Stockyards Act (PSA) was passed to ensure that the marketplace stays competitive. USDA's enforcement of PSA and other anti-trust laws and regulations are critical in identifying, investigating, and prosecuting anti-competitive actions by packers, dealers, markets, and others who fall under its jurisdiction. To add additional support, it is also important that USDA work with the Department of Justice to bring to justice those who collude against the individual rancher.

There has been evidence over the past number of years that USDA has not been as effective as it could in investigating allegations of anti-competitive activities, and even less effective at recommending cases for prosecution. We believe some beneficial changes have been made, but we encourage Congress to look at ways to help USDA overcome this issue and put the personnel and resources in place to make sure all cases are actively worked through the legal system. Increased activity in this effort would go a long way in discouraging people from engaging in anti-competitive acts.

NCBA supports a free market system and we trust in the ability, adaptability, and innovative skills of the U.S. rancher to be able to prosper in a relatively unregulated domestic and international marketplace. We rely on federal regulators to ensure that the marketplace is free from anti-trust, collusion, price fixing, and other illegal activities that damage the viability of the market and interfere with market signals, but also to keep the playing field level for cattle producers.

Our membership has consistently said that we want access to business opportunities that will help us improve our bottom line. Accordingly, keep in mind that for every agreement made by a packer, there is an individual rancher on the other side of that transaction who has decided that the agreement is in their own best interest, and they should be allowed to conduct that business privately, just like any other industry. Those cattlemen have exercised their personal right to willingly engage in that agreement because they perceive it to add value to their operation, to their business, to their livestock, and ultimately to their family. That opportunity in the end will help to continually improve their management, genetics, and long-term profitability. The opportunity to engage in and benefit from new advancements is good for the individual producer and good for the industry as we strive to supply the consumer with beef products they demand.

Another issue of concern is mandatory Country of Origin Labeling or COOL. Cattlemen across the country realize the benefit of labeling our product because we produce the best beef in the world. The ability to separate our product from everything else in an effort to market its superiority is a fundamental marketing strategy. There are voluntary labeling programs across the country that are being driven by the market, led by cattlemen, and are providing a higher return on their cattle. This is what a labeling program should be about...marketing. Instead, mandatory COOL has turned this into yet another commodity type program that treats all beef the same and does not allow for forms of niche marketing. This will cost producers money, but will not provide them with any return. Many proponents of mandatory COOL say that this law is about giving the consumer a choice. The current law, however, does not really do that. Restaurant and food service is exempt from mandatory COOL, but this is where over fifty percent of the consumer dollar is spent on beef. Instead of giving the consumer a choice, we are only providing a loophole that will allow all imported product to be funneled through the food services channels. In addition, mandatory COOL is being pushed by some as a food safety prevention tool and a non-tariff trade barrier. COOL is a marketing tool only, and in no way should be tied to food safety. We have firewalls in place to keep U.S. beef safe. COOL should also not be used as a non-tariff trade barrier. To label our beef in an effort to capitalize on the demand for our premium product is one thing, to label it as a way to block the competition is yet another.

Conclusion

As you can see, we are not coming to you with our hand out. Like I mentioned before, America's cattlemen are proud and independent, and we just want the opportunity to run our ranches the best we can to provide a high quality product to the American consumer, and even more importantly, provide for our families and preserve our way of life. We are coming to you in an effort to work together to find ways to use the extremely limited funds available in the best way possible to conserve our resources, build our industry, and provide for individual opportunity at success. We ask for nothing more than Federal agriculture policy that helps build and improve the business climate for cattlemen. We look forward to working with you on the 2007 Farm Bill.

JOHN M. QUEEN, III
NCBA President

John Queen is president and owner of John Queen Farms, a third generation cattle farm founded in 1917 and located in the western mountain region of North Carolina. His background in the beef industry includes cow/calf producer, stocker/backgrounder, feeder and grazer. He order buys, has been an auction barn owner and operator and currently is owner of Southeast Livestock Exchange, a video-telemarketing company working in the Southeast.

John has served the beef industry at the county, state, and national levels. He served on the nominating committee for NCA and was a Young Cattlemen's Conference participant in 1988. He has been on NCBA's (Policy) Board of Directors 1992-2004. He was NCBA Region II Vice-president and served on the Executive Committee 2003-2004.

John is a past president of the North Carolina Cattlemen's Association and served on their Executive Committee from 1989-2004. He is a past president of the North Carolina Cattlemen's Foundation and has served on their Board of Directors 1991-2004. He is also a member and director of the Haywood County Cattlemen's Association.

During his year as NCBA president-elect, John helped increase NCBA membership by 75 percent in the Southeast Region. That's a testament to his ability to communicate with cattle producers and help them see the value of supporting their national organization. John also spearheaded the fund-raising effort that helped thousands of Gulf Coast farmers and ranchers in their struggle to recover from the 2005 hurricanes.

John graduated from Western Carolina University with a double major in business and sociology. He has held political office, serving as Haywood County Commissioner for four years. He lives on the family farm in Waynesville with his wife Pat. He has two daughters, two stepsons and five grandchildren.

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STATEMENT REGARDING

ECONOMIC CHALLENGES AND OPPORTUNITIES FACING AMERICAN AGRICULTURAL PRODUCERS TODAY

HEARING OF THE
U.S. SENATE COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY

THE HONORABLE TOM HARKIN
CHAIRMAN

PRESENTED BY

WILLIAM P. ROENIGK
SENIOR VICE PRESIDENT
NATIONAL CHICKEN COUNCIL
WASHINGTON, DC

APRIL 18, 2007
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Thank you, Chairman Harkin, Senator Chambliss, and committee members for the opportunity to present the views and recommendations of the National Chicken Council on the very important and timely issue of the economic challenges and opportunities confronting agricultural producers. The National Chicken Council very much appreciates this effort to focus on the issues causing more than the usual number of challenges for animal agriculture.

My name is Bill Roenigk and I am Senior Vice President of the National Chicken Council. Companies that produce and process about 95 percent of the young meat chickens in the United States are members of the National Chicken Council. I am pleased to have this opportunity to share with you some of the challenges chicken producers/processors are attempting to successfully address. In today's operating environment the number of challenges seem to far out-weigh the number of opportunities. For my statement for today's hearing, I will use the term "chicken" and "broiler" somewhat interchangeably.

For the first time in 32 years, broiler production this year (2007) will be less than the previous year, according to USDA's latest (April 10, 2007) *World Agricultural Supply and Demand Estimate* report. Much of the cause for fewer pounds to be produced can be traced to government policy. In 1975 and in 1973, the last two times broiler production slipped below the previous year, government policy was also a major cause for the decline.

Essentially all of animal agriculture is reacting to the challenge of the very rapid and very significant increase in corn prices and related feed ingredients. One very fundamental example of the challenge is to note the decrease in the average per capita consumption of poultry/red meat. In May 2006, USDA forecast combined per capita consumption of poultry/red meat for 2007 to be 225.6 pounds, a record quantity.

In USDA's latest (April 10, 2007) report, combined poultry/red meat consumption is now expected to be 220.0 pounds or 5.6 pounds less than USDA first forecast for 2007. Much of the loss of 5.6 pounds is the result of animal agriculture producers reacting to not just current high corn prices but also the likelihood that high corn prices will be a major factor in the operating environment for the foreseeable years.

Here is the species breakout for the 5.6 pounds decrease in consumption:

Average Per Capita Consumption for 2007

	May 2006 Forecast	April 2007 Forecast	Change	
	------------- *pounds*	--------------	*Pounds*	*Percent*
Broilers	88.4	85.0	-3.4	-3.9
Turkey	16.6	17.0	+0.4	+2.4
Beef	66.9	66.1	-0.8	-1.2
Pork	50.8	49.3	-1.5	-3.0
Other	2.9	2.6	-0.3	-10.3
TOTAL	**225.6**	**220.0**	**-5.6**	**-2.5**

Broiler consumption is now expected to be 3.4 pounds or 3.9 percent less than when USDA first forecast its outlook for this year. Estimates for beef, pork, and other (veal/lamb/spent fowl) are also reduced. Fewer pounds of meat for consumers also mean fewer opportunities for farmers and ranchers to generate income, jobs, and local and national economic activity.

