DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

April 8, 1999

The Honorable Byron L. Dorgan
United States Senate
713 Senate Hart Office Building
Washington, D.C. 20510-3405

Dear Byron:

This is in response to your letter of February 26, 1999, to President Clinton, also signed by 22 of your colleagues, expressing continued concern about increased market concentration and vertical integration in agricultural markets and the effect of these developments on farmers and ranchers. I am responding on the President's behalf, and I can assure you that the Administration is likewise concerned about the effects of market conditions on our farmers.

As you noted in your letter, the National Economic Council (NEC), in response to the plunge in hog prices at the end of 1998, created a special task force to examine concentration and industry practices in the hog industry. This group brought together representatives of the Council of Economic Advisers; the Departments of Agriculture (USDA), Justice, and the Treasury; and the Federal Trade Commission. We have briefed interested Senate staff on the work and initial conclusions of that task force, and we have received valuable input from them. I am pleased to enclose with this letter the report of that task force, together with an executive summary. The report has been very useful to both the NEC and USDA in understanding the structure of the hog industry, marketing practices, and the farm-to-retail price spread. We hope it will also be useful to you and your staff.

The working group gathered information about the current structure of the hog processing industry and the causes for the recent significant decline in hog prices. It examined the presence of a "bottleneck" in slaughterhouse capacity in late 1998, which occurred just as hog production soared. It also examined the trend to greater use of forward contracting for hogs by packers and the effect that this practice has on the spot market.

The report includes a number of recommendations that we are beginning to implement. The most significant ones are Administration support for legislation to give the Secretary of Agriculture clear authority to require packers to report both prices and contract terms, and to publish such information on an aggregate basis to make livestock markets more transparent; and stepped-up efforts by USDA to find ways to help small producers participate more effectively in the contract market. The report also envisions the continuation of the interagency working group to monitor developments in the markets and make additional recommendations as appropriate.

We recognize that these recommendations are only a first step and that the continuing work of the interagency working group will be extremely important. As in the past, we expect to consult with you on the direction that the group should take, including whether to expand its inquiry beyond the livestock industry.

Thank you for sharing your concern with the Administration. We look forward to continuing to work with you and your staff on these important issues. I am sending identical letters to your colleagues who joined you in sending your letter.

Sincerely,

DAN GLICKMAN
Secretary

Enclosures

Fax Transmittal Cover Sheet

United States Department of Agriculture
Office of Communications

Andy Solomon, Deputy Press Secretary
Telephone: (202) 720-4623
Fax: (202) 720-5043

Date: 1/22/99

Name & Affiliation of Recipient: Tom Freedman / Mary Smith

Recipient's Fax #: 456-7431 No. Pages, Incl. Cover: 3

Message: _____

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

DRAFT

Honorable Janet Reno
Attorney General
Department of Justice
Constitution Avenue at Tenth Street, NW
Washington, D.C. 20530

Dear Ms. Attorney General:

Live hog prices have declined dramatically in the last few months without corresponding declines in wholesale and retail prices. The Department of Agriculture's (USDA) Grain Inspection, Packers and Stockyards Administration will examine current price spreads and packer pricing practices focusing on packer competition for retail sales. At the same time, I urge the Department of Justice to examine these abnormally wide price spreads and consider whether there is evidence that either packers or retailers are engaging in any activities that would allow them to maintain artificially wide price spreads or otherwise manipulate prices.

Prices to hog producers have fallen to levels not seen in over 50 years and the farm-to-retail price spread has risen to record levels. Retail prices always decline more slowly than prices at the farm level, but between November 1997 and November 1998, retail prices declined only about 2 percent (from $2.31 to $2.27 per pound). During the same period, wholesale prices dropped 21 percent (from $1.08 to $0.85 per pound), and farm-level prices dropped 60 percent (from $0.70 to $0.28 per pound), after adjusting for the value of byproduct credits. Since June, prices to producers have dropped 57 percent while wholesale prices declined 14 percent and retail prices declined only 1 percent.

Hog prices have been reported near $0.10 per pound in the spot market recently, after averaging over $0.41 in June of 1998 and over $0.51 for all of 1997. The National Pork Producers Council has reported that most pork producers are currently losing from $50 to $75 per hog sold, and producers as a group are receiving over $140 million per week less for their hogs than the average during the last 5 years. Large numbers of hog producers are threatened with financial ruin as are many related businesses and rural communities that depend heavily on pork production for a significant portion of their economic base.

USDA believes it is important to understand why farm prices have fallen to such critically low levels without a commensurate decline in wholesale and retail prices and requests that you investigate to assure the market is operating competitively. I am sending an identical letter to Federal Trade Commission Chairman Pitofsky.

Sincerely,

DAN GLICKMAN
Secretary

facsimile
TRANSMITTAL

hog pages

to: (See below)
fax #: (See below)
re: Hog Industry Task Force
date: January 15, 1999
pages: ~~21~~, including this cover sheet.
22

Per Harold Davis (USDA), the following information is forwward to you:

Dan Marcus, 456-1647

Will Tom, 326-2884

Roy Levy, 326-3443

John Nannes, 514-6543

Keith Collins, 690-4915

Dorothy Robyn, 456-2223

Howard Shelanski, 395-6870

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Sheldon, Kimmel, 307-3372

James Schaub, 690-4915

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Mary Smith, 456-7431

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Dan – Resent to include later version from DOJ.
Harold Davis

From the desk of...

Louise H. Jones
Secretary
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DRAFT cob January 15, 1999

REPORT OF TASK FORCE ON INDUSTRY STRUCTURE AND PRACTICES

I. Description of Pork Production and Marketing in the United States

A. Pork Producers

Over the last three decades the structure of hog production has trended toward fewer and larger operations, mirroring the general trend in the structure of American agriculture. In 1967 there were 1.047 million hog operations. This fell to 667,000 in 1980 and to 114,000 in 1998. Our most recent data show that between 1997 and 1998 the number of operations fell by 8,000 or 6.4 percent.

Large operations dominate the supply of hogs. Operations with more than 1,000 hogs accounted for only 5.9 percent of the operations in 1998 but 63.5 percent of total inventory. In just the past 6 years the percent of total inventory accounted for by these large operations has grown from 28 percent to 63.5 percent. There were 1,915 operations with over 5,000 head on inventory.

While large operations dominate hog supply, small operations with fewer than 100 head still account for 62 percent of all operations. These small producer account for only 2 percent of the U.S. hog inventory. Small hog operations are of insufficient size to provide a livelihood for their owners. Small operations are usually operated in conjunction with other farm enterprises such as grain production and with off-farm employment.

Hog production continues to be concentrated in the north central states. Iowa, Illinois, Minnesota, Indiana, Missouri, and Nebraska are major producers. Hog production has spread to other areas, notably North Carolina now the second largest hog producer, Oklahoma, and Colorado. Growth in these and a few other states has been characterized by a relatively few but very large operations.

The U.S. hog production has been becoming more efficient in general with larger operations tending to have higher litter rates and more litters per year than smaller operations. For example, operations with more than 5,000 hogs in 1998 had 24 percent more pigs per litter than operations with less than 100 head. Feed conversions to useable meat has been improving and the quality of hog marketed has improved. Producers are using improved genetic stock to produce more standardized hogs with carcass characteristics desired by meat packers and consumers. It is this ability to produce and deliver large lots of desirable quality hogs which explains in large part the trend we have seen in contracting.

Broadly defined, technology seems to be responsible for the geographic spread of hog production and the trend toward larger operations. Large confined operations appear to be more efficient and their location seems to be driven by low cost land, labor, and construction costs. It has been hypothesized that the stringency of state environmental regulations explains where new hog

production investment has taken place. Although empirical studies to date have not found conclusive evidence to support this conclusion, new state and local efforts to regulate hog facilities continue to emerge

B. Meatpacking

Press reports and many in the industry have blamed recent low hog prices, in part, on a lack of competition in hog slaughter and insufficient slaughter capacity. While the hog slaughtering industry has undergone consolidation in recent years, its current level of concentration is below the threshold level usually regerred to as "concentrated". In 1994, insufficient slaughter capacity also was blamed for low prices and low returns to producers. However, due to plant openings and expansion of existing plants, total hog slaughter capacity has increased since 1994 in spite of the closing of three large plants in 1997 and 1998. The data indicates there was excess capacity prior to these recent plant closings and the large increase in hog production in late 1998.

The four largest hog slaughter firms accounted for 54 percent of total commercial hog slaughter in 1997, up from 40 percent in 1990 and 34 percent in 1980. By comparison, the four largest firms accounted for 80 percent of federally-inspected steer and heifer slaughter in 1997. The eight largest firms accounted for 73 percent of total hog slaughter in 1996 (estimates aren't available for 1997), up from 58 percent in 1990 and 51 percent in 1980.

The Herfindal-Hirschman Index (HHI) is a measure of concentration used by the Department of Justice (DOJ) and Federal Trade Commission (FTC) in evaluating mergers. The HHI value for hog slaughter firms was 961 in 1996. An HHI value below 1000 is generally interpreted as indicating a relatively unconcentrated industry.

On a regional basis, there are fewer packers in the Southeast (NC, SC, VA), Southwest (TX, OK, NM), and West (CA, UT), because there are few large slaughter firms in each region. The four largest firms in each region slaughtered more than 90 percent of total federally-inspected hog slaughter in the region in 1997. However, a large share of the hogs produced in these regions is produced by packers or through contracts with growers. USDA's 1996 study of Concentration in the Red Meat Packing Industry found that geographic hog pricing patterns were consistent with a single national market for slaughter hogs.

The number of reporting hog slaughter plants (plants operated by firms purchasing $500,000 or more livestock annually) declined from 509 in 1980 to 232 in 1996. Average plant size has increased. The number of small and medium-size plants reporting to GIPSA (1,000 to 1,000,000 hogs per year) declined from 352 in 1980 to 169 in 1996, the latest available data. The number of large plants (over 1,000,000 head per year) also declined, from 41 in 1980 to 32 in 1997, but has remained constant since 1990. The average size of these large plants doubled from 1.4 million head in 1980 to 2.8 million head in 1997. Over half of the increase in the size of the

large plants occurred since 1990.

Plant openings and closings have resulted in some geographic redistribution of U.S. slaughter capacity, resulting in smaller shares for the Corn Belt and Plains regions and larger shares for the Southeast and Southwest regions. Capacity increased during the last five years due to new plant construction and expansion of existing plants in the Southeast and Southwest, primarily by Seaboard and Smithfield Foods, packers that both rely heavily on packer feeding and contract hog production. Capacity in the eastern Corn Belt (MI, IN, OH, PA, and KY) and Plains states (ND, SD, NE, KS, CO) has declined. Capacity in the western Corn Belt (MI, WI, IA, IL, MO) has remained essentially constant, as construction, reopenings, and expansion of some plants has offset closings of others. Major plant openings, expansion, and closings since 1994 include:

Openings

Plant	Location	Year	Weekly capacity
Farmland	Dubuque, IA	1996	60,500
(purchased, re-opened plant FDL closed in 1995)			
Seaboard Farms	Guymon, OK	1995	82,500
IBP	Logansport, IN	1995	73,700
(re-opened and expanded former Wilson plant)			
Premium Standard	Milan, MO	late 1994	38,500
Total			255,200

Expansions

			Increase
Smithfield	Tar Heel, NC	1994-98	82,500
(originally opened late 1992)			
Excel	Ottumwa, IA	1998	24,750
IBP	Waterloo, IA	1998	5,500
Indiana Pack	Delphi, IN	1996	22,000
Hormel	Austin, MN	1995	16,500
Hormel	Fremont, NE	1995	9,350
Total			163,350

Closings

			Weekly capacity
Thorn Apple Valley	Detroit, MI	1998	77,000
Dakota Pork	Huron, SD	1997	41,800
IBP	Council Bluffs, IA	1997	40,150
Fisher	Louisville, KY	1997	16,500
Premium Pork	Moultrie, GA	1996	25,850
Worthington Pack	Worthington, IN	1996	25,850
FDL	Dubuque, IA	1995	60,500
Total			287,650

C. Retailers

(Insert 1)

Insert 1

Retail Grocery Segment

1/15/99 DRAFT

The retail grocery segment supplies pork products, as well as other food items, directly to consumers. At the national level, the concentration of sales among chain and other grocery retailers has traditionally been relatively low, but has been increasing in the past few years. In 1997, for example, over 200 chain grocery stores operated in the U.S., along with several thousand independent grocers, and the 4 largest chains -- Kroger, Safeway, Albertson's, and American Stores -- accounted for approximately 23 percent of all supermarket sales.[1] If all the recent grocery mergers are consummated, the largest 5 chains may account for 40 percent of sales. At the local level, where competition for consumer dollars occurs, concentration of sales is generally higher, but varies across local areas. In 1996, for instance, the data in Table 1 indicate that the 4 largest supermarket operators accounted for 96 percent of sales in Miami and 52 percent of sales in New York. Table 1 also summarizes concentration for a select sample of a few other large metropolitan areas.

Recent conduct within the retail grocery segment coupled with ongoing developments within the pork processing industry have raised questions about what factors contribute to the prices grocers set for pork products in the short run. In particular, hog producer organizations that include the National Pork Producers

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[1]These data were computed from information contained in the *Directory of Supermarket, Grocery, & Convenience Store Chains*, 1998, and from statistics published by the Food Marketing Institute.

Table 1
Four-Firm Concentration of Supermarket Sales by Metropolitan Area for 1990 and 1996

Metropolitan Area	1990	1996
Boston	63.0	80.2
Chicago	85.4	82.4
Cleveland	83.2	85.9
Dallas	71.5	71.1
Detroit	85.0	77.5
Kansas City	86.7	85.2
Los Angeles	79.8	75.5
Miami	96.2	96.0
Minneapolis-St. Paul	98.5	99.5
New York	52.7	52.0
Philadelphia	75.5	68.5
Washington D.C.	81.9	82.8

Source: 1991 and 1997 Editions of *Market Scope*.

Council, question why the retail prices of pork products have not declined more substantially in the face of the recent sharp declines in hog prices.[2] Some suggest that instead of increasing pork product sales by reducing prices or otherwise promoting these products, grocery retailers have maintained relatively high prices for these products. Several considerations, however, suggest that the recent behavior of retail prices for pork, as well as other products, is largely the result of competitive forces.

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[2]Hog producers have also expressed concerns over long run trends in the prices of retail pork products relative to prices at the wholesale and producer levels. They indicate grocery retailers account for an increasing share of the sales dollar in this product category. These long run price trends are discussed further below.

The discussions on hog producers and packers above suggest that a combination of a few key variables may explain the recent rigidity of retail prices in the face of significant declines in hog prices. Most important among these are: (1) the significant glut in the availability of hogs for slaughter; (2) indications that packing plants are operating near short run capacity levels; and (3) robust downstream demand for pork products due to seasonal and other factors. Under these circumstances, price declines for hogs could significantly outpace price declines at retail, at least until the supply of hogs adjusts or capacity constraints at packing plants no longer limit pork production.

More generally, other factors also add to any explanation of the possible rigidity of retail pork prices in the face of significant changes in hog prices. First, readily available sources of data on retail prices, particularly data from the Bureau of Labor Statistics (BLS), might not fully reflect actual sale prices for pork products, leading to an upward bias in reported prices. In fact, grocery retailers maintain that pork product prices have declined by as much as 19 percent in the last year, even though BLS data record declines of only 2 to 3 percent.[3] This would be consistent with the view that consumers inventory pork and other meat products by purchasing most of their requirements at lower sale prices, but that these transactions are not fully reflected in the widely-cited BLS prices. Clearly, while BLS data are appropriately used in a wide variety of applications, a more systematic

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[3]See David Barboza, "The Great Pork Gap," *New York Times*, January 7, 1999.

assessment of transactions-type data would be necessary to better understand the adjustments of retail pork prices to changes in the prices of hogs.[4]

Second, prices at retail depend on a number of factors, including a number of input costs that are not faced by hog producers. These would include the costs of refrigerating, packaging, and marketing fresh pork products. In fact, an index that measures food marketing input prices increased 336 percent between 1968 and 1996.[5] These rising costs would have a more direct impact on retail than producer level prices, and could account for some of the divergence in prices of retail pork products and slaughter hog prices over time.

Third, research indicates that frequent changes in retail prices impose significant costs on grocery retailers, referred to in the literature as "menu costs".[6] In a recent study of the magnitude of these menu costs, researchers note that significant menu costs create barriers to changing prices at retail, and represent a source of price rigidity for at least some food items.[7] Menu costs could also explain observed lags in the adjustment of retail pork prices to changes in prices at the producer level as retailers attempt to control their costs by limiting price

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[4]Proprietary sources of data exist that may provide for a more accurate assessment of retail price changes, including retail grocery scanner data.

[5]See "Meat Price Spreads: What Do They Indicate," *Agricultural Outlook*, December, 1997, p 13. This article contains a broader discussion of factors that contribute to a divergence of retail pork and hog prices.

[6]Menu costs include the labor, material, and other costs associated with changing prices at retail establishments.

[7]See Daniel Levy *et al.*, "The Magnitude of Menu Costs: Direct Evidence From Large Supermarket Chains," *Quarterly Journal of Economics*, August, 1997.

changes, especially in the case of adjustments to frequent reductions in hog prices.[8] In any case, these lags lead to differences in price changes at the hog production and retail grocery levels of the industry.

Finally, while there has been some concern that high levels of concentration and consolidation among retail grocers may suggest that pork and other prices at retail are the result of competitive problems, evidence suggests otherwise. Consolidation among supermarket operators would not necessarily explain the long-term trend toward a widening gap between pork prices at retail and prices at other levels of the industry,[9] largely because mergers, if they are anticompetitive, are likely to cause more discrete increases in price.[10] In addition, the exercise of retail market power would be unlikely to generate higher retail prices in pork relative to other products.

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[8]Other reasons mentioned for the lags in these price adjustments include: (1) storage of processed pork and other factors that allow time to pass as products move through the various chains of distribution; and (2) retailer concerns over the reaction of consumers to sharp price changes, particularly price reductions followed by price increases. For a discussion of these issues, see "Meat Price Spreads: What Do They Indicate," *Agricultural Outlook*, December, 1997, p 14.

[9]An alternative explanation is that hog producers have innovated more rapidly than retail grocers, lowering their costs and prices relative to prices at the retail level of the industry. Although lower hog prices would eventually lead to reductions in retail pork prices if the retail segment is competitive, differences in productivity growth could remain. Data on the overall growth in the productivity of hog producers would support this trend, other factors equal.

[10]It is noteworthy that changes in concentration of supermarket sales appear to be more sporadic. The data in Table 1 indicate that, with the possible exception of Boston, concentration did not significantly increase in the subject metropolitan areas from 1990 to 1996. This also raises doubts about the view that trend changes in pork or other prices are related to merger activity in the grocery industry.

Overall, in addition to variations in the price of hogs, retail prices for pork products are likely to be influenced by a number of factors that could cause a divergence of prices at different levels of distribution. This divergence does not itself mean that retail grocery chains are fixing prices or are otherwise engaging in anticompetitive conduct that warrants intervention at the retail level.

II. Issues

A. Slaughter Capacity

Recent trade press reports and comments by the National Pork Producer's Council attribute the current low hog prices in part to insufficient slaughter capacity. Three plants closed by Thorn Apple Valley, Dakota Pork, and IBP in 1997 and early 1998 contributed to the shortage of slaughter capacity when hog supplies were very large in late 1998. However, the three firms claimed their decisions to close the plants were based on inability to operate the plants profitably, based on price and cost relationships at those specific plants at the time they were closed. For the industry as a whole, openings and expansions of other plants have increased total slaughter capacity by about 66,000 head per week (about 3.4 million head per year) since 1994, the last time low prices were blamed on insufficient capacity.

According to some industry members and market analysts, excess hog slaughter capacity existed in 1997 and was expected to continue beyond 1998.[1] That forecast underestimated the speed of the expansion in hog production that was already underway at that time. Ronald Plain at the University of Missouri said in February 1997 that it was likely the industry would reach slaughter levels of 100 million head per year within five years.[2] The expansion occurred faster than Plain anticipated in 1997. Slaughter volumes in late 1998 were equivalent to an annual slaughter rate of 100 million head.

Smithfield Foods has temporarily shelved plans for construction of a new plant in Utah, where the company is developing an integrated production system similar to the one it has in the Southeast. Smithfield purchased the Dakota Pork plant in Huron, South Dakota subsequent to the plant's closing in 1997, and also purchased a closed Georgia plant in

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[1] For example, John Lawrence at Iowa State University said throughout 1997 and 1998 that packer capacity was expected to remain in excess of hog supplies for several years. John D. Lawrence, "What's Ahead for the U.S. Pork Industry: 1997," Iowa State University, paper presented at National Pork Producers Competitiveness seminars in 1997 and 1998.

[2] Ronald L. Plain, "Changing Structure of the U.S. Hog Industry -- U.S. and Abroad," University of Missouri-Columbia, February 6, 1997.

1996. Smithfield Foods has given no indication it intends to reopen either plant. Questions have been raised about why Smithfield acquired closed plants. Seaboard has plans to build an additional plant in Kansas, and IBP reportedly is considering an additional plant in Kansas, but neither of these firms appear to be actively implementing these plans. Most new plant capacity in recent years has been associated with plans to expand contract hog production. In some cases, hog production was begun but the new packing plants weren't built.

Hog slaughter capacity expansion is affected by regulations and public resistance derived from environmental concerns. Several recent press reports have indicated that Smithfield Foods' Tar Heel, North Carolina plant is restricted to operating at 75 percent of capacity due to regulatory restraints on the volume of wastewater it may discharge. Hog slaughter plant expansion is also influenced by environmental constraints on hog production. Packing firms are less likely to initiate expansion plans if they believe hog production may be constrained or even reduced by environmental regulation. There have been and continue to be many instances of resistance to, and often regulatory denial of, producers' attempts to implement plans for expansion of hog production.

Although perhaps not the sole or even primary factor delaying Smithfield's, Seaboard's, or IBP's expansion plans, but it would be reasonable to conclude that environmental factors will play a significant role. Smithfield's and Seaboard's plant expansion plans also include expansion of both company owned and contract hog production facilities. All of these plans are affected by environmental regulations. Environmental restraints are not limited to the United States. A May 1998 Feedstuffs article reported that plans to construct a 5,000 head per day hog slaughter plant in Alberta, Canada were canceled due to public concerns about environmental impacts.

In summary, although recent low hog prices were influenced by limited slaughter capacity, there is no indication that the insufficient capacity and low hog prices resulted from non-competitive behavior by the meatpacking firms. Three large plants closed during the past 2 years due to high operating costs and low revenue conditions facing those plants. A number of factors would explain why packers did not expand slaughter capacity enough to handle all of the hogs that were produced in late 1998.

B. Contracting Practices

A large and growing proportion of hogs is produced and marketed under some form of contractual arrangement. Production contracts often specify production practices and genetics that help assure that hogs will conform to a packer's product requirements. Contract producers provide packers a steady supply of hogs, which leads to slaughter efficiencies. Contract arrangements have enabled producers to enter or expand in the hog industry and to reduce some price risks for hogs and feed.

Producers are concerned that hog production will follow the path of contrac poultry

production. Poultry production is heavily vertically integrated with poultry processors owning the chicks and contracting with contract growers for the finishing of the birds. The integrators also provide the feed. The term of poultry contracts is very short, usually covering a single flock, which is about six weeks. Growers are compensated for the use of their facilities, their time and their management of the flock. Grower payments are based, in part, on a grower's performance (for example, feed conversion efficiency) relative to the performance of other growers who receive birds at the same time.

At the current time, hog farmers normally own the pigs and sell the finished animal to the packer under a marketing agreement or contract arrangement. Payment terms under the contracts vary and contracts may have a term of several years. Some contracts pay on the basis of costs of production, but most pay on a formula with a basis of spot market hog prices or futures market prices. Hog contracts generally do not include payment provisions that link a producer's payment to the performance of other producers.

Many hogs are sold through long-term contractual arrangements that provide price guarantees to producers and packers if market prices fall outside a specified range or window (for example $30 to $40 per cwt). If market prices fall within the price window, the packer pays the market price.. If market prices fall below the window ($20 for example), the packer is obligated to pay a price that is above the market price but usually less than the lower window price ($25 for example). Conversely, if market prices exceed the upper limit ($50 for example), the packer pays less than the market price but usually more than the upper window price ($45 for example). Most of these contracts were initiated when market prices were considerably above current levels. Producers who entered into the contracts gave up some opportunity for high prices in return for a guarantee against very low prices. Packers in turn provided the price guarantee to assure a steady supply of hogs and protect against very high prices.

With some marketing contracts, called ledger contracts, some or all of the difference between the market price and the guaranteed price is recorded as a loan. Producers incur a debt obligation to the packer when the guaranteed minimum price is above actual market prices. Packers incur a debt obligation to the producers when the guaranteed maximum price is below actual market prices. When market prices are low, producers accumulate debt to the packer and the packer incurs above-average procurement costs. When market prices are high, packers enjoy low procurement costs but will owe money to the producers. At the time the contract expires, either party may have an outstanding balance in the ledger account that is owed to the other party. These contracts differ in the way the outstanding balance is handled, but frequently limit the choice to either paying off the balance or extending the contract. Although there is wide variation among the contracts, many have windows with lower limits around $35.00 and upper limits around $45.00. The recent low hog prices have caused some producers to accumulate large debts to packers. Prices would need to exceed $45.00 for an extended period of time to offset these debt obligations. Producers and packers who rely heavily on these ledger contracts may face considerable financial exposure.

The Grain Inspection, Packers and Stockyards Administration (GIPSA) recently completed a study of procurement practices in the western Cornbelt, which showed that hogs delivered on contracts were generally priced above those put into the residual, spot market. A followup investigation is underway to assess reasons for the price differences and to analyze contract terms to determine if any provisions violate the Packers and Stockyards Act.

Some smaller producers claim that forward marketing contracts, as a practical matter, are not available to them, putting them at an unfair competitive disadvantage. Some have called for outlawing such contracts. Available data indicate that many small producers do use forward marketing contracts and there is no evidence that the limited use of such contracts by small producers reflects any discriminatory practices by meat packers.

About 57 percent of hogs were marketed under some type of marketing contract with a packer in 1997 according to a recent report by Lawrence, Grimes and Hayenga.[3] This is up from 11 percent in 1993. Small and large growers both use marketing contracts, although large growers rely on them more. About 24 percent of the hogs sold by growers producing 1,000 to 2,000 head per year were sold under a marketing contract, while some 92 percent of hogs sold by growers producing more than 500,000 head per year were sold under such contracts.

Lawrence, et. al, reported that approximately 37 percent of hogs were finished by contract growers in 1997.[4] Sixteen percent of the hogs were finished under contract for firms that produced over 500,000 hogs in 1997. However, smaller firms that marketed 1,000 to 50,000 hogs per year also contracted with others to produce hogs for them, and these hogs accounted for eight percent of all slaughter hogs in 1997. Data are not available on the size of growers who produce hogs under contract for other firms, although many of them are likely to be relatively small.

Smaller producers can take several steps to enhance their operations and marketing opportunities For example, Lawrence, et. al, reported that many growers of all sizes are using networking linkages with other producers, feed companies, veterinarians, etc. to reduce costs, improve hog quality and market their hogs. The authors reported that among smaller growers producing less than 50,000 hogs per year in 1997, approximately 14 percent participated in hog marketing networks; 10 percent in pig production

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[3] John Lawrence, Glenn Grimes and Marvin Hayenga, "Production and Marketing Characteristics of U. S. Pork Producers, 1997-1998," Staff Paper 311, Department of Agricultural Economics, Iowa State University, December 1998.

[4] Hogs production may be separated into farrowing and finishing operations. Farrowing includes breeding sows and producing feeder pigs weighing about 20-30 pounds. Finishing operations grow the feeder pigs to slaughter weights of about 250 pounds. Farrowing and finishing operations often are combined, but may be performed by different producers.

networks; 9 percent in information sharing networks; and 8 percent in input purchasing networks.

Cooperatives play a major role in all aspects of production, marketing and slaughter of hogs and the sale of pork products. However, many obstacles make it difficult to form successful new cooperatives, so cooperatives are not a panacea for hog producers. There may be other opportunities for hog producers to form cooperatives to improve their efficiency and marketing opportunities. The most practical opportunities may lie with the formation of hog breeding and marketing cooperatives. Substantial obstacles limit opportunities to form cooperatives to operate slaughter facilities--large amounts of capital are required to operate plants that are large enough realize important size economies. USDA's Rural Business-Cooperative Services agency works aggressively with farmers to develop and successfully manage cooperatives.

The Nation's largest agricultural cooperative, Farmland Industries, owns and operates four hog slaughter plants and five additional facilities that further process pork into consumer-ready products. Farmland is a leader in the use of hog production and marketing contracts. Farmland was the first major hog slaughtering firm to begin voluntary daily reporting of individual plant prices on the Internet. Farmland also established a $15 per cwt base-price floor for hogs in December 1998 to help producer owners when spot market prices fell below $10 per cwt. Three of the Nation's largest agricultural cooperatives own and operate hog breeding herds: Land O' Lakes, Farmland Industries, and Gold Kist. National Livestock Producers Association (NLPA) members represent 10 of the 11 largest regional livestock marketing cooperatives in the United States and account for a large volume of hog sales.

As the volume of hogs traded on the spot market has declined, concerns have arisen about the accuracy and reliability of prices reported by market news services. GIPSA's investigation of the range of procurement and pricing arrangements for hogs in the western Cornbelt indicated that reported prices generally are lower than prices actually paid for hog because the base hog for which prices are publicly reported does not reflect the characteristics of typical carcasses. Consequently, the Agricultural Marketing Service is revising its reporting methods to report prices that reflect leading marketing practices. Moreover, GIPSA's analysis confirmed that higher prices tend to be paid when hogs are sold through marketing agreements based on carcass merit and that lower prices are paid for hogs sold on the spot market on a live weight basis. GIPSA has continuing oversight responsibility to monitor for violations of the Packers and Stockyards Act (Act). GIPSA is actively engaged in monitoring the industry for predatory or anticompetitive activity in violation of the Act and has established an office in Des Moines dedicated to addressing pork industry issues.

C. Increasing Price Spreads

(Insert 2)

Insert 2

ISSUE: Increasing Price Spreads

Hog producers have expressed concern about the apparent increase in the "price spread" for pork – the difference between the price paid to the producer by the packer and the price paid by the consumer to the retail grocer. This is often stated in terms of the producer getting a diminishing share of the consumer's dollar, with the rest going to processing and marketing middlemen. The concern is that these increasing price spreads may reflect anticompetitive practices on the part of the packers or retailers.

In analyzing price spreads, it is important to look at spreads over both the short and long term, and to focus on constant-dollar figures that, unlike nominal prices, control for the effect of inflation. It is also useful, in considering whether spreads may be suggestive of anticompetitive activity, to separate farm-to-retail price spreads into farm-to-wholesale and wholesale-to-retail segments.

These distinctions are important because, if anticompetitive activity were distorting prices, price-distorting effects would be expected to show up in long-term increases in the farm-to-retail price spread, beyond any increase attributable to overall inflation, and to show up in a way that indicates that those engaged in the anticompetitive activity are benefitting at the expense of others up and/or down the marketing chain.

Long-term changes in price spread

These hallmarks of possible anticompetitive activity have not been evident with pork. In fact, as the attached chart shows, if the effects of inflation are removed, the long-term farm-to-retail price spread for pork, expressed as an annual average, has remained essentially constant since at least as far back as 1970. What's more, the farm-to-wholesale segment of the price spread has declined more than the overall farm-to-retail spread, while the wholesale-to-retail segment has increased; this is the opposite of what would be expected if the packers were engaged in anticompetitive activity.

The price-spread statistics might suggest the possibility of anticompetitive activity at the retail grocer level. But if that were the case, wholesale-to-retail price spreads would be expected to be noticeably greater in areas in which there are fewer competing retail grocers. In fact, however, we do not observe such differences. [FTC, who has enforcement responsibility and experience at the retail level, should refine and elaborate this paragraph.]

If price statistics are looked at in a slightly different way, they show that the farm-retail pork price spread has kept up with inflation, while the farm-wholesale price spread has not. Viewed in isolation, one might argue that this indicates that packers have been

suffering. However, such an argument would not properly take into account the cost savings that packers have attained as a result of innovations in production and marketing. Likewise, although farm prices have also not kept pace with inflation, there are cost savings at work at the farm level as well - for example, increased yields per sow and specialization within the "farrow-to-finish" process. [USDA has expertise in this area and may want to refine this paragraph.]

Family hog farmers may also be subject to a predicament faced by family farmers in general; they are, to an unusual extent, tied to their occupation, even when the pay from that occupation falls very low. With steady gains in productivity, there is a natural tendency toward oversupply. Family farmers can -- in theory -- respond by leaving the farm to pursue other occupations, just as occurs in other occupations where there is an oversupply. But farmers face hurdles not generally found in other occupations. For one thing, a family farmer generally owns the capital -- the land and the equipment -- and often has the family's personal finances tied up in that capital, having incurred debt to obtain or increase it. For another, a family farm is generally passed on from one generation to the next, much more so than in other occupations, with a corresponding emotional pressure on the next generation to maintain it. Indeed, more than most occoupations, farming is considered not just an occupation but a way of life. For these reasons, exit by family farmers can lag behind market signals, leading to a tendency toward oversupply that makes it difficult for producers to keep pace with overall price increases in the economy. These kinds of effects have been experienced throughout the farm sector.

Our society has strong reasons for wanting to help as many people as possible who so desire to remain profitably engaged in farming, and for most of this century this has been a central farm policy goal. While pursuing this policy goal has benefitted our society in some important respects, it may well have also heightened the long-term oversupply problem.

Short-term price spread changes

While long-term price spread data do not suggest anticompetitive activity, there clearly has been a recent increase in price spread changes. The suddeness and magnitude of the recent increase warrants consideration.

Short-term fluctuations in the price spread -- even dramatic ones -- do not by themselves demonstrate anticompetitive activity. In a competitive market where supply and demand fluctuate, we would expect to see corresponding fluctuations in price, and price spread, over the short term. There is considerable evidence, in studies going back over a few decades, that this is the case for many agricultural commodities, including pork.

In a perfectly competitive market, we would expect to see price changes at one level quickly transmitted up and down the marketing chain, with lag times that should be similar for increases and decreases alike. The actual experience is somewhat different. Price increases at the farm and wholesale level are reflected much more quickly at the retail level than are price decreases.

There are factors explaining this asymmetry that suggest factors other than anticompetitive activity as the underlying cause(s). Retail grocers are generally reluctant and slow to lower retail food prices in response to short-term wholesale price reductions for numerous reasons. First, for perishable commodities such as fresh meat, grocers are already under some pressure to move product that has been in the stores the longest period first, before it spoils. Yet, many consumers tend to look for the product that has been in the stores the shortest period, so it will last in their refrigerators the longest. Thus, in order to lower the retail price of the new, lower-cost pork, the grocer would also have to lower the retail price of the older, higher-cost pork, likely taking a loss on it. This problem does not arise when the newer cuts are priced higher than the older cuts. This problem is exacerbated by the expense involved in re-marking cuts of meat to reflect the new lower price -- an expense that is easier to justify when marking up a cut of meat than when marking one down.