To meet the challenge of getting back on the upward path of producing more poultry and red meat, an adequate supply of corn at competitive values must be available in the critical years ahead. Corn usage for ethanol will undoubtedly continue to increase. The tax credit incentive to blend ethanol gives ethanol producers an economic advantage to devote more and more corn for ethanol production. Chicken producers understand that corn farmers must have a price incentive to continue to step-up the size of their harvests. At the same time, chicken producers must have access to an adequate supply of corn at a price that allows them to compete for consumers' food dollars at-home and abroad.

The National Chicken Council recommends that new provisions be created that provide options for non-environmentally sensitive acres in the Conservation Reserve Program (CRP) to better react to market forces. Such options will help in meeting the rapidly expanding demand for corn. In addition to provisions that would permit CRP contract holders of non-environmentally sensitive acreage to more timely react to market forces by exercising an option of early-release from their contracts, the National Chicken Council sees another option for these types of acres. Grains and oilseeds could be grown on non-environmentally sensitive cropland if the harvest of these crops is dedicated to the production of biofuels. These acres could continue to remain in the CRP. At the same time, crops for biofuels in these CRP acres would have to follow practices that protect wildlife reproduction and populations. Until there is a significant breakthrough in corn yields, the only measurable way to produce more corn is to have more corn acres harvested.

If there is a significant shortfall in any corn harvest over the next five to ten years, there will be little ability to allocate a severe shortage of corn without causing a major disruption in animal agriculture. Before U.S. animal agriculture faces a year when total demand for corn far outstrips the supply of corn, an appropriate plan of action must be developed. Such a plan should include a relief valve on the renewable fuels standard (RFS). This action would be warranted in such a major shortfall event. The ratio of projected corn ending inventory to corn usage could be one signal or factor to determine that a relief valve for the RFS is needed.

In addition to adjusting to the cost of feeding chicken, companies continue to work to improve their biosecurity, monitoring, and surveillance programs to protect their flocks from avian influenza (AI). USDA and the other agencies working to protect domestic flocks from all types of avian influenza are commended for the dedicated and diligent job they have done thus far. Adequate funding and resources are critical to maintaining the current success, particularly for surveillance activities in wild birds, commercial flocks, and live bird markets.

Adequate funding is also needed to support USDA's Foreign Agricultural Service to enhance and build on record farm exports. At the same time, the needs of USDA's Animal and Plant Health Inspection Service are expanding, especially internationally. With tariff trade barriers being reduced, foreign governments increasingly use non-science based sanitary and veterinary provisions to slow or halt U.S. agricultural exports. Agricultural animal disease issues continue to challenge APHIS personnel and budget resources.

As poultry growers and other animal agriculture producers work to become better stewards of land, water, and air, many have found USDA's Environmental Quality Incentive Program (EQIP) to be of great help. Assistance to farmers in developing and improving their nutrient management programs is a good use of EQIP funds. Also, assistance with the investment necessary to follow-through with a proper and complete implementation of the plan is a prudent use of EQIP funds. The National Chicken Council urges the committee to provide an adequate budget for EQIP so that the environment can become even more protected.

Market structure, contract production, and related issues remain a focus of certain interest groups. For the chicken industry, vertical integration and contracting with family farmers to grow chickens and produce hatching eggs has stood the test of time quite well. The chicken industry has over the past six decades provided consumers at-home and abroad with an abundance of wholesome, affordable, and nutritious food. In 1955, broiler production was 2.4 billion pounds, ready-to-cook weight basis. This year (2007) broiler production will be 35.2 billion pounds or more than 14.5 times the quantity in 1955. Today, the price of chicken to consumers, adjusted for inflation, is less than one-fourth the cost of chicken 50 years ago. Another way to measure the cost of chicken to consumers is to note that in the mid-1950s, it took the average manufacturing worker 19 minutes of work time to earn enough in wages to buy a pound of chicken. Today, the same worker needs to work less than four minutes to purchase a pound of chicken.

Contracts with growers offer many very important benefits. These benefits and advantages include substantially reduced market risks; quicker and more thorough understanding of production requirements; better access to capital; more reliable and predictable income flows to labor, management, and investment; and better opportunities to leverage success to expand and/or diversify farm operations.

Family farmers who contract with chicken companies have benefited in good measure over the past six decades. More than 25,000 family farms currently contract with companies to raise broilers and can do so more confidently because, to a very large degree, they are insulated from the risks of the chicken marketplace. Contract growers are basically guaranteed a fixed payment plus a bonus for above average performance. University studies have found that returns on investments for contract broiler farmers are very comparable to returns on investments for chicken companies. A young farmer starting out or a farmer with limited equity can obtain a loan to begin growing chickens because he/she can use the contract as collateral. Depending on the farmer's situation, more growout houses can be added to expand production and, in many cases, the farmer can mesh chicken growing with other aspects of the farming operation. Financial institutions tell the National Chicken Council that the default rate of contract growers is very low, perhaps, the lowest in all of agriculture.

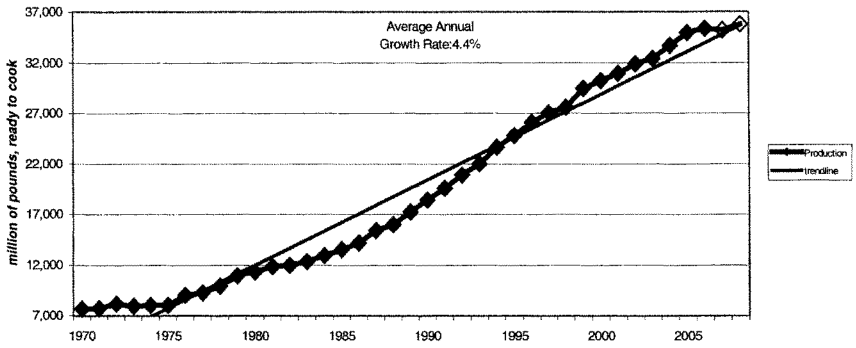
Another measure of the successful relationship between companies and contract growers is that the majority of companies have a waiting list of growers who are requesting to add to existing growout housing capacity or farmers who wish to begin broiler growout operations. If the system was not a favorable one, would these waiting lists exist year-after-year and decade-after-decade?

The National Chicken Council does not see the need for new or additional laws nor USDA regulations that would involve government further in the grower-company business relationship. Nonetheless, if the committee does have concerns or questions about the chicken industry, the National Chicken Council would very much appreciate the opportunity to respond to those questions and address those concerns.

The National Chicken Council looks forward to working with the committee to help craft a new farm bill that does not just meet the current challenges and opportunities but truly helps set the foundation for generations of American farmers involved in animal agriculture to more fully benefit from the success of the expanding demand for food.

Thank you again for the opportunity to share the thoughts and recommendations of the National Chicken Council.

U.S. Broiler Production
1970 to Estimated 2008



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Mr. Tim Schmidt
Pork Producer from Sioux County, Iowa

STATEMENT OF TIM SCHMIDT BEFORE THE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY UNITED STATES SENATE
APRIL 18, 2007

Good morning Chairman Harkin and Members of the Committee. Thank you very much for inviting me to appear here today to discuss some of the changes and challenges occurring in the US meat production industry.

I am Tim Schmidt, a third generation pork producer from Sioux County, Iowa. My partners and I operate a 250 sow farrow-to-finish hog operation on a Century Farm. Prior to entering the partnership, I worked for a major packer in Nebraska for several years, and also for an Agricultural Co-op. The strength and vitality of the US pork industry is very important to me and I serve in a leadership role in my county Pork Producer Association.

My comments today are about market access and market price changes that I've seen in the industry, stemming from consolidation in the US packing business.

Over the years we've sold weekly loads of hogs after shopping around for bids from packers. 10 years ago, our farm could get multiple competitive bids from several hog buyers. Around 5 to 6 years ago, we began having a hard time getting more than one bid from a group of buyers. Since we were only getting one bid, we ended up selling mostly to just one buyer. Today it is almost impossible to get a competitive bid on the 80 hogs we sell every week. So I have a less competitive bid and fewer market options. When you only receive one bid, the market price liquidity is poor, and market price transparency is questionable at best.

So what changed between 10 years ago when bids were readily available and 5 years ago when they stopped? The packers began aggressively signing contracts for hogs with producers. Those contracts lock in hog deliveries to the buyers and push my cash sale hogs into a residual supply situation which drops buyers' interest in competing for my hogs.