Second, against a backdrop of an overall inflationary trend in the economy, wholesale price reductions, because they go against the trend, are regarded as more transitory than wholesale price increases. A retail grocer who marks down prices expects to be reversing course shortly -- especially since his other costs are generally rising with inflation, regardless of short-term trends in the wholesale price of the commodity -- while a retail grocer who marks up prices does not expect to be reversing course. Grocers often express concern that their consumers will remember price increases more clearly than price decreases. While this will not prevent a grocer from eventually marking down a product in response to an enduring wholesale price reduction, it does slow down the grocer's response.

Price-spread data problems

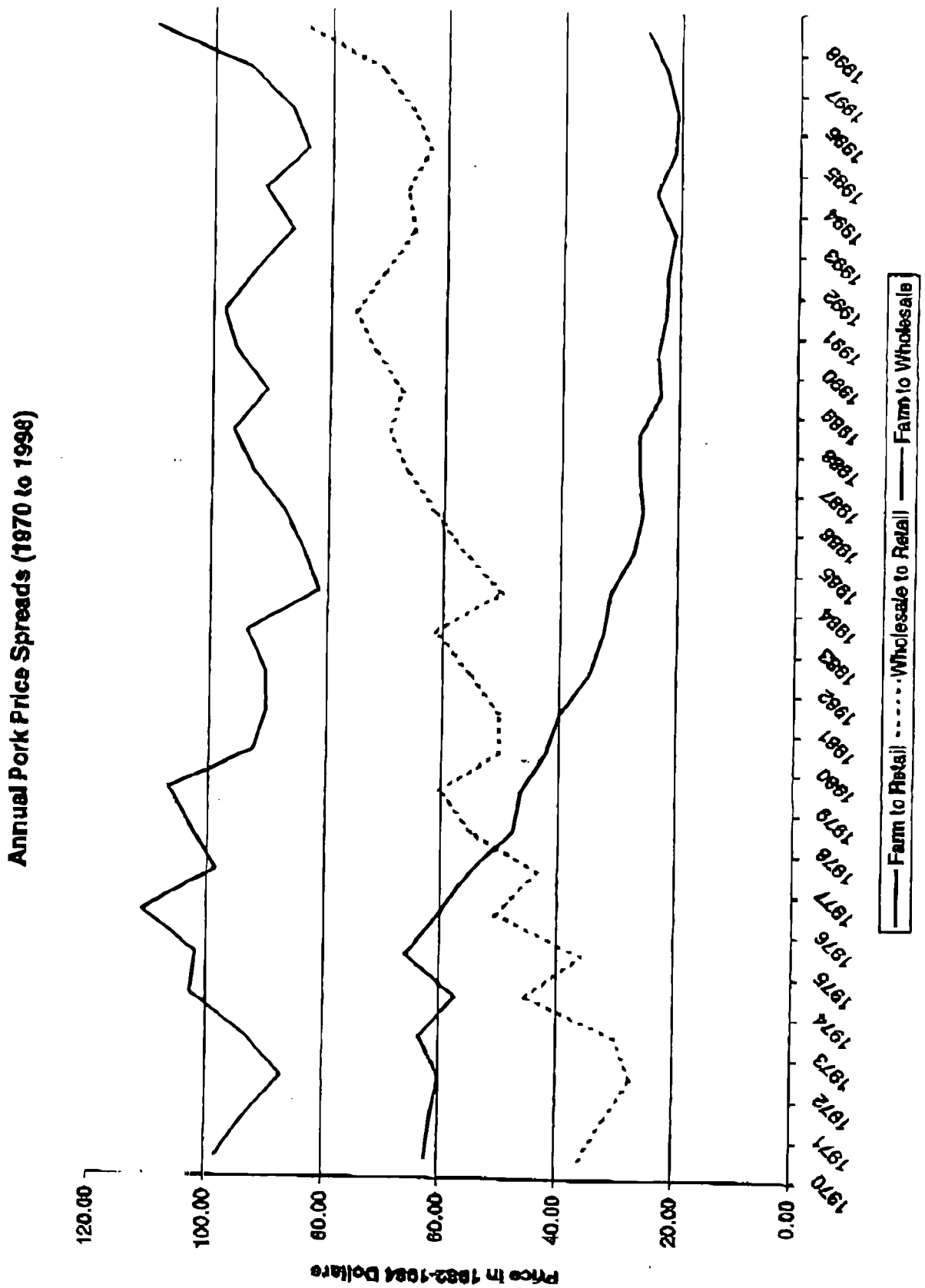
It should be noted that the reported retail prices, which are unweighted averages, do not adequately take into account the specials that grocers often run to move product at a reduced price, and the tendency of consumers to buy extra quantities during specials and stock up their freezers at home.

Additionally, the precipitous decline reported in wholesale pork prices in the last few months significantly overstates what has happened in the overall wholesale pork market. This is because the reported prices are spot market prices, and do not include sales under longer-term contracts. Historically, spot sales have constituted the lion's

share of the market; that has changed very dramatically over the last year or two, and contract sales now predominate. Because the contract sales are locked in far in advance, the volatility in the market is concentrated in the smaller spot market. As a result, recent events that have led to substantial oversupply relative to demand for hogs have depressed spot market prices far more than the forward contract market could have anticipated even as late as last summer. Pork producers who continue to sell primarily on the spot market have indeed suffered far greater farm price declines than usual, but they constitute a smaller and smaller share of the market.

Conclusion

In short, while price spread statistics implicate important farm policy concerns, they are not inherently suspicious from an antitrust perspective.


Annual Pork Price Spreads (1970 to 1998)
Price in 1982-1984 Dollars
120.00
100.00
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Farm to Retail
Wholesale to Retail
Farm to Wholesale

Press Release

Senate Agriculture, Nutrition and Forestry Committee

Chairman Dick Lugar, U.S. Senator for Indiana

Contact: Andy Fisher (202) 224-2079 or Tiffany Steele (202) 224-7435

Date: 1/21/99

Agriculture Committee Announces Witnesses for Concentration Hearing

WASHINGTON -- The Senate Agriculture, Nutrition and Forestry Committee today announced the following witnesses for a hearing to examine economic concentration in agribusiness:

What is Consisting? What have we done?

The Honorable Byron Dorgan
Senator, State of North Dakota

Panel I
Keith Collins
Chief Economist, U.S. Department of Agriculture

Mark Drabenstott
Vice President and Director, Center for the Study of Rural America, Federal Reserve Bank of Kansas City

C. Robert Taylor
Professor of Agricultural Economics, Auburn University

Panel II
Dean Kleckner
President, American Farm Bureau Federation

Leland Swenson
President, National Farmers Union

Donna Reifschneider
President, National Pork Producers Council

Paul Hitch
Chairman, National Cattlemen's Beef Association's Live Cattle Marketing Committee

Steve Hunt
Chief Executive Officer, U.S. Premium Beef

Panel III
Frank Sims
President, North American Grain Division, Cargill, Inc.

Patrick Boyle
President and CEO, American Meat Institute

The hearing will take place Tuesday, January 26, at 9:00 a.m. in SR-328A. Individuals with disabilities who require an auxiliary aid or service should contact the Chief Clerk or Hearing Clerk at 224-2035 no later than Thursday, January 21.

###

NATIONAL CATTLEMEN'S BEEF ASSOCIATION
1301 Pennsylvania Ave., NW, Suite #300 • Washington, DC 20004 • 202-347-0228 • Fax 202-638-0607

January 7, 1999

The Honorable Dan Glickman
Secretary of Agriculture
200-A Administration Building
Washington, D.C. 20250

Dear Secretary Glickman:

In our most recent letter to you regarding the pork situation, we voiced our concerns that many of the new initiatives would require substantial government intervention and utilize schemes that historically have proven to have disastrous impacts on other livestock sectors. Unfortunately, the reports out of Washington suggest, despite past assurances to the contrary, there is serious consideration of pork initiatives that would result in direct payments to hog farmers.

These "new" initiatives that we are aware of include:

- A non-recourse marketing loan on live hogs allowing producers to utilize the loan deficiency payment provision.
- Up to $50 million in direct payments to "small" hog producers.
- Establishing a floor price for market weight hogs.

In addition, there also are the suggestions from various interest groups that include sow-herd buyouts, subsidized futures contracts, "gilt lifts" to Latin American countries, etc.

None of these proposals seem to give consideration as to how these types of government intervention will economically impact other livestock sectors, despite the reality that over the past 18 months, cattlemen have lost $4.04 billion in equity compared to $1.3 billion in equity losses for pork producers. From a political standpoint, as cattlemen begin their fourth year of fighting depressed prices, we must ask, "Why not?"

During the past three years, we have been appreciative of your use of existing programs and authorities such as domestic feeding program purchases, foreign aid, GSM, etc., to prevent the losses to beef producers from being worse than has been experienced. We certainly have been aware and sympathetic to the plight of hog producers in recent months and supportive of your similar efforts to stem the hemorrhaging in their industry.

However, these new proposals are leading to tremendous pressure from the grassroots to ensure that cattlemen are included in any initiative being considered. If any of these reported new pork initiatives move forward without full and careful consideration of the equity losses experienced in the beef industry over the past three years, there will be commodity-against-commodity conflict.

As we stated three weeks ago, there is no silver bullet. We again urge you to carefully review all options to improve commodity prices across the board, reject the proposals that will lead to disastrous policy and political consequences, and work with all sectors on those solutions that will help us work together to build a bridge back to profitability in agriculture. We stand ready to work with you in any way that we are able.

Sincerely,

Clark S. Willingham
President

Charles P. Schroeder
Chief Executive Officer

6031 S.W. 37th Street • Topeka, Kansas 66614-5129 • (785) 273-5115

KANSAS LIVESTOCK ASSOCIATION

FOR

KLA fax number: (785) 273-3399

Transmitted to: _____

Date transmitted: 1-7-99

To: Honorable William J. Clinton

From: Larry Oltjen

Header sheet (+) 2 page(s)

Comments: _____

NOTE: Should problems occur with this transmission, please contact me at the above number. Thank you.

KANSAS LIVESTOCK ASSOCIATION

Since 1894

January 7, 1999

The Honorable William J. Clinton
President of the United States
1600 Pennsylvania Ave., NW
Washington D.C. 20500

The Honorable Albert Gore, Jr.
Vice President of the United States
Old Executive Office Building
Washington D.C. 20501

Gentlemen:

I am sincerely disappointed to hear the Administration is considering a $5 per head subsidy payment to pork producers. We are well aware of the serious financial plight of our friends in the pork industry. Beef cattle producers who have lost from $2.5 to $3 billion in equity since late 1997 can certainly sympathize with swine producers. We must object, however, to a program that is unfair and establishes a bad precedent for agriculture policy.

We've supported USDA's previous efforts to enhance federal purchases of pork and beef for international assistance and government feeding programs. These actions are more appropriate as they address the large supply situation and are nondiscriminatory in nature. A direct payment to a select group of pork producers is establishing a precedent for a new government commodity program that has consistently been opposed by the Kansas Livestock Association and most state and national livestock producer organizations.

Let's work together on activities that provide long term marketing opportunities for all livestock producers. You can help by continuing and increasing your Administration's efforts to gain access to foreign markets. Tempering the onslaught of new environmental regulations aimed at confined livestock facilities will lessen the financial burden of producers, especially small and moderate sized pork producers.

This latest proposal is the wrong approach and one I hope the Administration will reconsider.

Sincerely,

Larry Oltjen
President

cc: Secretary Dan Glickman

6031 SW 37th Street Topeka, KS 66614-5129 (785) 273-5115 Fax (785) 273-3399 E-mail: kla@kla.org

THE WHITE HOUSE
WASHINGTON

Pork

January 7, 1999

MEMORANDUM FOR: GENE SPERLING
RON KLAIN
JACK LEW
BRUCE REED
LARRY STEIN
JANET YELLEN
BOB RUBIN
LARRY SUMMERS
JOHN PODESTA

FROM: SALLY KATZEN

SUBJECT: Options for Addressing the Hog Price Crisis

Attached is a short paper that summarizes where we are as of this morning. Because the Chief of Staff's office wants a decision as soon as possible, we have triaged our consideration of the many issues and focused on the short-term responses available.

The "deputies" level group is recommending a prompt announcement of direct cash payments using Section 32 funds (existing, not new money). There are 2 suboptions: (1) targeting to hog producers with up to 1,000 hogs, with a cap of $2,500 per producer, which would use virtually the full $53 million available; or (2) greater targeting to those with up to 500 hogs, again with a cap of $2,500, which would use roughly $30 million of the $53 million available. USDA recommends suboption 1 -- "in for a penny, in for a pound" and objections to the use of these funds for this purpose will not be lessened if we leave a few dollars in the pot.

Please let me know as soon as possible, and in any event before 5:00 today, whether or not you agree with our going forward with the USDA's recommendation.

cc:
David Beier
Lynn Cutler
Tom Freedman
Elise Golan
Elgie Holstein
Lisa Kountoupes
Mark McClellan
Karen Tramontano

CONFIDENTIAL DRAFT FOR DISCUSSION PURPOSES ONLY

Options for Addressing Hog Price Crisis

An interagency group chaired by NEC is evaluating short, mid, and long term options for addressing the problems facing pork producers. This paper outlines the status of the work to date and contains recommendations for immediate short term actions.

Short Term

The group agrees that one of the most important short term issues is to provide small scale pork producers with direct cash payments. Two options were evaluated: (1) forward contracting with producers for future delivery using Commodity Credit Corporation (CCC) funds, and (2) direct cash payments using Section 32 funds. These funding accounts are within USDA and do not require an offset.

While discussed in the meeting with the Chief of Staff, the possibility of using CCC funds to forward contract with producers for delivery of hogs later this year raises a number of concerns. For example, it may not be possible to target this approach to small producers. In addition, USDA would be purchasing perishable products (live hogs), which has never been done and which raises numerous logistical and legal issues. Finally, the legal theory for this approach is premised on preventing waste, such as killing hogs, and it grows more problematic as prices continue to increase. In sum, while potentially providing greater levels of financial assistance, the group does not recommend this option at this time.

Section 32 funds, on the other hand, offer a more direct way of providing direct cash assistance to small pork producers. Funds are limited, however, because USDA is statutorily prohibited from spending more than $53 million on pork. Direct payments under Section 32 have only been made 4 times in history and have not been made since 1961.

There are various formulas under which direct payments under Section 32 could be made. For example, producers could receive a payment based on the number of pigs that were on farm on December 31, 1998, or on the number of pigs that were marketed in the fourth quarter of 1998. Only smaller producers would be eligible (e.g., who had less that 1,000 pigs on farm on December 31, 1998) and payments would be limited to $2,500 per producer. Based on a payment rate of $5 per pig and restricting payments to operations that had fewer than 1,000 hogs in inventory, total costs are estimated at $52.3 million. Payments could be further targeted. For example, if eligibility was limited to farmers who had 500 or fewer hogs on farm, payments could be raised to $8-9 per pig for a total cost of approximately $53 million. If payments were $5 per pig, the total costs under this option would be $30.4 million. Approximately 80% of hog farmers, or 89,353, would be covered under the 500 cap. Increasing the cap to 1,000 covers approximately 90% of all hog farmers, or 99,932.

Under the options discussed above, producers will not be eligible for payments on hogs that were marketed under contract because, in general, contract prices are higher than the prices on the cash market. Nonetheless, some producers under contracts that do not effectively provide higher prices may object to being excluded. In addition, producers participating in the pseudorabies

eradication program will not be eligible for payments.

Apart from setting a precedent that could be invoked when other commodity prices decline, there are three principal criticisms that could be made about this approach. First, spending the entire $53 million would leave approximately $114 million in Section 32 funds. Section 32 funds are typically used for bonus buys of products, particularly fruit and vegetable products, for the school lunch and USDA feeding programs. USDA typically maintains $100 million surplus account. Commodity groups that benefit from Section 32 purchases and the hunger/nutrition community would likely criticize our using this money for the hog producers, because it would not bring additional food into these programs and would limit the amount of funding for other commodity purchases.

Second, it is likely that this approach would be criticized as an inadequate response to a critical problem ($2,500 per producer is not much, although $5 per pig is almost 25% premium over current selling price).

Third, other commodity groups such as cattle producers would view the payments as subsidizing their competition.

Recommendation: Proceed with direct cash payment using Section 32 funds.

Mid Term:

USDA has both direct and guaranteed loan programs which may be of assistance to pork producers. However, funds for most of these programs will be depleted between February to April. USDA is developing a request for supplemental funding. In addition, producer groups have requested special loan programs for pork producers. While USDA would need legislation to meet these requests, USDA is evaluating whether any changes could be made to make existing programs more beneficial at this time.

International options are also under consideration. In particular, the group is evaluating whether excess slaughter capacity in Mexico could be utilized, with the resulting product being shipped as food aid to Central America. Initial discussions with the Mexicans are positive, but a number of issues remain to be resolved, and it is unclear as to the volume of product that could be handled under this approach. The group is also considering the feasibility of airlifting or shipping live hogs to Central America as humanitarian or food aid, as well as simply providing Central American countries with processed pork. Early indications suggest a preference for processed product, which does not alleviate the slaughter backlog in the U.S. In either event, the volume of product is not likely to be significant in terms of total U.S. production.

Long Term:

A subgroup including various WH offices, the Department of Justice, the Federal Trade Commission, and USDA is meeting to examine issues related to concentration, vertical integration, and retail. They have been asked to report back next week on key issues and data gaps relative to the concerns that have been expressed about structural changes in the pork industry. This report should set the framework for policy discussions on this broader, long term

issue.
There will also be a subgroup to consider "an alternative vision" of farm legislation for the future -- whether or not the 1996 Freedom to Farm Act is broken.