The interesting thing about these contracts is that most of them have price components that are formulas based upon the open cash market. This means that those hogs get priced based on my residual supply. On rare occasions when the hog supply is really short, that spot cash market can spike higher, but when hogs are in adequate supply – which is most of the time – the market is residual and soft. A high supply of hogs can break the market downward hard.

The consolidation of hogs under contract has made the market less liquid and less reflective of the true value of the hogs.

Another point about changes in the approach of the packing industry revolves around our county pork producer association's annual market contest. Each year eight or ten producers would bring in 20 hogs each to a packer on the same day and at the same time. We would have the hogs processed and compare the carcasses to see how well we were marketing and how our hogs compared for meat performance. Because we scheduled the pigs well in advance the packer always knew when the hogs were coming. They handled that as a spot cash sale. We stopped doing it because the packers wouldn't pay competitively the day the hogs were delivered. Association members, myself included, sold hogs to the same packer on that day that were not part of the market contest and received a higher market price. In essence the packer took advantage of our desire to improve our hogs and work together as a group. That was disappointing to those that participated.

Currently the Iowa legislature is debating a bill that would require meatpackers to buy 25 percent of their animals from non-affiliated livestock producers. The bill, SF 504, was passed by the Iowa Senate last month. It is currently awaiting action in the Iowa House.

I support the 25% open market bill because it would ensure more liquidity in the market and would ensure that contracts formulated off of the open market accurately reflect market conditions.

I also believe that in order to ensure true market transparency we need mandatory price reporting so that all hog prices are reported to the USDA and publicly reported each day. Factual information about all market price transactions – cash sales and contract deliveries – is an important key to market transparency.

Besides my personal issues, I am concerned about the next generation of hog producers. Without open, transparent and competitive markets the young men and women who are the future of our industry, will not have the opportunity to be independent pork producers. Without a level playing field, our rural youth with an interest in hog production will only have two options: work for an integrator or find another occupation. To limit their opportunity in pork production because we don't give them a free, open and transparent marketplace would be a real shame.

At issue today is not whether big farms or small farms are best. It's about independence and freedom that can only be achieved by having and maintaining a fair, free and honest marketplace. In order to have that, we need more open market transactions in a reportable and transparent market.

Thank you for listening, I appreciate this opportunity. If you have any questions, I'd be happy to answer them.

Statement of the

UNITED EGG PRODUCERS

Before the

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

April 18, 2007

Good morning, Mr. Chairman, Senator Chambliss and members of the committee. My name is Ron Truex and I am the president and general manager of Creighton Brothers, LLC, in Warsaw, Indiana. I appreciate the opportunity to testify on behalf of United Egg Producers. About 90% of all the eggs in the United States are produced by UEP members. UEP is a farm cooperative, and in addition to performing all the functions of a trade association, we also administer a program of animal husbandry standards called the UEP Certified Program, which I will discuss later in my testimony. In addition, we negotiate and conclude export sales through our subsidiary, U.S. Egg Marketers, as well as providing egg trading, access to insurance and other services.

Eggs are produced in virtually all the states represented on this committee, but I would especially note that the chairman's state of Iowa is the nation's #1 egg producer. Our organization's headquarters are located in the ranking member's state of Georgia. And my home state of Indiana, represented by the former chairman of this committee, is consistently among the top five egg-producing states.

The egg industry neither receives nor seeks price supports or income support payments. However, like the rest of the livestock and poultry sector, we have a major stake in this farm bill and appreciate being included in your deliberations. The farm policies you adopt will definitely affect our industry.

Alternative Fuels

The livestock, poultry and dairy industries are about half of U.S. agriculture when measured by cash farm receipts, and all these industries have been significantly affected by the booming demand for ethanol and biodiesel. Production costs for eggs have skyrocketed as rising demand for biofuels has driven up feed prices. We ask Congress to help the animal agriculture sector through research to commercialize ethanol production from cellulose, and we believe incentives for alternate fuel production should be more equitable.

About 55% of the cost of producing a dozen eggs is feed, and about 63% of a typical layer diet is corn. From September 2006 through the end of February 2007, a typical egg operation saw almost a 60% increase in feed costs per ton. During that period, corn prices rose from a little more than $2 a bushel to more than $4. The cost of getting each dozen eggs to the grocery store went up about 10¢ per dozen.

Most egg producers lost money from 2004 through 2006. Higher costs now, if sustained, are likely to cause further consolidation in our industry as weaker operations fall by the wayside. Although it is true that the price of corn has fallen since the March 30 Planting Intentions report, USDA's long-term projections suggest several years of unusually tight supplies and high feed costs. A short crop in the Corn Belt would, in these circumstances, be disastrous.

UEP supports alternative fuels as part of the nation's strategy for energy independence, but we believe that **U.S. policies must do a better job of taking into account the needs of egg, poultry, livestock and dairy producers.**

- In the 2007 farm bill, Congress should **expand research** to **(1)** commercialize technologies to make ethanol from cellulosic biomass; **(2)** modify dried distillers grains with solubles (DDGS) and other byproducts to expand their use in layer rations; and **(3)** develop other renewable energy sources, such as power generation using manure and mortality.
- If Congress expands the Renewable Fuels Standard, **the expansion should be limited to fuels that are made from non-corn feedstocks,** such as cellulose.
- Congress should consider replacing the current 51¢ ethanol tax credit with a **countercyclical credit** that would be lower when petroleum prices are very high.
- Congress should encourage the Secretary of Agriculture to allow **early release of some land in the Conservation Reserve Program**, so farmers can meet the demands of both the ethanol industry and the livestock sector.
- **Incentives to produce biofuels should be offered on an equitable basis.** Any tax credit or similar benefits available to ethanol or biodiesel should also be available for other sources of renewable fuels, including products of the livestock and poultry industries such as fats, tallow, animal waste and mortality.

Animal Welfare

During recent years, our organization has spent more time on animal welfare than on any other single issue. The U.S. egg industry has worked with top scientists to design and adopt animal husbandry standards based on science. About 85% of our industry has implemented these standards.

UEP has been a leader in forward-looking environmental, food safety and animal welfare activities. We feel strongly that **animal welfare standards should be based on science, not emotion or politics**. In the late 1990s, we commissioned an independent, unpaid scientific advisory committee that recommended **industry-wide guidelines** for animal husbandry – science-based standards for the best ways to care for laying hens. The advisory committee has remained active and comprises experts in animal well-being and related fields. For example, its chair is Dr. Jeffrey Armstrong, dean of agriculture and natural resources at Michigan State University.

About **85% of producers have voluntarily adopted** these guidelines, even though they involve increases in production costs. The guidelines are known as the **UEP Certified Program**. The program has been well accepted by our retail and food service customers, and provides assurance to consumers that the eggs they buy were produced under approved animal husbandry standards.

Despite the significant changes we have made in our production practices, we have continued to be attacked by some animal-rights activist groups. For some of these groups, only cage-free or free-range production is acceptable. We have numerous members who produce cage-free, free-range and organic eggs, and we believe it is important for consumers to be able to make these kinds of choices. However, over 95% of egg production here and around the world involves birds raised in cages, and our scientific advisory committee has consistently found that both caged and cage-free systems are acceptable production methods, each having advantages. If all production in the United States had to be free-range, consumers would pay $4.65 billion more for eggs every year, and we would need to identify an additional area of land the size of Delaware to produce the same number of eggs that we do now. I am not sure exactly where that land would come from.

For other activist groups, even free-range or cage-free production is unacceptable. These groups believe, sincerely, that humans should not consume meat, milk or eggs, which means they believe our industry should not exist, and we should find some other way to make a living. They are entitled to their opinions, but when one side of an argument starts with the premise that the other side is illegitimate, there is not much to talk about. Some of these groups have engaged in illegal activities such as breaking in to farming operations, which not only violates the law but also creates the risk of disease transmission. These groups also support legislation that would impose their views of appropriate production practices on U.S. animal agriculture.

We are concerned that when this committee takes its 2007 farm bill to the Senate floor, **a variety of amendments could be offered that would be hostile to animal agriculture.** These amendments may or may not have anything to do with eggs directly; they might target other species groups instead. But our request to you is simple: **Please vote against hostile, anti-livestock amendments that may be offered.** Instead, please support our industry in its use of science, not emotion, to develop and implement voluntary animal husbandry guidelines in the private sector.