THE WHITE HOUSE

WASHINGTON

January 7, 1999

MEMORANDUM FOR: GENE SPERLING
RON KLAIN
JACK LEW
BRUCE REED
LARRY STEIN
JANET YELLEN
BOB RUBIN
LARRY SUMMERS
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USDA

Rec'd
Staff Sec'y
Dec 30 7:05PM

December 30, 1998

United States Department of Agriculture

Office of the Secretary

1400 Independence Avenue, SW

Washington, DC 20250-0100

MEMORANDUM FOR THE PRESIDENT

From: Secretary Dan Glickman

Subject: USDA Response to the Current Crisis in Pork Prices

Beginning November 23, when I announced that USDA will buy this fiscal year $50 million worth of pork and donate it to school feeding programs and programs that feed the needy, USDA has taken several additional steps, summarized below, to alleviate the current crisis in pork prices, a slump that has pushed prices to their lowest in 5 decades and one-third of the level of just last year. Given our conversation today, I am also sending a similar memorandum to President Carter so he is fully informed.

- On December 21, the Vice President announced that USDA will purchase an additional $15 million worth of pork for programs that feed the needy.

  These purchases will be made only from hogs slaughtered and processed on Saturdays and Sundays, which is significant to ameliorating the current slump because though slaughter rates are near historically high levels, they are not keeping pace with consumer demand nor the amount of hogs ready for market because many plants are only operating single daily shifts and not on weekends. The conditions of the purchases the Vice President announced provide an incentive to processors to utilize their unused capacity, to ease the bottleneck contributing to weak cash prices.

- On December 23, I announced that under the terms of the Russian food aid package just completed, USDA will provide 50,000 tons of pork. Additionally, we are working on an export credit guarantee package for South Korea that will, we believe, include a significant amount of pork.

- On December 28, I placed a moratorium on further USDA lending for pork production facilities. Because part of the problem lies with the rapid increase in pork production over the last year, USDA's programs should not exacerbate the problem by providing incentives to increase supply.

  In addition, I announced that USDA will accelerate its psuedorabies eradication program. This action could remove as many as 1.7 million hogs and pigs from inventory, easing the supply glut as well as helping the US achieve psuedorabies-free status sooner than scheduled, which will ultimately help open additional export markets.

- Tomorrow, December 31, I will announce that USDA will ease its lending regulations to permit borrowers who have suffered from low commodity prices in 1998 to defer their 1998 payments until the end of the loan. Next month, USDA will also implement new procedures streamlining our credit programs, making them easier for farmers and for bankers, whose loans USDA guarantees.

  However, USDA does not have the legal authority to offer a loan program exclusively to pork producers, as they have requested. By statute, our credit programs are available to all farmers who meet the eligibility guidelines. Nonetheless, while the changes to our farm credit programs will apply to all borrowers, they were precipitated by the current crisis in pork prices.

- I am continuing to examine other options within my present authority to alleviate the crisis, including additional foreign humanitarian donations and whether USDA can make direct payments to pork producers to help bridge the current slump. I hope to act on these options next week. I am also studying whether we should seek legislation for other and additional forms of aid.

While current prices are depressingly low, they strengthened $2.50 last week, partly in reaction to USDA's steps and the announcement by two packers who have instituted minimum prices they will pay for live hogs, and this slump may continue – further pressuring farmers, heightening public interest, and increasing the already very significant interest it has generated among Members of Congress and Senators.

However, USDA's most recent estimate of industry trends, released yesterday, and futures prices are cautiously positive. The US hogs and pigs inventory is down 2% from September 1, and breeding stock is down 3%. Farrowing intentions are off 1% for the December to February quarter and down 7% for the March to May quarter. These projections suggest some easing of the over supply problem; a factor helping to strengthen April futures prices that, when equated to cash hogs prices, are roughly double current levels and June futures almost three times last week's price.

This has been a top priority of mine for the last couple of weeks, and will continue until we begin to work our way out of it. What we have done is discussed in greater detail in the attached materials.

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DRAFT

USDA DEFERS LOAN PAYMENTS FOR STRUGGLING FARMERS

WASHINGTON, December 31, 1998–In a move aimed at assisting America's hard pressed pork producers, Agriculture Secretary Dan Glickman announced today that USDA will postpone certain loan payments for farmers suffering from severe financial distress due to low prices.

"This step is not a panacea," said Glickman, "But it will help many farmers stay in business during this difficult period of low prices. USDA is committed to providing needy family farmers as much help handling loan repayments as we possibly can. And we are also making credit more accessible to farmers who need it."

Farmers are being paid 70 percent less than last year for their hogs. Many pork producers are facing bankruptcy and foreclosure because they cannot recover the cost of production in order to repay loans.

Today's loan deferment announcement covers 1998 farm ownership and operating payments that are normally due January 1, 1999. Under regulations to be published in today's *Federal Register*, these payments instead will be added on to the end of the repayment period.

Glickman also said that USDA will use all of its loan servicing authorities, including debt rescheduling and forgiveness, to assist needy farmers. USDA will inform lenders who make USDA-guaranteed loans about available options for distressed borrowers. Guaranteed lenders can reschedule and defer payments and write-down debt.

Federal laws authorize USDA to reschedule loan payments or write down part of a loan, depending on the recovery value of the loan and the borrower's ability to pay. Writing down debt is allowed only if USDA has no reasonable hope of collecting the entire amount of the debt.

USDA has taken other steps to ease the agricultural credit crunch. New regulations, effective early next year, will streamline loan guarantee procedures, making them easier for lenders. Secretary Glickman also announced that the Farm Service Agency will help producers applying for loans by basing anticipated pork prices on futures contracts rather than on lower, current market prices.

Secretary Glickman has also responded quickly to stimulate demand for pork, domestically and internationally. He has initiated bonus buys of pork products totaling $95 million. He included 50,000 metric tons of pork in the Russian food aid package and said he expects pork to be included in a package of export guarantees for South Korea. Secretary

Glickman also met with retailers to encourage them to feature pork and to ensure that retail prices accurately reflect the dramatic drop in farm prices.

Farm Loan Program borrowers may apply for debt relief at their local USDA Service Center or Farm Service Agency Office.

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Radio Address of Agriculture Secretary Dan Glickman
Pork Crisis 1998
December 24, 1998

Good morning. We are in the midst of a major crisis where hog prices have hit their lowest level in five decades and some producers are on the verge of losing their farms. A number of farmers are in deep financial difficulty. They can't afford to feed their hogs and the market is so glutted they can't sell them.

I wanted to take a moment to reassure America's pork producers and their families that we are moving as quickly as we can, exploring every option we may have under the law, to help producers get through this very difficult time. I am using whatever power and influence I have at my disposal. Our Pork Crisis Task Force has been working overtime to develop solutions.

I wanted to talk this morning about what we have been doing, some of the steps we are continuing to work on and announce additional actions we are taking today.

In the past few days, I have met with retailers, packers, processors, banks, farm groups and others to listen to their suggestions and explore ways we can work together to alleviate the crisis. I am particularly pleased that some packers have established a minimum price they will pay for hogs above the current spot price. This will help shore up prices. I commend them for their action and I hope more will follow suit.

And for the longer term, we are taking a hard look to determine whether prices are truly competitive and whether producers are being treated fairly.

With respect to farm credit, I have taken a number of steps. We are getting the word out to hog producers who traditionally have not taken advantage of our guaranteed loan programs. USDA has approximately $1 billion available to guarantee operating loans. The use of this guarantee is an incentive for private bankers to finance their producers during this difficult time. I am encouraging hog producers and their lenders to get into our Farm Service Agency offices and apply quickly. This money is made available on a first come first serve basis.

Today I have ordered a moratorium on the use of USDA credit to build new pork production facilities. Because the crux of the problem is oversupply, we want to stop any government action that could exacerbate the situation. I am also looking at other credit options which we hope to nail down in the next few days. I believe these and other steps we are considering will help encourage creditors to be more flexible with farmers who may be on shaky ground now, but whose long term outlook is positive.

To help get more hogs through the system, we are talking with members of Congress, governors and CEO's of major slaughterhouses to see what can be done to increase slaughter. I am encouraging packers to increase their capacity and we are offering incentives for them to work weekends. We are exploring with Mexican officials the possibility of using excess slaughter capacity in Mexico. I have spoken with Canadian Agriculture Minister Van Cleef about our

mutual concerns regarding slaughter capacity.

We are looking at ways to increase demand for pork products including encouraging retailers and consumers to take advantage of a good buy. I have spoken with other federal agencies – the Defense Department, Veterans Affairs, the Justice Department and the Bureau of Indian Affairs – to increase the amount of pork in their volume purchases.

We are also expediting Russian pork purchases under the current food aid package. Yesterday I announced the signing of the food aid package with Russia provides for 50,000 tons of pork. We are also exploring increased use of our export credit guarantees and are looking at ways to accelerate and increase USDA's announced pork purchases of $121.5 million.

I also want to announce that today I have directed our Animal and Plant Health Inspection Service to accelerate the voluntary pseudo-rabies eradication program. They will develop an indemnification program that could remove up to 1.7 million hogs from the market and achieve pseudo-rabies free status for the United States. This would provide an added bonus of opening up new foreign market opportunities.

These are just some of our immediate actions. There are other options we are working on and we will continue to make announcements of our actions as soon as we make them.

You know, demand for pork is strong. The futures market is improving and exports are actually up. So though folks are in a crunch now, the long term outlook is positive and I want to encourage everyone to help producers to hang on.

In the spirit of the season, I'm reminded of the movie "It's A Wonderful Life," when Jimmy Stewart called on all the folks in his town to not panic, to come together and work through a banking crisis. In that same spirit, I am saying to everyone in the pork industry, from the lenders to the retailers, from the farmers to the packers, let's all be flexible, let's all be creative, and most of all, let's all understand that together we can work through this crisis and put an industry temporarily derailed back on the track to continued growth and prosperity.

Again, I want to emphasize that we are working and will continue working to find ways to help pork producers get through this crisis.

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Release No. 0523.98

Fact Sheet

USDA ACTIONS TO ASSIST AMERICA'S PORK PRODUCERS

December 24, 1998

The U.S. Department of Agriculture has responded quickly and on many fronts to help America's struggling pork producers.

Increasing demand for pork products.

- USDA has purchased over $70 million in pork this year to bolster prices and provide nutritious food for federal food assistance programs. The Department will purchase an additional $50 million of pork products by March, 1999.

- This week, Vice President Gore announced an additional $15 million buy of pork for distribution to the needy.

- Secretary Glickman contacted officials at the Department of Defense, Department of Veterans Affairs, Bureau of Indian Affairs, and Bureau of Prisons, agencies that routinely make large volume meat purchases, to encourage the procurement of increased quantities of U.S. pork products.

- Secretary Glickman met with representatives of the retail food industry to urge them to take advantage of large hog supplies by featuring pork products and reflecting lower farm prices in their prices to consumers.

Promoting pork exports.

- Secretary Glickman included 50,000 metric tons of pork in the Russian food aid package that was signed yesterday. He also pledged to expedite movement of that product. Tendering for the pork may begin as early as January.

- Secretary Glickman has approved pork as an eligible commodity under nearly every allocation of GSM-102 credit guarantees. He has also said that he expects pork to be included in a package of export guarantees for South Korea.

-more-

- USDA's Foreign Agricultural Service is working closely with the pork industry to maximize use of these credit guarantee lines, including holding seminars to assist exporters who may not be familiar with the credit guarantee programs.

- This year, USDA has targeted more than $12.5 million to promote sales of U.S. pork, beef and lamb in overseas markets. U.S. pork exports are up 19 percent by volume this year. Since 1992, pork exports have more than doubled and are now over $1 billion.

- The Clinton Administration continues to make progress in negotiations to lower tariffs and expand market access for U.S. pork going into Venezuela, Singapore, Taiwan, the Philippines, Jamaica and Argentina.

- After lengthy negotiations, USDA won agreement allowing slaughter swine from 33 pseudorabies-free states to enter Canada without undergoing the previous 30-day quarantine. This should greatly facilitate movement of slaughter hogs into Canada. Secretary Glickman has also contacted Canadian Agriculture Minister Lyle Vanclief to encourage Canadian action to help alleviate the economic crisis in the U.S. pork industry.

- These efforts appear to be effective. U.S. pork exports for 1998 are forecast 18 percent higher than 1997. Japan, the leading importer, is 8.5 percent ahead of last year's pace and exports to Mexico are up 70 percent. Overall, USDA projects pork exports to be up over 60,000 tons for 1999.

Increasing hog slaughter.

- USDA's Agricultural Marketing Service has restricted recently announced federal bonus purchases to hogs slaughtered on Saturday or Sunday.

- Secretary Glickman met with representatives of major slaughterers and processors to encourage increased slaughter.

Expanding financial protections for pork producers.

- FSA will help producers applying for loans by basing anticipated pork prices on futures contracts rather than on the lower, current market prices.

- FSA is streamlining its loan guarantee procedures to make them easier and less complicated for lenders.

- FSA is working to rapidly process all loan and loan guarantee requests.

- Secretary Glickman met with representatives of major lenders in hog-producing states to encourage loan restructuring and patience until intervention steps have a chance to work.

Reviewing pricing information and pricing practices.

- USDA's Grain Inspection, Packers and Stockyards Administration is examining current price spread and packer pricing practices focusing on packer competition for retail sales to determine why wholesale prices have not declines and to determine if the market is operating competitively.

- USDA's Agricultural Marketing Service will publish improved market reports for live hogs beginning in January.

- Secretary Glickman met with representatives of major slaughter companies to encourage greater cooperation with market news reporters.

Additional actions.

- Secretary Glickman imposed a moratorium on USDA credit lending for new pork production facilities. This is an important signal to the market and to lenders that USDA is taking bold steps to deal with this crisis.

- Secretary Glickman has accelerated USDA's voluntary pseudo-rabies eradication program by developing an indemnification program that could remove up to 1.7 million hogs from the market, achieve pseudo-rabies free states for the United States, and open new foreign market opportunities.

- Secretary Glickman has also created a Pork Crisis Task Force within USDA to recommend additional actions to help hog producers during this stressful economic period.

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GLICKMAN ANNOUNCES SIGNING OF RUSSIAN FOOD AID AGREEMENTS

WASHINGTON, Dec. 23, 1998–Agriculture Secretary Dan Glickman today announced that the United States and Russian governments have signed two food aid agreements, one for U.S. concessional credit sales and one for donations, totaling 3 million metric tons of grains, meats, oilseeds, and dry milk.

"This is a particularly appropriate time of year to talk about sharing America's agricultural abundance with others," Glickman said. "We will be providing a substantial food assistance package that should help the Russian people through some very difficult times, and we are prepared to consider additional assistance, if the need arises and the initial shipments are successful in reaching needy beneficiaries."

Under the first agreement, the United States Department of Agriculture's Commodity Credit Corporation (CCC) will provide long-term, low-interest-rate loans for the Russian government to purchase 1.5 million tons of various commodities from the U.S. Commodities to be purchased are 500,000 metric tons of corn, 300,000 tons of soybean meal, 200,000 tons of soybeans, 200,000 tons of wheat, 100,000 tons of rice, 120,000 tons of beef, 50,000 tons of pork, and 30,000 tons of nonfat dry milk. The current commodity value of these sales is estimated at about $400 million. CCC will also finance an estimated $62 million in transportation costs and pay an ocean freight differential of around $58 million.

The products will be sold in Russia at market prices, thereby increasing available food supplies for the Russian people. Under terms of the agreement, the Russian government will act in accordance with an agreed food distribution plan, which will target regions with substantial food deficits. All proceeds from the commodity sales will go into the Russian Pension Fund to help meet pressing social needs. The Russian government or its agent is expected to begin tendering for these products next month, and shipments will begin soon thereafter.

Under the second agreement, the United States will donate 1.5 million metric tons of Section 416(b) wheat to Russia. Section 416(b) of the Agricultural Act of 1949 authorizes overseas donations of surplus U.S. commodities. The current commodity value of this wheat is estimated at around $225 million. CCC will also pay an estimated $85 million in transportation costs.

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The donated wheat will be sold or distributed to various regions in Russia and processed into flour. The agreement calls for about 75 percent of the flour from donated wheat to be sold at market prices, with proceeds going into the Russian Pension Fund. The remainder is intended for direct distribution to vulnerable portions of the population, such as orphanages, hospitals, and homes for the elderly. Initial shipments of U.S. wheat under Section 416(b) are expected to begin in January. The wheat will be provided from CCC stocks acquired through surplus purchases.

Both agreements mandate extensive monitoring and reporting arrangements on the distribution of the commodities. To assist in this effort, USDA is sending a monitoring team to Russia whose members will serve with an independent United States-Russia food distribution monitoring group. In the agreement the Russian government also guarantees that import duties and taxes will not be levied on the entry, initial distribution, or sale of U.S. products received as part of the food assistance package. The United States will retain the right to delay or stop shipments if any abuses are detected. We are also exercising care to avoid any actions that would disrupt international agricultural markets, hinder the development of agricultural markets inside Russia, or reduce incentives for Russian farmers.

In addition to the two government-to-government agreements, USDA will also be signing agreements with several private voluntary organizations for the humanitarian distribution of 100,000 tons of various U.S. commodities in Russia under the Food for Progress program. Details will be announced in coming weeks when final agreements are signed with selected private organizations. These commodities will be distributed to some of the most vulnerable Russian citizens, especially the elderly and the poor.

Although signed in Moscow by the deputy prime minister of the Russian Federation and a U.S. embassy official, the two government-to-government agreements do not become effective until the official documents are returned to Washington, D.C., and countersigned by USDA's general sales manager.

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NOTE: USDA news releases and media advisories are available on the Internet. Access the USDA Home Page on the World Wide Web at http://www.usda.gov

THE WHITE HOUSE

Office of the Vice President

For Immediate Release
Monday, December 21, 1998

Contact:
(202) 456-7035

VICE PRESIDENT GORE ANNOUNCES US GOVERNMENT WILL PURCHASE AN ADDITIONAL $15 MILLION IN PORK TO HELP AMERICA'S FARMERS, FOOD BANKS

Washington, DC -- Vice President Gore announced today that the U.S. Department of Agriculture will purchase $15 million in pork to help America's struggling hog farmers and to avoid food shortages at our nation's food banks this holiday season.

Today's announcement is the latest in a series of actions the Administration has taken to assist struggling pork producers. For example, since March, USDA has purchased over $80 million worth of pork to help bolster prices. Further, USDA announced last week that it will accelerate the purchase of pork products and will urge the Departments of Defense and Veterans Affairs to consider additional pork purchases.

"These are incredibly difficult times for America's small and medium-size pork producers," Vice President Gore said. "We have already taken a number of steps to help reduce the glut of pork and this additional $15 million buy should be of further assistance. But we will need action from America's meat packers, processors, and retailers to move us out of this slump for the long-term."

"This commitment will help pork producers and ensure a happier holiday season for our nation's hungry," said Secretary Dan Glickman. "Traditionally, many of America's food banks face food shortages during this time of year. Up to 50 million pounds of pork will be targeted at federal food assistance programs and food banks nationwide."

Information on USDA's pork purchase program may be obtained via the world wide web at: http://www.ams.usda.gov/lsg/cp/pork/pork_index.htm.

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Release No. 0518.98

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GLICKMAN ANNOUNCES ADDITIONAL STEPS TO HELP PORK PRODUCERS

WASHINGTON, Dec. 17, 1998 -- Agriculture Secretary Dan Glickman today announced that the Clinton Administration is taking several additional steps to help pork producers through the toughest economic times they have faced in 35 years.

Specifically, Glickman said he is accelerating USDA's purchase of pork products and urging the Departments of Defense and Veterans Affairs to consider additional pork purchases. He said he also expects pork to be included in a package of export guarantees for South Korea.

Glickman announced that he will meet with meat packers and processors to explore ways to increase hog slaughter and move more pork through the marketing system. He said he will also meet with retail food industry representatives to urge them to take advantage of large hog supplies by featuring pork products and reflecting lower farm prices in their prices to consumers.

"Hog prices are now 70 percent below last year's levels," Glickman said. "Producers are being paid far less than the cost of production for their animals. These massive losses may drive small and medium-size producers out of business. I want USDA to help, but I also want to understand more fully why pork producers are receiving such a small share of the prices consumers are currently paying for pork products."

In immediate response to the crisis, Glickman announced that USDA is accelerating the purchase of $50 million in pork for the National School Lunch Program and other federal food assistance programs that was announced in late November. In the first of these accelerated purchases, the Department this week is buying more than 4 million pounds of pork valued at over $3.1 million. At least 36 million pounds more pork will be purchased by the end of February. Since July 1, USDA has bought 52.6 million pounds of pork valued at $49.5 million.

Glickman also announced that he expects meat, including pork, to be included in the upcoming allocation of credit guarantees to support exports to South Korea. The Secretary previously approved pork as an eligible commodity under nearly every allocation of GSM-102 credit guarantees. USDA's Foreign Agriculture Service will work closely with the pork industry to maximize use of these credit guarantee lines, including holding seminars to assist exporters who may not be familiar with the credit guarantee programs.

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Secretary Glickman included 50,000 metric tons of pork in the Russian food aid package, equal to about 15 percent of annual pork exports. Today he promised to expedite movement of that product. This year, USDA has targeted more than $12.5 million to promote sales of U.S. pork, beef and lamb in overseas markets. U.S. pork exports are up 19 percent by volume this year.

In other actions to assist hog farmers, Glickman announced that he has –

- Scheduled a meeting on December 21, 1998 with meat packers, processors, and retail food industry representatives to urge them to expand hog slaughter and increase movement of pork products in retail outlets.

- Directed the Farm Service Agency to help producers applying for loans by basing pork prices on futures contracts rather than lower, current market prices. FSA will also soon permit certain existing borrowers to shift payments due in 1999 to the end of their loan period, increasing flexibility during this time of financial stress.

- Created a Pork Crisis Task Force within USDA to recommend other actions that could help support hog prices.

"I will do whatever I can to help solve this problem, but it will require cooperation from the processing industry to increase slaughter rates, retailers to price products more in line with farm prices, and producers to more carefully monitor production to move us out of the slump," Glickman added.

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USDA TO PURCHASE UP TO $50 MILLION OF PORK

WASHINGTON, Nov. 23, 1998--Agriculture Secretary Dan Glickman today announced that USDA will purchase up to $50 million of pork products to help improve prices to pork producers.

"Pork producers are experiencing more than a 50 percent decrease in hog prices from last year," said Glickman. "This purchase is the latest in a series of steps the Clinton Administration has taken to assist pork producers in these difficult economic times."

"Last fiscal year, USDA purchased $85 million worth of pork, including a $30 million bonus buy, for distribution to emergency food assistance programs and the National School Lunch Program," said Michael V. Dunn, undersecretary for marketing and regulatory programs.

Glickman also recently announced the inclusion of 50,000 metric tons of pork in a food aid package for Russia. This is equivalent to 15 percent of last year's U.S. exports of pork. Glickman has also approved pork as a food commodity for international assistance under the GSM-102 export credit guarantee program.

The pork purchase announced today will include pork roasts, hams, and ground pork items under Announcements LS-59 and LS-60. Canned pork will be purchased under Announcement LS-64. All products must be produced from domestic livestock and will be distributed to recipients in federal food assistance programs.

Inquiries for purchases announced today should be addressed to the Contracting Officer, Livestock and Seed Program, AMS, USDA, Room 2610-South, P.O. Box 96456, Washington, D.C. 20090-6456; tel. 202-720-2650; fax 202-720-7271.

Information on the pork purchase programs is available on the World Wide Web at: http://www.ams.usda.gov/lsg/cp/pork/pork_index.htm

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NATIONAL CATTLEMEN'S BEEF ASSOCIATION
1301 Pennsylvania Ave., NW, Suite #300 • Washington, DC 20004 • 202-347-0228 • Fax 202-638-0607

January 13, 1999

The Honorable Dan Glickman
Secretary of Agriculture
200-A Administration Building
Washington, D.C. 20250

Dear Secretary Glickman:

On behalf of our grassroots members, we are concerned and frustrated that the Administration's decision to make direct cash payments to hog producers does not address the fundamental need to restore price and profitability to the livestock sector through improved demand. Our members are anxious to hear the Administration's announcement on its plans to address the chronic low prices cattlemen have been fighting for over three years.

We must stress, however, that we are not interested in direct payments. Even if we were, common sense suggests that the federal fiscal realities – not to mention political realities – could not provide sufficient funds to even begin to make up for the billions in lost equity experienced by beef producers over the last few years. We also believe that direct payments will not alleviate supply problems for beef or pork. But there are initiatives you can aggressively pursue that will help cattlemen restore price, and eventually profitability to the beef industry.

Resolve the EU hormone ban: For over a decade, U.S. beef producers have been unfairly banned from the EU market. While we recognize that progress is being made, we strongly urge that USDA, USTR and the White House insist on EU compliance with WTO rulings. If the EU is not in compliance by the May 13, 1999, date specified, every available trade and policy weapon at your disposal should immediately be brought to bear on getting the ban lifted.

Increase government beef purchases: We have appreciated the government purchases of beef for use in domestic feeding programs. We are hopeful that the recent announcement has not minimized the funds available for additional purchases of beef or other meats. We urge you to make additional purchases, either through Section 32 or some other authority, to take advantage of the current low beef prices to increase the beef available for these beneficial feeding programs.

Finalize inspection inequities decisions: You are well aware of our petition to resolve several inequities between meat and poultry inspection. These inequities not only provide poultry a comparative advantage over red meat in the marketplace, they negatively affect red meat's ability to utilize proven food safety technologies that could improve consumer safety and confidence in the U.S. meat supply. We urge you to incorporate our revisions into the proposed rules you have been considering and publish the final revised rules as soon as possible.

Rescind use of USDA quality grades on imported meat: Current regulations allow imported meat and cattle directly for slaughter to utilize USDA quality grades. This, in turn, effectively

allows our competitors to market their product as U.S. beef to American consumers. This is not fair to U.S. cattlemen or consumers. Removing this trade advantage from their marketing schemes no doubt will anger our competitors as they clearly recognize that the USDA quality grades impart value to their product in the retail meat case. Unfortunately, they are not willing to pay for that added value. We urge you to immediately begin rulemaking procedures to rescind the use of USDA quality grades on imported meat and meat from animals imported directly for slaughter.

Mr. Secretary, we appreciate the difficult situation you are in and we know you have not forgotten the tough situation cattlemen are facing. We appreciate the projects you have underway to improve the economic situation for U.S. cattle and beef through increased access to foreign markets, more accurate and timely market information, and full implementation of importation procedures to protect against our herds from potentially devastating cattle diseases.

We hope you appreciate the mounting grassroots frustration among beef producers regarding the recent pork-specific announcement. We cannot stress enough the importance of your consideration of the four points outlined above.

Just as we will be working with our grassroots members, state affiliates and member organizations to pursue these objectives, we stand ready to work with you in any way that we are able to restore profitability to the cattle industry.

Sincerely,

Clark S. Willingham
President

Charles P. Schroeder
Chief Executive Officer

Yahoo! News **Politics Headlines**

Monday January 11 2:12 PM ET

U.S. Farmers Criticize Clinton's Plight

ALBUQUERQUE (Reuters) - President Clinton, never popular among farmers, was the butt of criticism Monday from U.S. farm leaders for his impeachment plight.

Dean Kleckner, president of the American Farm Bureau Federation, made an oblique reference to Clinton during a keynote speech at the group's annual convention while calling for "leaders with ideas."

"We need people of conviction, not those who should be convicted," Kleckner said to the applause of about 6,000 farmers.

That jibe came after Kleckner said, "We need officials who will stand up for our Constitution," a line that also drew applause.

Earlier Stories

- Low Prices Dog U.S. Farmers In 1999 - Analysts (January 11)
- Low Prices Dog U.S. Farmers In 1999-Analysts (January 10)

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Questions or Comments

690 2179

Pork Hogs

February 3, 1999

REPORT
OF NATIONAL ECONOMIC COUNCIL TASK FORCE ON HOG INDUSTRY STRUCTURE AND PRACTICES

The recent sharp decline in prices paid to hog producers, and the failure of wholesale (packer) or retail prices to reflect that decline has led to concerns, by producers and others, that wholesale and retail hog/pork markets are not functioning properly, because of increased concentration and the exercise of market power by packers in their dealings with producers, or because of unfair or anticompetitive practices by packers or retailers. This report was prepared at the request of the National Economic Council. Its preparation was coordinated by the Office of the White House Counsel with the participation of the U. S. Department of Agriculture, the Antitrust Division of the Department of Justice, and the staff of the Federal Trade Commission. The report describes how pork is produced and marketed in the United States; analyzes concentration at both the packer and retail levels; evaluates capacity constraints at the packer level and the impacts of the trend toward greater use of forward contracting by packers in purchasing hogs for slaughter; and discusses the reasons for the recent increases in the spread between retail prices and the prices received by hog producers. Finally, the report sets forth some initial recommendations.

I. Hog Production and Marketing in the United States

Hog production, measured by number of head slaughtered, was 101 million head in 1998. This is the first time slaughter exceeded 100 million head and represented a 10 percent increase from 1997. Pork production in 1998 was 19 billion pounds, up 10 percent over 1997. Per capita pork consumption increased from 48.7 pounds in 1997 to an estimated 52.8 pounds in 1998. (See Appendix 1.) The total hog and pig inventory in December 1998 was 62.2 million head, 2 percent more than a year earlier. Because of the large inventory, USDA is projecting that slaughter levels and pork production during the first half of 1999 will exceed levels observed in the first half of 1998. Year-over-year declines are expected in the second half of 1999 so that annual pork production is forecast to be marginally smaller, at 18.9 billion pounds.

A. Hog Producers

Over the last three decades the structure of hog production has evolved toward fewer and larger operations, mirroring the general trend in the structure of American agriculture. In 1967 there were 1.047 million hog operations. This fell to 667,000 in 1980 and to 114,000 in 1998. Our most recent data show that between 1997 and 1998 the number of operations fell by 8,000 or 6.4 percent.

Commercial hog production traditionally consisted of small to medium size farrow-to-finish operations. In such operations, the farmer owned sows that produced pigs, which were then raised to market weight, often using grain produced on the same farm. Marketing was primarily on a cash-market basis. These farrow-to-finish systems are still

common, especially in the traditional Cornbelt hog production region.

Today, larger operations dominate the supply of hogs. Operations with more than 1,000 hogs accounted for only 5.9 percent of the operations in 1998 but 63.5 percent of total inventory. In just the past 6 years the percentage of total inventory accounted for by these large operations has grown from 28 percent to 63.5 percent. There were 1,915 operations with over 5,000 head on inventory.

While large operations dominate hog supply, operations with fewer than 100 head still account for 62 percent of all operations. These small producers account for only 2 percent of the U.S. hog inventory. Small hog operations are of insufficient size to provide a livelihood for their owners. As a result, they are usually operated in conjunction with other farm enterprises such as grain production and/or off-farm employment.

Hog production continues to be concentrated in the north central states. Iowa, Illinois, Minnesota, Indiana, Missouri, and Nebraska are major producers. Hog production has spread to other areas, notably North Carolina, now the second largest hog producer, Oklahoma, and Colorado. Growth in these and a few other states has been characterized by relatively few but very large operations.

Hog production in the United States has become more efficient in general, with larger operations tending to have higher litter rates and more litters per year than smaller operations. For example, operations with more than 5,000 hogs in 1998 had 24 percent more pigs per litter than operations with less than 100 head. Feed conversion to useable meat has been improving and the quality of hogs marketed has also improved. Producers are using improved genetic stock to produce more standardized hogs with carcass characteristics desired by meat packers and consumers. The growth in large operations can be attributed to efficiencies from economies of scale and pecuniary economies that come from bulk purchases of inputs at lower unit prices.

Technology seems to be responsible for the geographic spread of hog production and the trend toward larger operations. Large confined operations appear to be more efficient than smaller operations and their location seems to be driven by low land, labor, and construction costs. It has been hypothesized that the stringency of state environmental regulations partly explains where new hog production investment has taken place. Although empirical studies to date have not found conclusive evidence to support this conclusion, new state and local efforts to regulate hog facilities continue to emerge.

B. Meatpacking

Press reports and many in the industry have blamed recent low hog prices, in part, on a lack of competition in hog slaughter and insufficient slaughter capacity. While the hog

slaughtering industry has undergone consolidation in recent years, its current level of concentration is below the threshold level usually viewed by antitrust enforcement agencies as "concentrated". In 1994, insufficient slaughter capacity also was blamed for low prices and low returns to producers. However, as a result of plant openings and expansion of existing plants, total hog slaughter capacity has increased since 1994 in spite of the closing of three large plants in 1997 and 1998. The data indicate there was excess capacity prior to these recent plant closings and the large increase in hog production in late 1998.

The four firm concentration ratio for commercial hog slaughter has increased from 34 percent in 1980 to 54 percent in 1997, and the eight firm ratio increased from 51 to 73 percent. By comparison, the four largest firms accounted for 80 percent of steer and heifer slaughter in 1997. (See Appendix 2.)

The Herfindahl-Hirschman Index (HHI) is a measure of concentration used by the Department of Justice (DOJ) and Federal Trade Commission (FTC) as one tool in evaluating mergers. The HHI value for hog slaughter firms was below 1,000 in 1996 which is generally interpreted as indicating a relatively unconcentrated industry.

On a regional basis, there are fewer hog slaughter firms in the Southeast (NC, SC, VA), Southwest (TX, OK, NM), and West (CA, UT). A large share of the hogs produced in these regions is produced by packer-owned production units or through contracts with hog farmers. However, a 1996 USDA study found that this higher regional concentration in hog slaughter was not reflected in prices paid for hogs; it found that geographic pricing patterns were consistent with a single national market for slaughter hogs.

The number of hog slaughter plants operated by firms purchasing $500,000 or more of livestock annually has declined since 1980, while average plant size has increased. The number of small and medium size plants slaughtering 1,000 to 1,000,000 hogs per year declined from 393 in 1980 to 201 in 1996, the latest available data. The number of large plants (over 1,000,000 head per year) also declined, from 41 in 1980 to 32 in 1997, but has remained constant since 1990. The average size of these large plants doubled from 1.4 million head in 1980 to 2.8 million head in 1997. Over half of the increase in the size of the large plants occurred since 1990 as slaughter firms moved to achieve economies of scale. The slaughter plants that closed were generally older, less efficient plants.

C. Retailers

The retail grocery segment supplies pork products, as well as other food items, directly to consumers. At the national level, the concentration of sales among chain and other grocery retailers has traditionally been relatively low, but has been increasing in the past few years. In 1997, for example, over two hundred grocery store chains operated in the U.S., along with several thousand independent grocers, and the four largest chains—

Kroger, Safeway, Albertson's and American Stores—accounted for approximately 23 percent of all supermarket sales.[1] If all the recently announced grocery mergers are consummated, the five largest chains may account for 40 percent of sales. At the local level, where competition for consumer dollars occurs, concentration of sales is generally considerably higher, but varies across local areas and has not increased significantly since 1990. In 1996, for instance, the data in Appendix 3 indicate that the four largest supermarket operators accounted for 96 percent of sales in Miami but only 52 percent of sales in New York. The appendix also summarizes concentration for a sample of a few other large metropolitan areas.