Other Issues

Agricultural Research

UEP members feel strongly that the nation should invest more in basic and applied agricultural research, extension and education. For more than a century, our country has proven the benefits of research in expanding output, increasing efficiency and raising living standards for all our people. Compared to other scientific fields, federal funding for agricultural research has been stagnant at best. We commend land-grant institutions and others who have been thinking creatively about the best way to maximize both the resources available, the quality and the balance of research and extension. The CREATE-21 proposal endorsed by these institutions is an important contribution to the debate, and we are in support of its goals, including the urgent need to attract more talented young scientists to agriculture-related disciplines. We do feel that, while better coordination between intramural and outside research is important, the Agricultural Research Service should remain a separate agency.

For animal agriculture, research can help us not only make our own farms more viable, but also serve public goods. For example, the government has paid increasing attention to **air emissions from livestock and poultry operations**. Our industries are currently working with the Environment Protection Agency in a large-scale study that will establish scientific measurements of actual emissions from different types of farms. Through the American Egg Board, producers in our industry have invested some $3 million of our own money in this study.

However, it is important to move beyond measurement to mitigation. Already, there are several technologies that show promise for reducing air emissions when tested in the laboratory. The next step is to test them on actual farms, in order to demonstrate their efficacy and economic feasibility. Once that is done, producers can begin to adopt the new technologies. We have worked with the nation's top scientists on this topic, at institutions like Iowa State University, The Pennsylvania State University and the University of Kentucky. **We hope this committee will consider authorizing air emission mitigation research in the research title of this farm bill.**

Industry Structure and Competition

Earlier today, the committee heard testimony on issues involving concentration in the livestock industry, with discussion of various issues that arise from contract production. Here, egg production is somewhat different from other segments of the poultry industry, in that contracting is not the norm. There is a measurable amount of contract production in the egg industry, but the large majority of output – and the overwhelming majority of new construction – involves integrated operations where the same farm owns both birds and buildings, raises them from day-old chicks and markets the birds' eggs.

From that standpoint, we are not in a position to comment on contracting issues with as much expertise as some of your other witnesses. However, we would generally urge you to be cautious about legislating in this area. We are not aware of significant problems with current contract arrangements in our industry. Often, contract producers are delivering their eggs to a farmer cooperative of which they are members. The cooperative then markets the eggs. We think this is a viable business model for some producers and would not want to see it restricted.

However, we also would point out some of the advantages of the dominant model in our industry, where a farm both produces and markets its own eggs. That is how Creighton

Brothers works. For decades, farmers have been told by experts that we need to add value to our products. We need to move closer to the consumer so that middlemen do not capture all the profits. That is essentially what we have done in the egg industry. Creighton Brothers is an egg producer, but we sell directly to major retail grocery chains, restaurant chains and other large customers. We also have our own egg processing plant, where we break eggs and sell yolks, whites, whole eggs and other products to the food manufacturing industry as ingredients for a variety of foods.

By adding value and integrating toward the ultimate consumer, we have been able to survive as a farming business. We are not among the nation's largest egg producers, but we have been successful and we are a significant employer in northeast Indiana.

I mention all this, not to criticize any particular legislative proposals, but simply to point out that caution is warranted when Congress considers legislation that could affect the way individual business operations are structured. If any legislation were proposed that would affect the egg industry, we hope you will first ask: What is the problem that the legislation is trying to solve? Is there actual evidence of a problem that market forces are unable to deal with?

Mr. Chairman, I appreciate the chance to offer this testimony and will be glad to answer any questions at the appropriate time.

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DOCUMENTS SUBMITTED FOR THE RECORD

APRIL 18, 2007

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Written Statement
of
National Association of State Departments of Agriculture (NASDA)
for the
Senate Agriculture Committee
Regarding
Competition in Agricultural Markets and Interstate Meat Sales
April 18, 2007

The National Association of State Departments of Agriculture (NASDA) represents the commissioners, secretaries and directors of agriculture in the fifty states and four territories. As Congress develops the 2007 Farm Bill, we urge the committee to address an important market competition issue and allow state-inspected meat and poultry to be sold in the national marketplace. Current law restricts fair, competitive, and open markets for small farms and meat processors.

Consumers in the United States enjoy the safest meat and poultry supply in the world. The foundation of this success is our system of food safety laws and inspection programs. Ironically, these same laws also unfairly penalize hard-working small business owners in the U.S. while giving preference to imports of meat products from foreign countries such as Croatia and Nicaragua. Meat and poultry products (beef, poultry, pork, lamb and goat) inspected under state inspection programs may only be sold within the borders of the state in which it is inspected. This makes no sense, whatsoever.

Three USDA Advisory Committees have recommended repealing the outdated law because it would create jobs and stimulate rural economic growth. More than 40 national, state and local agricultural organizations have urged Congress to level the economic playing field for small meat processors, and to allow them national market access. Congress needs to finally address this issue in the 2007 Farm Bill.

FAIR COMPETITION AND MARKET ACCESS

Twenty-eight states currently have their own meat and poultry inspection programs. We serve more than 2,000 state-inspected meat processors–mostly small, family-owned businesses–who are prevented from competing in the national marketplace. Consolidation in the meat processing industry continues to leave smaller farmers and ranchers with fewer and fewer buyers for their livestock and poultry. How can this arbitrary marketing restriction be justified, especially when imported foreign meat and poultry products can be freely shipped and sold anywhere in the United States?

The question before Congress is a simple fairness issue. Allowing interstate meat sales will resolve a basic inequity that has existed since 1967. The reasons to act promptly are clear and compelling:

- Meat and poultry products from 34 foreign countries can be freely shipped and sold anywhere in the United States, but domestic small businesses and processors cannot. This is unfair and wrong. *Why are small businesses in the U.S. denied the same market opportunities that are given to companies in foreign countries?*

- The restriction on interstate meat sales does not apply to "non-amenable" products—such as venison, pheasant, quail, rabbit, alligator and a host of others. These products are normally regulated by state inspection programs, yet can be shipped in interstate commerce without restriction. It does not make sense to allow these products across state borders while beef, pork, lamb and goat cannot be shipped interstate. *Where is the logic in this?*

- No other state-inspected food commodities are prohibited from being shipped across state lines. Other state-inspected food products (milk, dairy products, fruit, vegetables, fish and shellfish) are freely marketed across the country. *Why aren't the same market options available for meat and poultry?*

- Our locally-produced, state-inspected meat are some of the best specialty products in the country. Most of these small, state-inspected companies make and sell specialty products such as sausages, bratwurst, jerky and ethnic meat products which are generally not cost-effective product lines for large operations. *It doesn't make sense to say consumers in Iowa can enjoy these products while consumers across the state border in Missouri cannot eat and enjoy the same products.*

ECONOMIC GROWTH FOR RURAL SMALL BUSINESS

Livestock production and processing are the most important agricultural industries in many rural communities. Most state-inspected meat and poultry plants are owned and operated by small business owners who want to sell their products in the local region. Most of them produce specialty and seasonal meat products. They provide a market for local cattle, hog, goat, and sheep producers. However, the current ban on interstate meat sales prevents these small processors and businesses from serving rural areas which straddle state boundaries.

Market access is critical for small producers and processors who want to market and sell their products to consumers, grocery stores, and other retailers in multi-state regions. Maintaining the interstate sales ban denies these market sales to them. It also prevents them from capitalizing on other sales opportunities such as niche marketing through mail-order gift catalogs and internet sales. Internet sales now offer a huge potential for small rural businesses to sell their specialty products in the global marketplace. This innovation in the marketplace did not exist a few years ago, yet the interstate sales ban prevents these entrepreneurs from using this technology today.

Small processors and businesses are denied other economic opportunities as well, including sales to federally-inspected plants for further processing into finished products.

Concentration in the food processing sector continues to trend upward. This reduces market competition, and leaves farmers and ranchers with fewer and fewer buyers for their livestock. In some regions, farmers have to transport animals over long distances. The state-inspected plant is the most likely choice for farmers selling locally because they are generally smaller and more locally available. Allowing more competition in the national marketplace will give farmers and ranchers more local plant options for delivering their livestock.

Increased markets will not only benefit producers, processors and small businesses, but it also gives consumers more choices at the supermarket and convenient stores. It's just common sense and it's the right thing to do. *It is ridiculous that under current law, a restaurant in Minnesota or Virginia can purchase beef from a foreign competitor overseas, but not from a plant in Texas. How can anyone justify this?*

LOCAL ECONOMIC BENEFITS

Interstate markets for state-inspected products will help stimulate rural economies, create jobs and increase local tax bases. Increased markets will not only benefit producers and processors, but related industries such as paper products, printers, seasonings, distributors, and local shops carrying regional products. The Wisconsin Association of Meat Processors conducted a survey of their small business owners in April 2006. In the survey:

33% believed that interstate shipment would increase their total sales by more than 10%.
33% responded that interstate shipment would increase their total sales by 5 to 10%.
29% believed their sales would grow by 1 to 5%.

The Wisconsin survey also asked how this potential, additional sales increase would benefit their business and local economy. The survey showed:

79% would add employees or increase payroll hours.
83% would invest in additional equipment.
64% would expand their existing plant.
42% would open new retail locations.

SUPPORT FROM USDA & ADVISORY COMMITTEES

The debate about interstate meat sales has gone on long enough. Three USDA Advisory Committees have recommended that the ban on interstate shipment be removed because it would create jobs and stimulate rural economic growth:

- USDA's Advisory Committee on Agricultural Concentration (June 1996) issued a report recommending that USDA take "*aggressive action to end the inequities in meat inspection and that appropriate steps be taken to promote the ability of state-inspected packing plants that meet federal standards of inspection to compete by selling meat in interstate commerce.*"

- USDA's National Commission on Small Farms (January 1998) issued a report "*A Time to Act.*" The report outlines a general policy goal to "promote, develop and enforce fair, competitive and open markets for small farms." Specifically, the report "*urges USDA to take aggressive action in a timely manner to end the inequities in meat inspection. With regard to federal and state inspections, the commission recommends that appropriate steps be taken to promote the ability of state-inspected packing plants that meet federal standards of inspection to compete by selling meat in interstate commerce. Provided, however, that such steps do not undermine the integrity of the U.S. position regarding acceptable standards and safeguards for imported meat.* "

- The National Advisory Committee on Meat and Poultry Inspection (NACMPI) endorsed interstate meat sales in two reports (May 1998 and June 2002). NACMPI serves as an advisory committee to the USDA Secretary to consult before issuing product standards and labeling changes and on other matters affecting federal and state inspection programs.

LEGISLATIVE SUPPORT IN CONGRESS

Legislation to allow interstate meat sales has been introduced and debated in Congress for more than a decade. All of the hearings, reports, recommendations, and legislation have supported removing the ban on interstate meat sales.

The 1996 Farm Bill required USDA to submit recommendations to Congress on the steps necessary to achieve interstate meat sales. USDA sought public comment, held public hearings and developed a legislative proposal, which was subsequently introduced in Congress in 1999. At Senate Agriculture

Committee hearings in April 2000, USDA Deputy Secretary Richard Rominger testified for USDA and supported removing the ban on interstate meat sales.

The 2002 Farm Bill included language supporting the merits of interstate meat sales and required USDA to conduct a new, comprehensive review of state inspection programs. USDA began this review and further strengthened testing and training requirements in spring 2003, and in January 2007 issued a report which concluded that state inspection programs are "at least equal to" federal inspection. This review data continues to show that state inspection programs are highly effective and provide consumers with a wholesome, unadulterated food product that is properly labeled and safe.

There simply is no longer any valid reason to continue the ban on interstate meat sales. Congress needs to finally address this issue in the 2007 Farm Bill. The state departments of agriculture stand ready to work with the Committee on this effort which will greatly benefit producers, processors, and consumers.

QUESTIONS AND ANSWERS

April 18, 2007

Grassley

Possible Questions

Questions for Mr. Carstensen:

Isn't it true that when the spot market drops to less than 10% with a few packers, the risk of price manipulation increases?

Do you agree that consumer meat prices do not follow cheaper livestock prices?

If you were selling, for example, a hand made product in a local auction, isn't it true you would rather have 10 bidders than 2 or 1.

Question for Tim Schmidt:

We have heard from the packers that contracting is necessary to provide quality incentives, but Isn't true that the quality payment system and quality incentives are the same for hogs sold under both contract and the open market?

Question for National Pork Producer:

Grassley

Do you agree with me that, in a fully competitive market at all levels, cheaper livestock prices would be reflected by cheaper consumer meat prices?

Question for R-Calf:

If a regional market has one packer, isn't competition gone, and prices go down as a matter of both theory and fact? (American West in cattle, Southeast U.S. for Smithfield in hogs, etc).

Questions for RTI person:

The RTI study discussed national markets extensively, but did it ever define the actual local/regional geographic markets in which producer sell their hogs/cattle?

Isn't true that the risk of intentional price manipulation from captive supplies were beyond the scope of your study?

Can you name one person or organization the RTI authors consulted, among industry organizations and experts, that had very strong concerns about harm to competition from captive supplies and horizontal concentration in hogs or cattle?

Senator Harkin
QUESTIONS TO MARY MUTH

1. The RTI study assumes that hogs are sold through a national market, where all producers are treated the same and have the same number of buyers. As I stated at the hearing, the marketing of hogs is regional. Some regions have fewer buyers than others. Some areas producers have only one buyer. Market power is clearly different for different regions of the country especially if one packer can dictate complete control over the producer.

Since RTI did not scrutinize the hog industry by region, it fails to take into account how corporate farm laws, such as Iowa's packer ban could be the very reason that region has a higher percentage of spot market than the eastern region. Yet, RTI stated that state and regional regulatory restrictions were not studied and were outside the scope of this report.

In response to my question, you stated that USDA directed RTI to conduct the analysis as a national marketing system. In examining the Federal Register notice (Vol. 68, No. 104, May 30, 2003), objective 10 stated the study should "examine the implications of spot and alternative marketing arrangements on barriers to entry, industry concentration, and other factors that have the potential to increase market power in livestock production, meatpacking, and retailing." There are no details of limiting this analysis on only a national basis nor is there any limitations on whether or not state and regional regulatory restrictions can be evaluated or not.

QUESTIONS

What was the criteria that RTI used to conduct the study to evaluate industry concentration and factors that have the potential to increase market power in livestock production, meatpacking and retailing?

Did RTI use criteria or partial submissions of criteria from sources other than provided in the Federal Register notice (vol. 68, No. 104, May 30, 2003)? If so, was this criteria provided to you by USDA? Please provide details and documentation of any criteria that USDA provided to you and RTI employees to conduct the study.

Did USDA staff at any time tell you or other RTI employees to not evaluate market power on a regional level? Did USDA tell you or other RTI employees to not evaluate regional differences between regions that have (had) corporate farm laws? Why is an evaluation of state and regional regulatory restrictions on market power outside the scope of the report?

Did USDA staff at any time tell you or other RTI employees to not focus on any particular issue?

Since RTI was awarded the contract to conduct the meat marketing study, how involved has USDA been in influencing, directing, commenting on conclusions on RTI's study? Did they ever tell you or other RTI employees to change conclusions

or any findings that RTI found?

Roberts

Questions for Dr. Muth:

Dr. Muth, I read in your testimony that in the research RTI and several universities conducted you all examined two and half years worth of purchases, sales transactions and other empirical data. But, I also see you conducted interviews within all segments of the industry, including producers.

1. I'm curious what your interviews with producers told you about using Alternative Marketing Arrangements. What incentives did your research find for producers to use AMA's?

2. Some want to paint the picture that producers have few marketing options. Did you find that producers were forced into using AMA's? Additionally, did you find that producers relied solely on one marketing strategy or a mix of them, like marketing agreements, cash, and cooperatives?

3. On the flip side, did you find any situations where producers with smaller operations were unable to participate these marketing agreements?

4. We're hearing testimony today from others who believe AMA's have a negative impact on producers, yet your research indicates AMA's benefit all sectors of the livestock industry.

   Specifically, your research concludes that restricting AMA's will hurt the industry, including producers and consumers. Since I represent a state with more cattle than people, can you give me a dollar amount on the estimated impact to beef producers if Congress were to pass legislation prohibiting or restricting AMA's?

5. Much of the testimony offered for this hearing focuses on the supply side of the industry, but I briefly want to touch on the demand side. Dr. Muth, would you expand on what impact consumer demand has on the use of AMA's?