The Federal Trade Commission reviews mergers among retail grocers, and from time to time has challenged mergers to protect competition in local markets in which the merger would have resulted in undue concentration among retail grocers. Typically, consent decrees have been reached allowing the merger to go forward once the parties agreed to divest a sufficient number of stores in the local markets where the merger would have otherwise threatened to harm competition.

A large volume of meat is consumed at hotels, restaurants and institutions (HRI) and is not sold by grocery stores. In 1992 (the latest data available), about 7 percent of meat packers' sales and 22 percent of meat wholesalers' sales were to HRI customers. Separate data are not available for pork products. The Government's farm-to-retail price spread series (see Appendix 4) includes prices at grocery stores but does not include prices paid by the HRI segment of the market.

Consumer demand for pork is relatively unresponsive to price changes (inelastic). A decrease in the price of pork will encourage some people to consume more meat products and encourage others to reallocate their meat budget from other meats to pork. However, the increase in pork consumption will not be proportionate to the fall in price. Economists have estimated that a 10 percent decrease in the price of pork at retail, holding other prices constant, will result in about a 7 percent increase in pork consumption.[2] Conversely, a 10 percent increase in the quantity of pork supplied would require about a 14 percent decrease in price to clear the market. As the quantity of pork increases, it would require proportionately larger reductions in price to clear the market.

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[1] These data were computed from information contained in the *Directory of Supermarket, Grocery & Convenience Store Chains, 1998*, and from statistics published by the Food Marketing Institute.

[2] S. H. Huang and R. Haidacher. 1989. "An Assessment of Price and Income Effects on Changes in Meat Consumption." In *The Economics of Meat Demand,* ed. R. C. Buse. Proceeding of the Conference on the Economics of Meat Demand, October 20-21, 1986, Charleston, South Carolina.

II. Issues

A. Slaughter Capacity

Recent press reports and comments by the National Pork Producers' Council attribute the current low hog prices in part to a marketing "bottleneck" created by insufficient slaughter capacity. USDA has been investigating plant closings to determine the reasons for the closings and their impact on overall capacity.

Three plants closed by Thorn Apple Valley, Dakota Pork, and IBP in 1997 and early 1998 contributed to the shortage of slaughter capacity when hog supplies were very large in late 1998. However, the three firms claimed that their decisions to close the plants were based on inability to operate the plants profitably, based on price and cost relationships at those specific plants at the time they were closed. For the industry as a whole, openings and expansions of other plants have increased total slaughter capacity by about 66,000 head per week (about 3.4 million head per year) since 1994, the last time low prices were blamed on insufficient capacity.

According to some industry members and market analysts, excess hog slaughter capacity existed in 1997 and was expected to continue beyond 1998.[3] That forecast underestimated the speed of the expansion in hog production that was already underway at the time. Ronald Plain at the University of Missouri said in February 1997 that it was likely the industry would reach slaughter levels of more than 100 million head per year within 5 years.[4] The expansion occurred faster than expected and slaughter volumes in late 1998 were equivalent to an annual slaughter rate of more than 100 million head.

Smithfield Foods has temporarily shelved plans for construction of a new plant in Utah, where the company is developing an integrated production system similar to the one it has in the Southeast. Smithfield purchased the Dakota Pork plant in Huron, South Dakota subsequent to the plant's closing in 1997, and also purchased a closed Georgia plant in 1996. Smithfield has given no indication it intends to reopen either plant. Seaboard has plans to build an additional plant in Kansas, and IBP reportedly is considering an additional plant in Kansas, but these firms do not appear to be actively

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[3] For example, John Lawrence at Iowa State University said throughout 1997 and 1998 that packer capacity was expected to remain in excess of hog supplies for several years. John D. Lawrence, "What's Ahead for the U.S. Pork Industry: 1997," Iowa State University, paper presented at National Pork Producers Competitiveness seminars in 1997 and 1998.

[4] Ronald L. Plain, "Changing Structure of the U.S. Hog Industry -- U.S. and Abroad," University of Missouri-Columbia, February 6, 1997.

implementing these plans.

Hog slaughter capacity expansion is affected by regulations and public resistance derived from environmental concerns. Several recent press reports have indicated that Smithfield Foods' Tar Heel, North Carolina plant is restricted to operating at 75 percent of capacity due to regulatory restrictions on the volume of wastewater it may discharge. Hog slaughter plant expansion is also influenced by environmental constraints on hog production. Packing firms are less likely to initiate expansion plans if they believe hog production may be constrained or even reduced by environmental regulation. There have been and continue to be many instances of resistance to, and often regulatory denial of, producers' attempts to expand hog production.

Plant openings and closings have resulted in some geographic redistribution of U.S. slaughter capacity, resulting in smaller shares for the Corn Belt and Plains regions and larger shares for the Southeast and Southwest regions. Capacity increased during the last five years as a result of new plant construction and expansion of existing plants in the Southeast and Southwest, primarily by Seaboard and Smithfield Foods, packers that both rely heavily on packer feeding and contract hog production. Capacity in the eastern Corn Belt (MI, IN, OH, PA, and KY) and Plains states (ND, SD, NE, KS, CO) has declined. Capacity in the western Corn Belt (MN, WI, IA, IL, MO) has remained relatively constant, as construction, reopenings, and expansion of some plants has offset closings of others. (See Appendix 5.) Further, USDA's 1996 study of Concentration in the Red Meat Packing Industry found that geographic hog pricing patterns were consistent with a single national market for slaughter hogs.

In summary, recent low hog prices were likely influenced by limited slaughter capacity, in the face of rapidly expanding production. While some existing slaughter plants are expanding capacity, three other large slaughter plants were closed in 1997 and 1998. As the number of hogs available for slaughter varies with the swings in the production cycle, there are likely to be future periods when the slaughter capacity will be insufficient. Likewise, there will likely be periods of excess capacity when less efficient plants may be under considerable pressure.

B. Contracting Practices

A large and growing proportion of hogs—more than half—is marketed under some form of contractual arrangement between the producer and packer. Production contracts often specify production practices and genetics that help assure that hogs will conform to a packer's product requirements. Contract producers provide packers a steady supply of hogs, which leads to slaughter efficiencies. Most contracts and other marketing agreements provide for delivery of a specific number of hogs on a regular schedule, the increased certainty of which benefits both the producer and the packer. Contract arrangements have often enabled producers to obtain credit to enter or expand hog

production and to reduce some price risks for hogs and feed. Because these contractual arrangements are premised on volume and consistency of supply, they are generally not as available or accessible to smaller producers.

Producers are concerned that hog production will follow the path of contract poultry production, and that they will lose their independence. Poultry production is heavily vertically integrated with poultry processors owning the chicks and contracting with growers for the finishing of the birds. The processor/integrator also provides the feed. The term of poultry contracts is very short, usually covering a single flock, which is about six weeks. Growers are compensated for the use of their facilities, their time and their management of the flock. Grower payments are based, in part, on a grower's performance (for example, feed conversion efficiency) relative to the performance of other growers who receive birds at the same time.

At least to date, the pattern of contracting in the hog market is very different. In contrast to contract poultry production, hog farmers normally own the pigs and sell the finished animals to the packer under a marketing agreement or contract arrangement. Payment terms under the contracts vary, and contracts may have a term of several years. Some contracts pay on the basis of costs of production, but most pay on a formula with a basis of spot market hog prices or futures market prices. Hog contracts generally do not include payment provisions that link a producer's payment to the performance of other producers.

Many hogs are sold through long-term contractual arrangements that provide price guarantees to producers and packers if market prices fall outside a specified range or window (for example $40 to $45 per cwt). If market prices fall within the price window, the packer pays the market price. If market prices fall below the window ($30 per cwt, for example), the packer is obligated to pay a price that is above the market price but usually less than the lower window price ($35 for example). Conversely, if market prices exceed the upper limit ($55 for example), the packer pays less than the market price but usually more than the upper window price ($50 for example). Most of these contracts were initiated when market prices were considerably above current levels. Producers who entered into the contracts gave up some opportunity for high prices in return for a guarantee against very low prices. Packers in turn provided the price guarantee to assure a steady supply of hogs and protect against very high prices.

With some marketing contracts, called ledger contracts, some or all of the difference between the market price and the guaranteed price is recorded as a debit or credit. When market prices are low, producers accumulate debt to the packer and the packer incurs above-average procurement costs. When market prices are high, packers enjoy low procurement costs but will owe money to the producers. At the time the contract expires, either party may have an outstanding balance in the ledger account that is owed to the other party. These contracts differ in the way the outstanding balance is handled, but

frequently limit the choice to either paying off the balance or extending the contract. Producers and packers who rely heavily on these ledger contracts may face considerable financial exposure, depending on market price fluctuations.

Many producers have expressed concern that forward contracts and marketing agreements are, as a practical matter, not available to smaller producers, putting them at an unfair competitive disadvantage—particularly in a sharply falling market, where spot prices are much lower than prices under contracts negotiated before the market dropped. Available data indicate that many mid-size and small producers do have forward marketing arrangements with packers. However, the smallest producers (100 animals or fewer) are not able to contract unless they cooperate with other producers to meet packer quantity and assured supply requirements. This has not yet happened to any significant extent.

About 57 percent of hogs were marketed under some type of marketing contract with a packer in 1997 according to a recent study.[5] This is up dramatically from 11 percent in 1993. The study also showed that large producers rely on contracts more. About 24 percent of the hogs sold by farmers producing 1,000 to 2,000 head per year were sold under a marketing contract, while some 92 percent of hogs sold by producers marketing more than 500,000 head per year were sold under such contracts.

Historically, livestock producers have been less likely than dairy or crop producers to use cooperative marketing strategies. This has been attributed to livestock producers' preference for independence. The importance of cooperative marketing by livestock producers can be assessed by cooperatives' shares of products marketed. According to data collected by USDA's Rural Business Cooperative Services for 1997, cooperatives marketed 12 percent of the livestock and wool marketed off the farm, compared with 87 percent of the milk and 42 percent of the grains and oilseeds. Data do not provide sufficient information to report volumes or values segregated by species.

Despite the lack of detailed national level data, we know that cooperatives play a role in all aspects of production, marketing, and slaughter of hogs and the sale of pork products. The Nation's largest agricultural cooperative, Farmland Industries, owns and operates four hog slaughter plants and five additional facilities that further process pork into consumer-ready products. Farmland was the first major hog slaughtering firm to begin voluntary daily reporting of individual plant prices on the Internet. Farmland also established a $15 per cwt base-price floor for hogs in December 1998 to help producer owners when spot market prices fell below $10 per cwt, and ten regional livestock marketing cooperatives have hog sales operations.

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[5]John Lawrence, Glenn Grimes and Marvin Hayenga, "Production and Marketing Characteristics of U. S. Pork Producers, 1997-1998", Staff Paper 311, Department of Agricultural Economics, Iowa State University, December 1998.

A number of producer cooperatives have recently investigated opportunities for cooperatively owned hog slaughter facilities with the objective to increase net returns to producers through value-added pork marketing activities. These groups, however, face substantial hurdles related to economics of size and scale and capital requirements associated with the operation of slaughter facilities. The loss of equity among hog producers because of recent low prices only exacerbated the difficulties of producers to raise sufficient capital to meet minimum equity requirements to finance cooperative hog slaughter operations.

There may be other opportunities for hog producers to form cooperatives to improve their efficiency and marketing opportunities. The most practical opportunities may lie with the formation of hog breeding and marketing cooperatives. Such cooperatives might help smaller operators share in the advantages that large producers enjoy from access to improved genetic stock preferred by meat packers and to marketing arrangements which generally call for more deliveries than small and mid-sized operators can provide. USDA's Rural Business Cooperative Service works aggressively with farmers to develop and successfully manage cooperatives.

As the volume of hogs traded on the spot market has significantly declined, concerns have arisen about the accuracy and reliability of reported prices. A USDA investigation of the range of procurement and pricing arrangements for hogs in the western Cornbelt indicated that reported prices generally are lower than prices actually paid for hogs because the base hog for which prices are publicly reported did not reflect the characteristics of typical carcasses. Improvements are being made in USDA's reporting system to more nearly reflect current hog characteristics.

C. Increasing Price Spreads

Hog producers have expressed concern about the significant recent increase in the farm-to-retail "price spread" for pork—the difference between the price paid by the packer to the producer and the price paid by the consumer to the retail grocer. This concern is often stated in terms of the producer getting a diminishing share of the consumer's dollar, with the rest going to processing and marketing middlemen. The concern expressed is that these increasing price spreads may be a product of anticompetitive practices on the part of the packers or retailers. In recent weeks, hog producers have specifically questioned why retail prices for pork products have not declined more substantially in the face of the sharp declines in hog prices during the last few months in 1998. (See Appendix 6 for hog and pork price changes since 1970.)

The farmer's decreasing share of the retail commodity price is a phenomenon that has occurred not just in hogs or livestock, but throughout agriculture. The farm-value share for all domestically raised foods declined from 41 percent in 1950 to 23 percent in 1996. As touched upon below, this decline appears to be largely attributable to productivity

gains as well as conditions that make it more difficult for farmers to leave their occupation in times of economic hardship than it is for people in other walks of life.

In analyzing price spreads, it is important to look at spreads over the long term as well as over the short term, and to focus on constant-dollar figures that, unlike nominal prices, control for the effect of inflation. It is also useful, in considering whether spreads may be suggestive of anticompetitive activity, to separate the farm-to-retail price spread into its farm-to-wholesale and wholesale-to-retail segments. And it is important to keep in mind that, because the farm price is significantly lower than the retail price, a drop in farm value price, even if fully reflected at the retail level, will appear to have a proportionately smaller effect. For example, if the farm-value share for hogs is 25 percent of the prevailing retail price, then a 40 percent plunge in the farm price for hogs would translate into only a 10 percent change in the retail price.

These distinctions are important because, if anticompetitive activity were distorting prices, price-distorting effects would be expected to show up in long-term increases in the farm-to-retail price spread, beyond any increase attributable to overall inflation, and to show up in a way that indicates that those engaged in the anticompetitive activity are benefitting at the expense of others up or down the marketing chain.

Long-term price spread changes

These hallmarks of possible anticompetitive activity have not been evident with pork. As Appendix 7 shows, if the effects of inflation are removed, the long-term farm-to-retail price spread for pork, expressed as an annual average, has remained fairly constant since at least as far back as 1970—with the notable exception of 1998. Moreover, analysis indicates that the farm-to-wholesale segment of the price spread has declined over this 29-year period, while the wholesale-to-retail segment has increased; this is the opposite of what would be expected if the packers were engaged in anticompetitive activity.

At the retail level, although there has been an increase in the wholesale-to-retail segment of the long-term price spread over this 29-year period, the surrounding circumstances suggest that factors other than anticompetitive activity at the retail grocer level account for this increase.

First, if market power at the retail grocer level were causing the increase in the wholesale-to-retail price spread, one would expect the increase to be far more pronounced in the most concentrated local markets, rather than a generally observable phenomenon. And if undue consolidation at the retail grocer level were the culprit, one would expect the price spread increases to be discrete jumps that track mergers in specific markets, rather than an overall steady trend. We are not aware of data that show that either of these is the case.

Second, if market power at the retail grocer level were causing the increase in the

wholesale-to-retail price spread, one would also expect to hear the same complaints for all other items that grocery stores sell almost exclusively. Again, this is not the case.

Third, concentration in major local retail markets has remained virtually unchanged in recent years. An increase in retail margins because of retail grocer market power would have to be explained by an increase in retail grocer concentration, and could not be explained by high but unchanged levels of concentration.

If the price statistics are looked at in a slightly different way, they show that, while all three price levels—farm, wholesale, and retail—have steadily declined in constant dollar terms during the last 23 years, the wholesale-to-retail price spread has kept up with inflation, while the farm-to-wholesale price spread has not. This does not mean that the packers have been suffering, for they have realized significant cost savings as a result of innovations in production and marketing.

Likewise, although farm prices have also not kept pace with inflation, there are cost savings at work at the farm level as well—for example, increased yields per sow and specialization within the "farrow-to-finish" process. As mentioned earlier, retail grocers have many other cost inputs, which have risen significantly over this period. There have not been the same kinds of cost-reducing innovations at retail as there have been in hog production and pork packing.

Moreover, there is another reason why hog prices have not paralleled increases in retail prices. Family hog farmers may be subject to the predicament faced by family farmers in general: they are, to an unusual extent, tied to their occupation, even when the pay from that occupation falls very low. With steady gains in productivity, there is a natural tendency toward oversupply. Family farmers can, in theory, respond by leaving the farm to pursue other occupations, just as occurs in other occupations where there is an oversupply. But they face hurdles not generally found in the other occupations. For one thing, a family farmer generally owns the capital—the land and the equipment—and often has the family's personal finances tied up in that capital, having incurred debt to obtain or increase it. For another, a family farm is generally passed on from one generation to the next, much more so than in other occupations, with a corresponding emotional pressure on the next generation to maintain it. Indeed, more than most occupations, farming is considered not just an occupation, but a way of life. These factors reinforce a tendency toward oversupply that makes it difficult for producers to keep pace with overall price increases in the economy.

Our society has strong reasons for wanting to help as many family farmers as possible who so desire to remain profitably engaged in their livelihood, and for most of this century this has been a central farm policy goal. While pursuing this policy goal has benefitted our society in important respects, policymakers also need to be cognizant of the effects this may have on supply.

Short-term price spread changes

While long-term price spread data do not suggest anticompetitive activity, there clearly has been a recent increase in the farm-to-retail price spread. The suddenness and magnitude of the recent increase warrants examination.