June 26, 2007

Response to Supplemental Questions
Related to the Hearing of April 18, 2007 before the
Senate Committee on Agriculture, Nutrition and Forestry

Peter C. Carstensen

I was asked to supplement my responses to the following three questions:

1. Isn't it true that when the spot market drops to less than 10% with a few packers, the risk of price manipulation increases?

My response: When the proportion of business done in a spot market falls significantly below the amount done outside that market where the prices for the non-cash products are based on those market prices, the incentive to manipulate market prices increases. Basically, it pays the manipulator to under- or over-pay in the thin market in order to affect the large volume of business it is doing outside that market. One illustration comes from the old cheese exchange in Green Bay. Although a very low volume of cheese was actually sold (the exchange only had sessions on Friday afternoon, I believe), the prices set there determined the prices of cheese in most transactions around the country. As a result large buyers of cheese had every incentive to manipulate the price on the exchange. The largest buyer of cheese was, as a result, an active seller of cheese on the exchange. This had the effect of driving down the price for all its purchases.

In the case of livestock, the incentive is to limit the price paid in the cash market in order to keep down contract prices based on the cash market price. As the cash market losses volume, the cost of manipulating price declines and the incentive to manipulate increases.

2. Do you agree that consumer meat prices do not follow cheaper livestock prices?

My response: Yes, declining prices at the farm-gate at most only indirectly affect the price of retail meat. Both retailers and packers have every incentive to keep retail prices up and appropriate the increased margin. These problems have been significantly increased as a result of the wave of mergers in retail grocery markets and the increased concentration in meat packing. The only way that lower prices for inputs affect the final price to the consumer is if competition works. But when the intermediate markets are concentrated, competition can not work.

3. If you were selling, for example, a hand made product in a local auction, isn't it true you would rather have 10 bidder than 2 or 1?

My response: Yes, any seller definitely wants to have a number of competing buyers. Indeed, I recently participated in the review of PhD thesis in economics where the student developed an economic model that provided a fuller explanation for this phenomenon. Essentially, when there are few buyers (or sellers which was the focus of the thesis), they have little incentive to behave in ways that will maximize the benefit for the seller. Only when the seller has a number of options will buyers have the incentive to step forward with their best offers.

Responses to questions from Senator Harkin:

1. **What was the criteria that RTI used to conduct the study to evaluate industry concentration and factors that have the potential to increase market power in livestock production, meatpacking and retailing?**

Response: In contrast to the 1996 GIPSA study, which analyzed the effects of concentration on the livestock industry, the focus of our analyses, as specified by the Performance Work Statement (PWS) for the contract, was to determine the extent of use of alternative marketing arrangements (AMAs) and the effects of their use. Specifically, following the PWS (enclosed with this letter), our research team addressed the following:

A. Identify and classify spot and alternative marketing arrangements into appropriate categories for examining alternative types of vertical coordination and pricing.
B. Describe the terms and availability of various types of spot and AMAs and associated pricing methods, and examine why firms use them.
C. Determine the extent to which various types of spot and AMAs are used, analyze price differences among the marketing arrangements, and analyze the effects of alternative arrangements on short-run spot market prices.
D. Measure and compare possible costs and benefits associated with the various types of spot and AMAs.
E. Analyze the implications of AMAs for the livestock and meat marketing system.

We allowed for potential market power in the economic analyses described in Section 6 of the respective volumes of the final report for beef (Volume 3) and lamb (Volume 5) based on data from previous studies, and we tested for market power in the economic analyses conducted for the pork industry. The results of testing found evidence of market power in the pork industry and, thus, the modeling approach presented in Section 6 of the pork volume of the final report (Volume 4) accounted for this market power.

2. **Did RTI use criteria or partial submissions of criteria from sources other than provided in the Federal Register notice (vol. 68, No. 104, May 30, 2003)? If so, was this criteria provided to you by USDA? Please provide details and documentation of any criteria that USDA provided to you and RTI employees to conduct the study.**

Response: The criteria that USDA provided to RTI to conduct the study are outlined in the attached PWS. There are differences in wording between the Federal Register notice and the PWS. Because RTI was required to respond to the PWS under the contract, we followed the PWS in conducting the study.

3. **Did USDA staff at any time tell you or other RTI employees to not evaluate market power on a regional level? Did USDA tell you or other RTI employees to not evaluate regional differences between regions that have (had) corporate farm laws? Why is an evaluation of state and regional regulatory restrictions on market power outside the scope of the report?**

Response: Following award of the contract, USDA allowed RTI and the other team members to design and implement the data collection procedures and conduct the analyses independently. We developed and conducted the analyses based on the combined expertise of the team of researchers, many of whom have expertise in modeling and testing for market power in the livestock and meat industries.

We considered regional differences in many of the analyses conducted for the study. Transactions data were analyzed at the individual plant level and were summarized by region of the country. We delineated three regions for cattle (Cornbelt/Northeast, High Plains, and West) and three regions for hogs (East, Midwest, and Other). Note that the Confidential Information Protection and Statistical Efficiency Act (CIPSEA) of 2002 prevents confidential data collected for statistical purposes from being disclosed in any reports. Thus, results for individual plants or small geographic regions cannot be reported under the law.

We considered the possible effects of corporate farming laws when developing the analyses, but determined that the models did not need to be altered to account for the effects of these laws because they had had little effect on the industry during the time period of the analysis. There are states, particularly in the Midwest/Cornbelt, that have restrictions on ownership of livestock and/or production facilities.

However, the market areas for plants cross state lines. The 1996 GIPSA study addressed regional markets and found that in the case of cattle, 64% were procured within 75 miles of the plant, 82% within 150 miles, and 95% within 270 miles. Furthermore, based on previous analyses conducted for the hog industry, members of the study team have found that the hog market is national in scope (see Wohlgenant, Michael K. "Market Modeling of the Effects of Adoption of New Swine Waste Management Technologies in North Carolina." Prepared under the Economic Assessment of Alternative Swine Waste Management Systems: The Smithfield Foods-Premium Standard Farms Agreement with the North Carolina Attorney General, Department of Agricultural and Resource Economics, N.C. State University, July 2005).

State laws that ban packer ownership of cattle or hogs do not prevent a farmer from entering a marketing agreement with a packer. Furthermore, corporate farming laws do not prevent a packer from owning livestock in one state and trucking the livestock to a plant in a state where packers are not allowed to own livestock. Thus, the data were examined at the plant level and reported by region; however, given that livestock often cross state boundaries, the effects of corporate farming laws were not substantial enough to incorporate into the models developed for the study.

4. **Did USDA staff at any time tell you or other RTI employees to not focus on any particular issue?**

Response: No. Although USDA determined the scope of our analyses in the PWS, our research team determined the study methodology according to best practices, as well as our expertise and knowledge of the livestock industry.

5. **Since RTI was awarded the contract to conduct the meat marketing study, how involved has USDA been in influencing, directing, commenting on conclusions on RTI's study? Did they ever tell you or other RTI employees to change conclusions or any findings that RTI found?**

Response: USDA was involved in facilitating the data collection for the study, including assisting with obtaining approval for the data collection from the Office of Management and Budget and enforcing packers' compliance with the mandatory collection of transactions data. USDA was not involved in influencing or directing the conclusions of the study. Economists on USDA's staff provided comments on a preliminary draft of the report, but USDA did not require us to address or respond to the comments. USDA's comments focused on the clarity of the presentation and indicated questions that might be raised by readers. USDA also sent the draft reports out for external peer review by qualified economists throughout the United States. Reviewers' comments and RTI's responses are provided on GIPSA's Web site.

Responses to questions from Senator Roberts:

1. **I'm curious what your interviews with producers told you about using Alternative Marketing Arrangements. What incentives did your research find for producers to use AMA's?**

Response: The beef producers we interviewed noted a number of incentives for using AMAs for sales of cattle, such as guaranteed return of value on quality cattle, improved feedlot capacity utilization, guaranteed financing or access to additional capital if a buyer for cattle is assured, price risk management, and significant operational cost and time savings (see pp. 4-34 through 4-38 of the July 2005 interim study report for more details). The pork producers we interviewed noted incentives for using AMAs for sales of hogs. For example, AMAs allow for expanded hog operations by ensuring a market for finished hogs, avoid the need to negotiate every load of hogs and ensure shackle space at the packer, and allow for risk management (see pp. 4-69 through 4-71 of the July 2005 interim report for more details). We also conducted formal surveys in which we asked producers that use AMAs to indicate the reasons why they use AMAs. The beef producers we surveyed indicated the following top reasons: AMAs allow for sale of higher-quality cattle, producers can sell calves and cattle at higher prices, AMAs reduce risk exposure, and AMAs reduce price variability (see pp. 6-51 and 6-52 of Volume 2 of the final report). The pork producers we surveyed indicated the following top reasons: AMAs reduce risk exposure, reduce price variability, and secure a buyer for hogs (see p. 6-110 of Volume 2 of the final report). Based on the results of the data collection efforts for the study, livestock producers have multiple incentives for using AMAs to improve their business operations.