Short-term fluctuations in the price spread—even dramatic ones—do not by themselves demonstrate anticompetitive activity. In a competitive market where supply and demand fluctuate, one would expect to see corresponding fluctuations in price, and price spread, over the short-term. There is considerable evidence, in studies going back over a few decades, that this is the case for many agricultural commodities, including pork.

In the theoretical model of a perfectly competitive market, one would expect to see price changes at one level quickly transmitted up and down the marketing chain, with short lag times that should be similar for increases and decreases alike. The actual experience is somewhat different: price increases at the farm and wholesale level influence prices at the retail level more quickly than do price decreases.

There are reasons explaining this asymmetry that are entirely consistent with competitive retail markets. Retail grocers are generally reluctant and slow to lower retail food prices in response to short-term wholesale price reductions for numerous reasons. First, for perishable commodities such as fresh meat, grocers are already under some pressure to move the product that has been in their stores or refrigerators the longest period first, before it spoils. In order to lower the retail price of the new, lower-cost pork, the grocer would also have to lower the retail price of the older, higher-cost pork, taking a loss or a lower profit on it. This problem does not arise when the newer cuts are priced higher than the older cuts.

Second, against a backdrop of an overall economy in which price levels tend to increase over time, wholesale price reductions, because they go against the trend, are regarded as more transitory than wholesale price increases. A retail grocer who marks down prices expects to be reversing course shortly, especially since other input costs are generally rising with inflation, regardless of short-term trends in the wholesale price of the commodity. On the other hand, a retail grocer who marks up prices does not expect to be reversing course. Grocers often express concern that their consumers will remember price increases more clearly than price decreases. While this will not prevent a grocer from eventually marking down a product in response to an enduring wholesale price reduction, it does slow down the grocer's response.[5]

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[5]See "Meat Price Spreads: What Do They Indicate", *Agricultural Outlook,* December, 1997, p. 14.

Third, in the particular market situation of the last three months of 1998, there was a surge in the number of hogs brought to the market that may have strained the capacity of pork packing plants. As mentioned above, there are indications that packing plants have recently been operating near or at full capacity. Such a short-term bottleneck at the packer level could be expected to result in price declines for hogs that might significantly outpace price declines at the retail level, at least until the supply of hogs adjusts or capacity constraints at packing plants no longer limit pork production.

Fourth, because many retailers have contracts with suppliers, it may take several weeks for contracts to reflect lower prices.

Fifth, because pork is just one of many products sold by a typical retail grocer, one would not expect as much pressure on such a grocer to immediately lower the retail pork price in order to preserve market share.

Price-spread data problems

There are also data problems at both the farm price and retail price levels that probably exaggerate the size of the price spread.

At the retail price level, the reported prices, which are usually based on unweighted averages published by the Bureau of Labor Statistics, probably do not adequately take into account the specials that grocers often run to move product at a reduced price, and the tendency of consumers to buy extra quantities during specials and stock up their freezers at home. Retail grocers maintain that pork product prices have declined by as much as 19 percent in the last year, even though BLS data record declines of only 2-3 percent.[6] While BLS data are useful for a wide variety of applications, a more systematic assessment of transactions-type data would enable a more accurate tracking of the adjustments of retail pork prices in response to changes in hog slaughter prices. Proprietary sources of data, such as retail grocery scanner data, are available that would enable a more precise measure of this response.

At the farm price level, the precipitous decline reported in hog slaughter prices in the last few months overstates what has happened in the overall hog slaughter market. This is because the reported prices are spot market prices, and do not include sales under longer-term contracts. Historically, spot sales have constituted the lion's share of the market; that has changed very dramatically over the last year or two, and contract sales now constitute more than 50 percent of all sales. Although some types of forward contracts—such as "window contracts"—adjust to partially reflect changes in the spot market price, long-term contracts are insulated from market fluctuations to a significant degree.

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[6]See David Barboza, "The Great Pork Gap", *New York Times*, January 7, 1999.

Accordingly, the volatility in the market is concentrated in the smaller spot market. As a result, recent events that have led to substantial oversupply relative to demand for hogs have depressed spot market prices far more than the forward contract market could have anticipated even as late as last summer.

Moreover, the quoted spot market price tends to understate even the actual prevailing spot market price. This is because, as mentioned above, the base hog for which prices are publicly reported does not reflect the characteristics of typical hog carcasses which lead to somewhat higher prices.

In sum: While price-spread statistics implicate important farm policy concerns and warrant further study, they are not inherently suspect from a competition perspective.

III. Recommendations

While this report has focussed on hog markets because of the severity of the recent price declines suffered by hog producers, the following recommendations apply as well to other livestock sectors, which are experiencing similar problems.

1. The Administration should support legislation to give the Secretary of Agriculture authority to require packers to report to USDA information on (a) prices paid by packers to livestock producers or others for animals for slaughter, either on the spot market or by contract; and (b) the terms of any such contracts. Such legislation should also authorize the Secretary, with appropriate protections for proprietary or competitively sensitive information, to publish data and information on prices and contract terms.

2. USDA should give a high priority to its efforts to educate small livestock producers about the functioning of the spot and contract markets, the formation of marketing cooperatives, and other collective action that small producers can take to pool their resources, reduce their risks, and participate in the contract market.

3. USDA should continue its active monitoring and review of contracting practices, other marketing practices, and plant closures by packers, to assure compliance with the Packers and Stockyards Act.

4. The NEC should appoint an inter-agency task force to monitor the functioning of the livestock markets for the remainder of 1999 and to make additional recommendations as appropriate.

5. The NEC should designate a small task force of economists to discuss ways in which the technology for estimating farm-to-retail price spreads for meat products can be made more accurate. The task force should meet with the staff of the Bureau of Labor Statistics to examine improvements in retail price reporting.

Appendix 1

Meat: Per capita consumption 1/

ITEM	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998 F*	1999 F*
			Pounds								
Beef	69.3	67.8	66.8	66.5	65.1	67.0	67.4	68.2	66.9	68.2	63.9
Veal	1.2	1.1	1.0	1.0	0.9	0.9	1.0	1.2	1.0	0.8	0.8
Pork	52.0	49.6	50.4	53.1	52.3	53.0	52.4	49.1	48.7	52.7	52.0
Lamb and mutton	1.4	1.4	1.4	1.4	1.3	1.2	1.2	1.1	1.1	1.1	1.0
Red meat	123.9	120.1	119.6	121.9	119.7	122.1	122.0	119.5	117.8	122.9	117.6
Broilers	57.2	59.5	62.1	65.9	68.5	69.6	68.8	70.8	72.7	74.2	76.8
Other chickens	2.1	2.0	1.9	1.9	1.8	1.8	1.5	0.9	0.5	0.4	0.5
Turkeys	16.8	17.6	17.9	17.9	17.7	17.8	17.9	18.5	17.8	18.0	17.5
All Meat	199.8	199.2	201.5	207.6	207.7	211.0	210.2	209.6	208.6	215.5	214.4

F* = Forecasts. 1/ Retail weight basis.

Source: ERS - USDA

Cattle balance sheet

Concentration of 4 and 8 largest hog, and steer and heifer slaughter firms, selected years, 1980-97[1]

Year	Top 4 firms	Top 8 firms	HHI index[2]
	-------Percent-------		
Hogs[3]			
1980	34	51	436
1985	32	51	456
1990	40	58	593
1995	46	69	754
1996	56	73	961
1997	54	76	NA
Steers and heifers[4]			
1980	36	51	561
1985	50	64	999
1990	72	82	1661
1995	79	86	1982
1996	79	86	1935
1997	80	88	NA

[1] Concentration is percentage of total commercial slaughter. Numerator values are number of head procured for slaughter during each firm's reporting (fiscal) year for 1980-95, and number of head slaughtered during the calendar year for 1996 and 1997.

[2] The HHI (Herfindahl-Hirshman Index) equals the sum of each firm's squared percentage share of total commercial slaughter.

[3] The eight largest hog slaughter firms in 1997, in alphabetical order, were ConAgra, Excel, Farmland, Hormel, IBP, Seaboard Farms, Smithfield Foods, and Thorn Apple Valley.

[4] The eight largest steer and heifer slaughter firms in 1997, in alphabetical order, were BeefAmerica, ConAgra, Excel, Farmland, Greater Omaha, IBP, Nebraska Beef, and Packerland.

Four-Firm Concentration of Supermarket Sales by Metropolitan Area for 1990 and 1996

Metropolitan	1990	1996
Boston	63.0	80.2
Chicago	85.4	82.4
Cleveland	83.2	85.9
Dallas	71.5	71.1
Detroit	85.0	77.5
Kansas City	86.7	85.2
Los Angeles	79.8	75.5
Miami	96.2	96.0
Minneapolis-St.Paul	98.5	99.5
New York	52.7	52.0
Philadelphia	75.5	68.5
Washington D.C.	81.9	82.8

Source: 1991 and 1997 Editions of *Market Scope*.

Table 2- PorkP Values Sp

Year	Retail price	Whsle. value	Gross farm value	By-prod. allow-ance	Net farm value	Farm-ret ll spread			Share of retail price			5&6-mkt. hogs
						Total	Whsle. retail	Farm whsle.	Whsle. retail	Farm whsle.	Farmers' share	
					Cents/lb.				Percent	Percent	Percent	$/cwt
1996												
Jan	201.1	102.1	71.9	4.8	67.1	134.0	99.0	35.0	49	17	33	42.26
Feb	208.2	105.7	78.0	4.9	74.1	134.1	102.5	31.6	49	15	36	46.47
Mar	209.7	108.3	82.9	5.2	77.7	132.0	101.4	30.6	48	15	37	48.76
1st qtr.	206.4	105.4	77.8	4.9	73.0	133.4	101.0	32.4	49	16	35	45.83
Apr	208.6	111.1	85.6	5.3	80.3	128.3	97.5	30.8	47	15	38	50.34
May	213.6	120.8	98.0	6.3	91.7	121.9	92.8	29.1	43	14	43	57.62
June	222.5	116.9	95.4	6.5	88.9	133.6	105.6	28.0	47	13	40	56.13
2nd qtr.	214.9	116.3	93.0	6.0	87.0	127.9	98.6	29.3	46	14	40	54.70
July	225.7	122.8	100.8	6.9	93.9	131.8	102.9	28.9	46	13	42	59.30
Aug	231.4	126.6	101.5	7.1	94.4	137.0	104.8	32.2	45	14	41	59.72
Sept	234.2	120.8	92.6	6.7	85.9	148.3	113.4	34.9	48	15	37	54.44
3rd qtr.	230.4	123.4	98.3	6.9	91.4	139.0	107.0	32.0	48	14	40	57.82
Oct	233.0	121.7	93.8	6.5	87.3	145.7	111.3	34.4	48	15	37	55.15
Nov	231.6	123.9	93.2	6.4	86.8	144.8	107.7	37.1	47	16	37	54.81
Dec	231.2	126.2	93.5	6.4	87.1	144.1	105.0	39.1	45	17	38	55.01
4th qtr.	231.9	123.9	93.5	6.5	87.0	144.9	108.0	36.9	47	16	38	54.99
1996												
Annual	220.9	117.2	90.7	6.1	84.6	136.3	103.7	32.6	47	15	38	53.33
1997												
Jan	232.7	118.6	80.8	6.2	84.4	148.3	113.1	35.2	49	15	36	53.30
Feb	231.3	117.6	87.4	6.1	81.3	150.0	113.7	36.3	49	16	35	51.43
Mar	228.9	115.7	82.1	5.8	76.3	152.6	113.2	39.4	49	17	33	48.27
1st qtr.	231.0	117.7	86.7	6.0	80.7	150.3	113.3	37.0	49	16	35	51.00
Apr	226.5	120.8	92.7	5.9	86.8	139.7	105.7	34.0	47	15	38	54.50
May	229.0	124.6	97.7	6.2	91.5	137.5	104.4	33.1	46	14	40	57.47
June	233.7	123.0	97.5	6.3	91.2	142.5	110.7	31.8	47	14	39	57.37
2nd qtr	229.7	122.8	95.9	6.1	89.8	139.9	106.9	33.0	47	14	39	56.45
July	232.7	123.4	100.0	6.7	93.3	139.4	109.3	30.1	47	13	40	58.82
Aug	236.0	123.3	91.6	6.5	85.1	150.9	112.7	38.2	48	16	36	53.89
Sept	234.7	117.4	84.2	5.9	78.3	156.4	117.3	39.1	50	17	33	49.53
3rd qtr.	234.5	121.4	91.9	6.3	85.6	148.9	113.1	35.8	48	15	36	54.08
Oct	234.9	110.5	78.9	5.7	73.2	161.7	124.4	37.3	53	16	31	46.41
Nov	231.3	107.9	75.3	5.4	69.9	161.4	123.4	38.0	53	16	30	44.33
Dec	226.8	101.5	67.0	4.9	62.1	164.7	125.3	39.4	55	17	27	39.40
4th qtr.	231.0	106.6	73.7	5.3	68.4	162.6	124.4	38.2	54	17	30	43.38
1997												
Annual	231.5	117.1	87.1	6.0	81.1	150.4	114.4	36.0	49	16	35	51.23
1998												
Jan	234.8	96.2	61.5	4.1	57.4	177.4	138.6	38.8	59	17	24	36.20
Feb	234.5	94.0	58.4	3.8	54.6	179.9	140.5	39.4	60	17	23	34.38
Mar	229.8	91.4	58.2	3.9	54.3	175.5	138.4	37.1	60	16	24	34.24
1st qtr.	233.0	93.8	59.3	3.9	55.4	177.6	139.2	38.4	60	16	24	34.93
Apr	225.0	91.0	59.7	4.0	55.7	169.3	134.0	35.3	60	16	25	35.12
May	226.7	99.8	71.0	4.7	66.3	160.4	126.9	33.5	56	15	29	41.77
June	228.9	98.0	70.7	4.9	65.8	163.1	130.9	32.2	57	14	29	41.60
2nd qtr	226.9	96.3	67.1	4.5	62.6	164.3	130.6	33.7	58	15	28	39.50
July	231.0	94.9	61.7	4.1	57.6	173.4	136.1	37.3	59	18	25	36.32
Aug	230.9	96.4	59.3	3.9	55.4	175.5	134.5	41.0	58	18	24	34
Sept	231.2	93.2	51.2	3.3	47.9	183.3	138.0	45.3	60	20	21	30.13
3rd qtr.	231.0	94.8	57.4	3.8	53.6	177.4	136.2	41.2	59	18	23	33.77
Oct	230.2	91.1	45.0	3.0	42.0	188.2	139.1	49.1	60	21	18	26.51
Nov	226.9	84.6	30.2	2.1	28.1	198.8	142.3	56.5	63	25	12	17.75
Dec	223.5	80.1	23.4	1.6	21.8	201.7	143.4	58.3	64	26	10	13.77
4th qtr.	226.8	85.2	32.8	2.2	30.6	196.2	141.6	54.6	62	24	13	19.34
1998												
Annual	229.5	92.6	54.2	3.6	50.6	178.9	136.9	42.0	60	18	22	31.89

Major hog slaughter plant openings, expansions, and closings since 1994

Plant	Location	Year	Weekly capacity
Openings			
Farmland[1]	Dubuque, IA	1996	60,500
Seaboard Farms[2]	Guymon, OK	1995	82,500
IBP[3]	Logansport, IN	1995	73,700
Premium Standard	Milan, MO	late 1994	38,500
Total			255,200
Expansions			Weekly capacity increase
Excel	Ottumwa, IA	1998	24,750
IBP	Waterloo, IA	1998	5,500
Indiana Pack	Delphi, IN	1996	22,000
Smithfield[4]	Tar Heel, NC	1996	44,000
		1995	41,250
Hormel	Austin, MN	1995	16,500
Hormel	Fremont, NE	1995	9,350
Total			163,350
Closings			Weekly capacity
Thorn Apple Valley	Detroit, MI	1998	77,000
Dakota Pork	Huron, SD	1997	41,800
IBP	Council Bluffs, IA	1997	40,150
Fisher	Louisville, KY	1997	16,500
Premium Pork	Moultrie, GA	1996	25,850
Worthington Pack	Worthington, IN	1996	25,850
FDL	Dubuque, IA	1995	60,500
Total			287,650

[1] Farmland purchased and re-opened the plant in 1996, which FDL had closed in 1995.