2. **Some want to paint the picture that producers have few marketing options. Did you find that producers were forced into using AMA's? Additionally, did you find that producers relied solely on one marketing strategy or a mix of them, like marketing agreements, cash, and cooperatives?**

Response: In the interviews we conducted for the study, no producers told us that they were forced into using particular AMAs. All producers appear to evaluate their options and make decisions regarding their marketing methods based on what works for their operations. Many producers use a mixture of marketing arrangements, but based on the survey responses, a relatively high percentage of producers use only the cash market. Based on the survey, approximately 85% of small beef producers and 24% of large beef producers use only the cash market (see p. 6-43 of Volume 2 of the final report), and 58% of small pork producers and 17% of large pork producers use only the cash market (see p. 6-101 of Volume 2 of the final report). Other producers use a mixture of the cash market and/or AMAs.

3. **On the flip side, did you find any situations where producers with smaller operations were unable to participate these marketing agreements?**

Response: During the interviews we conducted for the study, no producers told us they were unable to participate in particular types of AMAs. However, the number of interviews we conducted was limited by the Paperwork Reduction Act, which would have required Office of Management and Budget approval if we interviewed more than nine producers with a specific set of questions (the questions we asked differed by species, so we were able to interview up to nine producers for each species). Thus, we do not have sufficient evidence from the study to make definitive statements about whether some producers with smaller operations were not able to participate in AMAs because of the size of their operations.

4. **We're hearing testimony today from others who believe AMA's have a negative impact on producers, yet your research indicates AMA's benefit all sectors of the livestock industry.**

   Specifically, your research concludes that restricting AMA's will hurt the industry, including producers and consumers. Since I represent a state with more cattle than people, can you give me a dollar amount on the estimated impact to beef producers if Congress were to pass legislation prohibiting or restricting AMA's?

Response: Based on the analysis conducted for the study, following implementation of a prohibition on AMAs, fed cattle producers (feedlots) in the United States would lose a cumulative $17 billion in present value terms, and feeder cattle producers (cow-calf operations) would lose a cumulative $24 billion in present value terms over a 10-year period. These estimates represent 8% and 16% of the value of the respective industries. Table 6-17 on page 6-56 of Volume 3 of the final report provides the detailed results of the analysis.

5. **Much of the testimony offered for this hearing focuses on the supply side of the industry, but I briefly want to touch on the demand side. Dr. Muth, would you expand on what impact consumer demand has on the use of AMA's?**

Response: The study found that AMAs are used to meet consumer demand for quality meat products based on the results of the industry interviews, industry surveys, and analysis of transactions and other data for the study. During the industry interviews, beef packers told us they use AMAs to procure fed cattle because AMAs help them obtain consistent-quality cattle to provide more desirable products for retail and foodservice (see p. 4-35 of the July 2005 interim report). Likewise, pork packers told us they use AMAs to procure finished hogs because AMAs allow them to procure lean, consistent-quality hogs or hogs with specific genetics to meet quality requirements (see p. 4-70 of the July 2005 interim report).

Based on the industry surveys, 54% of beef packers responded that the ability to secure higher-quality cattle was one of the top three reasons they use AMAs, and 46% of beef packers responded that the ability to secure fed cattle for particular product branding programs was one of the top three reasons they use AMAs (see p. 7-45 of Volume 2 of the final report). Likewise, 60% of pork packers responded that the ability to secure higher-quality hogs was one of the top three reasons they use AMAs; however, only 6% of pork packers responded that they use AMAs for particular product branding programs (see p. 7-73 of Volume 2 of the final report).

Finally, we analyzed the relationship between measures of quality and use of different marketing methods using the transactions data and other USDA data. Fed cattle procured through marketing agreements—the primary AMA for beef—had the best trade-off in terms of level and consistency of quality across cash and AMAs (see Section 4 of Volume 3). Finished hogs procured through marketing contracts—the primary AMA for hogs—were of higher quality. Additional analyses of the quality of hogs found that a quality index and the use of AMAs are positively correlated (see Section 4 of Volume 4). Thus, the evidence from the study indicates that the desire to meet consumer demand for quality meat products is a substantial motive for the use of AMAs in the livestock industry.

Responses to questions from Senator Grassley:

1. **The RTI study discussed national markets extensively, but did it ever define the actual local/regional geographic markets in which producers sell their hogs/cattle?**

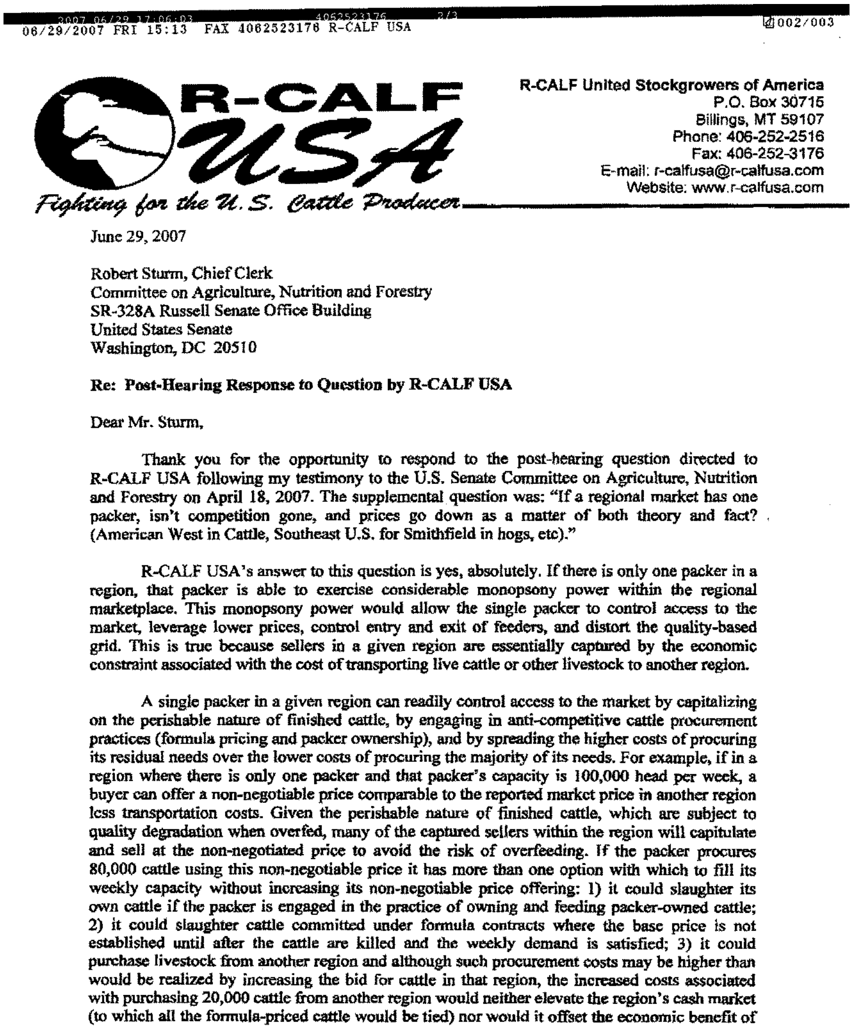
Response: In the study, we delineated three regions for cattle (Cornbelt/Northeast, High Plains, and West) and three regions for hogs (East, Midwest, and Other). For the purposes of this report, the CIPSEA of 2002 prevents the disclosure of confidential data collected for statistical purposes. Thus, results for individual plants or small geographic regions cannot be reported under the law. However, we considered regional differences in many of the analyses conducted for the study. Transactions data were analyzed at the individual plant level and were summarized by region of the country.

2. **Isn't it true that the risk of intentional price manipulation from captive supplies was beyond the scope of your study?**

Response: Yes. The study was a statistical analysis of the effects of AMAs and, thus, investigations into intentional price manipulation were outside of the scope of the study. It is also important to note that the CIPSEA of 2002 prohibits data collected for statistical purposes to be used for investigational purposes. For details regarding the scope of out study, please see the attached PWS.

3. **Can you name one person or organization the RTI authors consulted, among industry organizations and experts, that had very strong concerns about harm to competition from captive supplies and horizontal concentration in hogs or cattle?**

Response: All members of the study team, the trade association representatives with whom we met, and the industry participants we interviewed have strong concerns about the relative benefits and costs related to the use of AMAs. The analyses we conducted were designed to be objective and to use sound economic methods to evaluate these costs and benefits.



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R-CALF USA

Fighting for the U.S. Cattle Producer

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June 29, 2007

Robert Sturm, Chief Clerk
Committee on Agriculture, Nutrition and Forestry
SR-328A Russell Senate Office Building
United States Senate
Washington, DC 20510

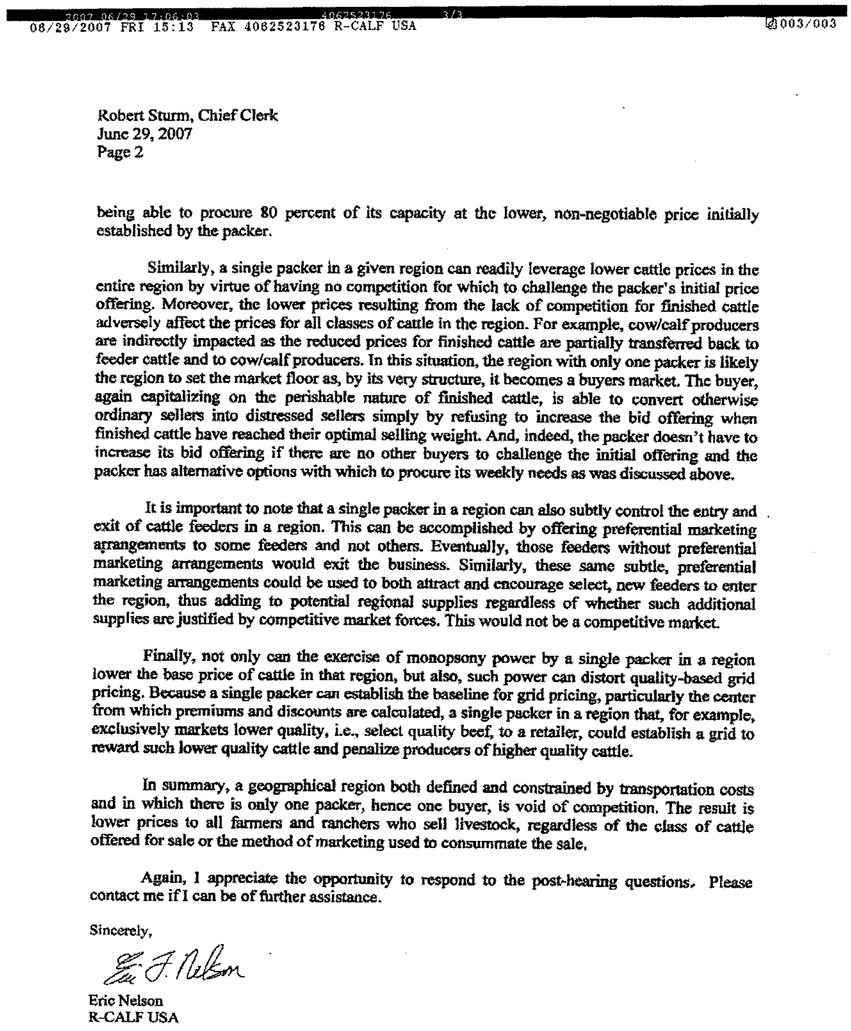
Re: Post-Hearing Response to Question by R-CALF USA

Dear Mr. Sturm,

Thank you for the opportunity to respond to the post-hearing question directed to R-CALF USA following my testimony to the U.S. Senate Committee on Agriculture, Nutrition and Forestry on April 18, 2007. The supplemental question was: "If a regional market has one packer, isn't competition gone, and prices go down as a matter of both theory and fact? (American West in Cattle, Southeast U.S. for Smithfield in hogs, etc)."

R-CALF USA's answer to this question is yes, absolutely. If there is only one packer in a region, that packer is able to exercise considerable monopsony power within the regional marketplace. This monopsony power would allow the single packer to control access to the market, leverage lower prices, control entry and exit of feeders, and distort the quality-based grid. This is true because sellers in a given region are essentially captured by the economic constraint associated with the cost of transporting live cattle or other livestock to another region.

A single packer in a given region can readily control access to the market by capitalizing on the perishable nature of finished cattle, by engaging in anti-competitive cattle procurement practices (formula pricing and packer ownership), and by spreading the higher costs of procuring its residual needs over the lower costs of procuring the majority of its needs. For example, if in a region where there is only one packer and that packer's capacity is 100,000 head per week, a buyer can offer a non-negotiable price comparable to the reported market price in another region less transportation costs. Given the perishable nature of finished cattle, which are subject to quality degradation when overfed, many of the captured sellers within the region will capitulate and sell at the non-negotiated price to avoid the risk of overfeeding. If the packer procures 80,000 cattle using this non-negotiable price it has more than one option with which to fill its weekly capacity without increasing its non-negotiable price offering: 1) it could slaughter its own cattle if the packer is engaged in the practice of owning and feeding packer-owned cattle; 2) it could slaughter cattle committed under formula contracts where the base price is not established until after the cattle are killed and the weekly demand is satisfied; 3) it could purchase livestock from another region and although such procurement costs may be higher than would be realized by increasing the bid for cattle in that region, the increased costs associated with purchasing 20,000 cattle from another region would neither elevate the region's cash market (to which all the formula-priced cattle would be tied) nor would it offset the economic benefit of



Robert Sturm, Chief Clerk
June 29, 2007
Page 2

being able to procure 80 percent of its capacity at the lower, non-negotiable price initially established by the packer.

Similarly, a single packer in a given region can readily leverage lower cattle prices in the entire region by virtue of having no competition for which to challenge the packer's initial price offering. Moreover, the lower prices resulting from the lack of competition for finished cattle adversely affect the prices for all classes of cattle in the region. For example, cow/calf producers are indirectly impacted as the reduced prices for finished cattle are partially transferred back to feeder cattle and to cow/calf producers. In this situation, the region with only one packer is likely the region to set the market floor as, by its very structure, it becomes a buyers market. The buyer, again capitalizing on the perishable nature of finished cattle, is able to convert otherwise ordinary sellers into distressed sellers simply by refusing to increase the bid offering when finished cattle have reached their optimal selling weight. And, indeed, the packer doesn't have to increase its bid offering if there are no other buyers to challenge the initial offering and the packer has alternative options with which to procure its weekly needs as was discussed above.

It is important to note that a single packer in a region can also subtly control the entry and exit of cattle feeders in a region. This can be accomplished by offering preferential marketing arrangements to some feeders and not others. Eventually, those feeders without preferential marketing arrangements would exit the business. Similarly, these same subtle, preferential marketing arrangements could be used to both attract and encourage select, new feeders to enter the region, thus adding to potential regional supplies regardless of whether such additional supplies are justified by competitive market forces. This would not be a competitive market.

Finally, not only can the exercise of monopsony power by a single packer in a region lower the base price of cattle in that region, but also, such power can distort quality-based grid pricing. Because a single packer can establish the baseline for grid pricing, particularly the center from which premiums and discounts are calculated, a single packer in a region that, for example, exclusively markets lower quality, i.e., select quality beef, to a retailer, could establish a grid to reward such lower quality cattle and penalize producers of higher quality cattle.

In summary, a geographical region both defined and constrained by transportation costs and in which there is only one packer, hence one buyer, is void of competition. The result is lower prices to all farmers and ranchers who sell livestock, regardless of the class of cattle offered for sale or the method of marketing used to consummate the sale.

Again, I appreciate the opportunity to respond to the post-hearing questions. Please contact me if I can be of further assistance.

Sincerely,

E. F. Nelson

Eric Nelson
R-CALF USA

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