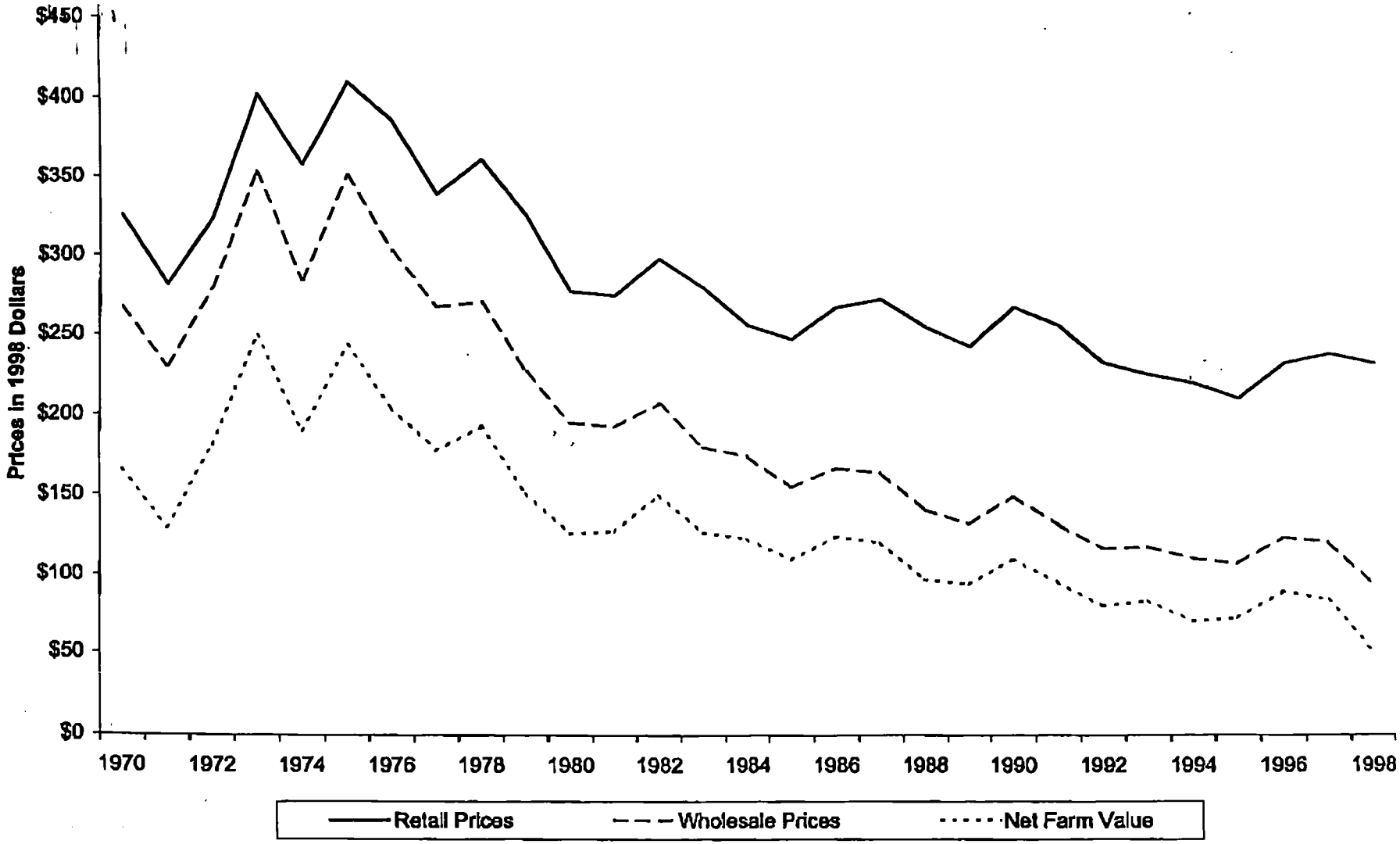
[2] Seaboard opened the plant in 1995 and doubled its capacity in 1998 to the volume indicated.

[3] IBP purchased and re-opened the former Wilson plant in 1995 and doubled its capacity in 1996 to the volume indicated.

[4] Smithfield originally opened this plant late in 1992 and increased its capacity by the amounts indicated in 1995 and 1996. The plant is currently operating at approximately 75 percent of its estimated 176,000 head per week capacity due to environmental restrictions.

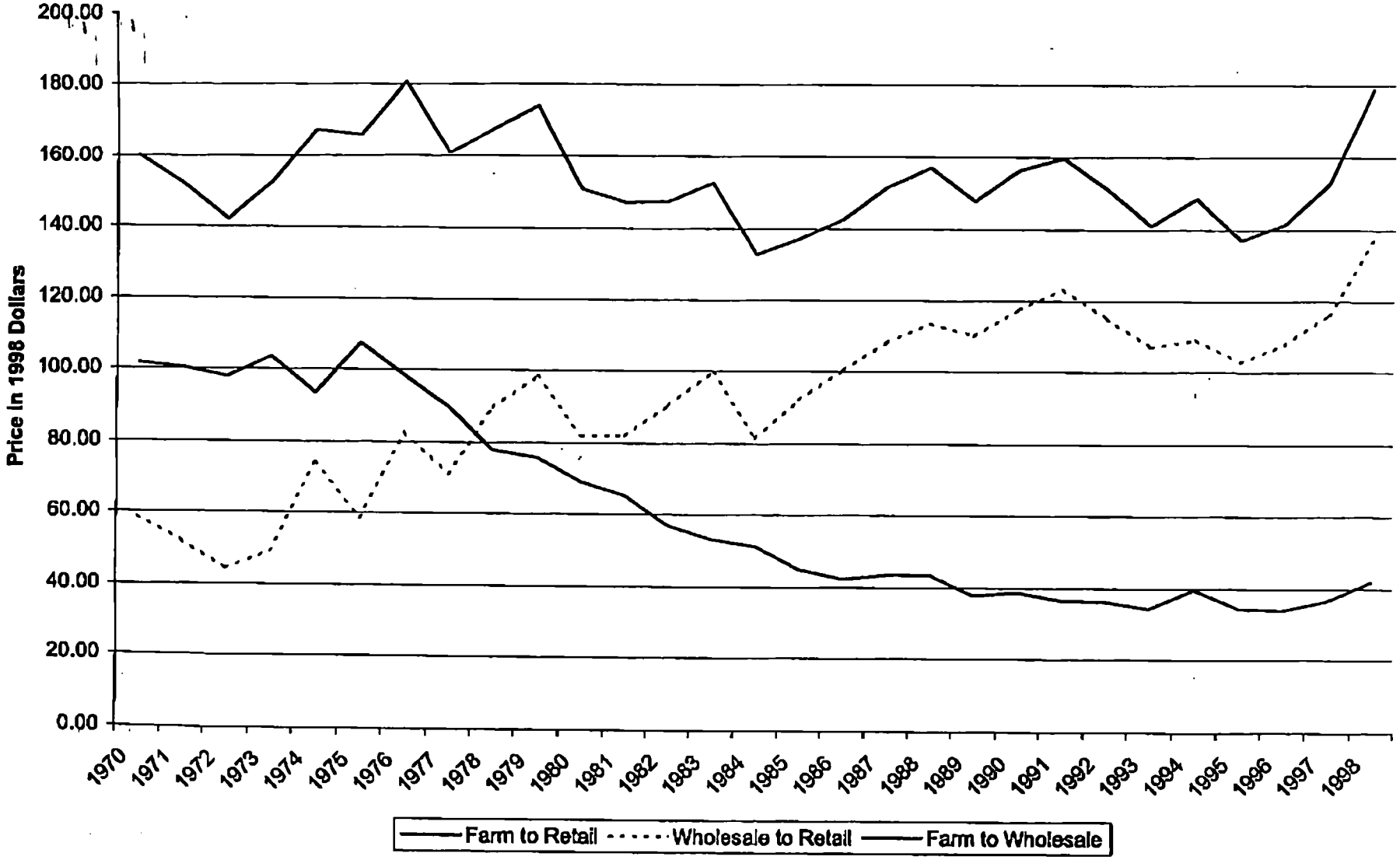
Appendix B

Annual Pork Prices



Source: USDA-Economic Research Service and Bureau of Labor Statistics

Annual Pork Price Spreads (1970 to 1998)



February 3, 1999

REPORT
OF NATIONAL ECONOMIC COUNCIL TASK FORCE ON HOG INDUSTRY STRUCTURE AND PRACTICES

EXECUTIVE SUMMARY

This report addresses concerns expressed by hog producers and others that the recent sharp decline in hog prices—and the failure of wholesale (packer) and retail pork prices to fully reflect that decline—indicates that markets are not functioning properly. Specifically, questions have been raised as to whether the recent price changes are a result of undue concentration at the packer level or unfair or anticompetitve practices by packers or retailers.

There is no question that there is a long-term trend toward fewer, and larger, hog producers. There are now about 114,000 hog producers, as opposed to more than 1,000,000 thirty years ago. While there is still a sizeable number of small producers (about 70,000 who produce fewer than 100 hogs a year), large producers (1000 hogs or more) now account for 63.5% of total production. This trend toward larger production units reflects economies of scale that have accompanied technological developments in hog production.

At the same time, concentration at the meatpacker level has increased, with the top four packers now accounting for 54% of hog slaughter (as compared to 34% in 1980), and the top eight firms now accounting for 73% of hog slaughter. But these concentration levels are still considerably lower than those that prevail in cattle slaughter, and lower than levels that antitrust enforcement agencies regard as triggering concern about market power. While concentration is higher if analyzed on a regional basis, a USDA study found that pricing patterns are consistent with a national market for hog slaughter.

At the retail level, national concentration is low. Concentration in local retail markets is often relatively high, but has not increased significantly in recent years. Nor is there evidence that pricing patterns correlate with the degree of concentration in local markets.

The task force examined some of the specific allegations of market problems. It found that slaughter capacity was strained and that there was a "bottleneck" problem at the packer level in late 1998, when hog production soared. There also have been some recent packer acquisitions of closed plants that have not been reopened. But, taking a longer view, there does not appear to be a capacity problem. Some of the recent closings and decisions not to expand may have reflected a reaction to an excess capacity situation in 1997. And over the last five years, total slaughter capacity actually increased somewhat, with added capacity from openings and expansions of facilities exceeding decreases in capacity resulting from plant closings.

A great deal of concern has been expressed about the trend to greater use of forward contracting for hogs by packers, and the concomitant decline in volume on the spot market. A few years ago, the spot market accounted for 80% of hog sales to packers; now the figure is less than 50%. There are reasons why forward contracting makes economic sense for both packers and producers: it assures packers a steady and predictable supply of hogs meeting their quality standards, and protects both buyer and seller against market price swings. But there is no question that long-term contracting is not, as a practical matter, easily available to the smallest producers, who are not in a position to satisfy the packers' requirements for quantity and certainty of supply. In a sharply declining spot market such as the one that prevailed in 1998, smaller producers are hurt more, while their larger competitors enjoy considerable protection from the downward spiral as a result of their long-term contracts. These smaller producers, moreover, have historically been reluctant to form marketing cooperatives so that they could participate more effectively in the contract market.

The other issue of major concern has been the dramatic increase in the farm-to-retail price spread in 1998, as hog prices dropped sharply. The report concludes that this appears to be a short-term phenomenon; there is no evidence that the price spread has grown significantly over the long term, once the effects of inflation are eliminated. The short-term increase in the price spread has been almost all in the wholesale-to-retail portion of the spread, and there are a number of factors other than anticompetitive conduct by retailers that appear to be at work. These include a long-observed natural lag in reflecting reductions of meat prices at the retail level, the temporary bottleneck in hog slaughter, and inaccuracies in the reported price data that lead to the conclusion that the price spread is somewhat overstated.

While there may not be a basis for antitrust concern because of undue concentration or overt anticompetitive practices, there is no question that small producers have been disadvantaged by recent marketplace developments, and that steps should be taken to assure that they can compete effectively and survive. The report concludes with a number of recommendations designed to increase the transparency of the market for the sale of hogs for slaughter, assist small producers in coping with changes in that market, and improve the accuracy of price spread data. The most important recommendation is for new legislation giving USDA authority to require packers to report to the Government the prices they pay for hogs (both on the spot market and under contracts) and the terms of contracts; USDA would, in turn, make that information, in appropriate form, available to the public. The report also recommends that USDA give priority to its efforts to educate smaller producers about the marketplace and opportunities for them to pursue cooperative marketing strategies to participate in the contract market. USDA should also continue its active monitoring and review of contracting and other marketing practices by packers, so that any unfair practices can be eliminated. Finally, the NEC should establish an inter-agency task force to monitor the functioning of livestock markets over the remainder of this year, and should work with USDA and the Bureau of Labor Statistics to improve the accuracy of the reporting of farm-to-retail price spreads.

Accordingly, the volatility in the market is concentrated in the smaller spot market. As a result, recent events that have led to substantial oversupply relative to demand for hogs have depressed spot market prices far more than the forward contract market could have anticipated even as late as last summer.

Moreover, the quoted spot market price tends to understate even the actual prevailing spot market price. This is because, as mentioned above, the base hog for which prices are publicly reported does not reflect the characteristics of typical hog carcasses which lead to somewhat higher prices.

In sum: While price-spread statistics implicate important farm policy concerns and warrant further study, they are not inherently suspect from a competition perspective.

III. Recommendations

While this report has focussed on hog markets because of the severity of the recent price declines suffered by hog producers, the following recommendations apply as well to other livestock sectors, which are experiencing similar problems.

1. The Administration should support legislation to give the Secretary of Agriculture authority to require packers to report to USDA information on (a) prices paid by packers to livestock producers or others for animals for slaughter, either on the spot market or by contract; and (b) the terms of any such contracts. The Secretary could tailor the reporting requirements to assure that they do not impose an undue reporting burden on the industry. Such legislation should also authorize the Secretary, with appropriate protections for proprietary or competitively sensitive information, to publish data and information on prices and contract terms.

2. USDA should give a high priority to its efforts to educate small livestock producers about the functioning of the spot and contract markets, the formation of marketing cooperatives, and other collective action that small producers can take to pool their resources, reduce their risks, and participate in the contract market.

3. USDA should continue its active monitoring and review of contracting practices, other marketing practices, and plant closures by packers, to assure compliance with the Packers and Stockyards Act.

4. The NEC should appoint an inter-agency task force to monitor the functioning of the livestock markets for the remainder of 1999 and to make additional recommendations as appropriate.

5. The NEC should designate a small task force of economists to discuss ways in which the technology for estimating farm-to-retail price spreads for meat products can be made more accurate. The task force should meet with the staff of the Bureau of Labor Statistics to examine improvements in retail price reporting.

February 12, 1999

REPORT
OF NATIONAL ECONOMIC COUNCIL TASK FORCE ON HOG INDUSTRY STRUCTURE AND PRACTICES

EXECUTIVE SUMMARY

This report addresses concerns expressed by hog producers and others that the recent sharp decline in hog prices—and the failure of wholesale (packer) and retail pork prices to fully reflect that decline—indicates that markets are not functioning properly. Specifically, questions have been raised about increased concentration at the packer level and whether the recent price changes are a result of unfair or anticompetitve practices by packers or retailers.

There is no question that there is a long-term trend toward fewer, and larger, hog producers. There are now about 114,000 hog producers, as opposed to more than 1,000,000 thirty years ago. While there is still a sizeable number of small producers (about 70,000 who produce fewer than 100 hogs a year), large producers (1000 hogs or more) now account for 63.5% of total production. This trend toward larger production units reflects economies of scale that have accompanied technological developments in hog production.

At the same time, concentration at the meatpacker level has increased, with the top four packers now accounting for 54% of hog slaughter (as compared to 34% in 1980), and the top eight firms now accounting for 73% of hog slaughter. But these concentration levels are still considerably lower than those that prevail in cattle slaughter, and lower than levels that antitrust enforcement agencies regard as indicative of a highly concentrated industry. While concentration is higher if analyzed on a regional basis, a USDA study found that pricing patterns are consistent with a national market for hog slaughter.

At the retail level, national concentration is low. Concentration in local retail markets is often relatively high, but has not increased significantly in recent years. Nor is there evidence that pricing patterns correlate with the degree of concentration in local markets.

The task force examined some of the specific allegations of market problems. It found that slaughter capacity was strained and that there was a "bottleneck" problem at the packer level in late 1998, when hog production soared. There also have been some recent packer acquisitions of closed plants that have not been reopened. But, taking a longer view, there does not appear to be a capacity problem. Some of the recent closings and decisions not to expand may have reflected a reaction to an excess capacity situation in 1997. And over the last five years, total slaughter capacity actually increased somewhat, with added capacity from openings and expansions of facilities exceeding decreases in capacity resulting from plant closings.

A great deal of concern has been expressed about the trend to greater use of forward contracting for hogs by packers, and the concomitant decline in volume on the spot market. A few years ago, the spot market accounted for 80% of hog sales to packers; now the figure is less than 50%. There are reasons why forward contracting makes economic sense for both packers and producers: it assures packers a steady and predictable supply of hogs meeting their quality standards, and protects both buyer and seller against market price swings. But long-term contracting is not, as a practical matter, easily available to the smallest producers, who are not in a position to satisfy the packers' requirements for quantity and certainty of supply. In a sharply declining spot market such as the one that prevailed in 1998, smaller producers are hurt more, while their larger competitors enjoy considerable protection from the downward spiral as a result of their long-term contracts. These smaller producers, moreover, have historically been reluctant to form marketing cooperatives so that they could participate more effectively in the contract market.

The other issue of major concern has been the dramatic increase in the farm-to-retail price spread in 1998, as hog prices dropped sharply. The report concludes that this appears to be a short-term phenomenon; there is no evidence that the price spread has grown significantly over the long term, once the effects of inflation are eliminated. The short-term increase in the price spread has been almost all in the wholesale-to-retail portion of the spread, and there are a number of factors other than anticompetitive conduct by retailers that appear to be at work. These include a long-observed natural lag in reflecting reductions of meat prices at the retail level, the temporary bottleneck in hog slaughter, and inaccuracies in the reported price data that lead to the conclusion that the price spread is somewhat overstated.

While there may not be a basis for antitrust concern because of concentration levels or evidence of anticompetitive practices, there is no question that small producers have been disadvantaged by recent marketplace developments, and that steps should be taken to assure that they can compete effectively and survive. The report concludes with a number of recommendations designed to increase the transparency of the market for the sale of hogs for slaughter, assist small producers in coping with changes in that market, and improve the accuracy of price spread data. The most important recommendation is for new legislation giving USDA authority to require packers to report to the Government the prices they pay for hogs (both on the spot market and under contracts) and the terms of contracts; USDA would, in turn, make that information, in appropriate form, available to the public. The report also recommends that USDA give priority to its efforts to educate smaller producers about the marketplace and opportunities for them to pursue cooperative marketing strategies to participate in the contract market. USDA should also continue its active monitoring and review of contracting other marketing practices, and plant closures by packers, so that any unfair practices can be eliminated. Finally, the NEC should establish an inter-agency task force to monitor the functioning of livestock markets over the remainder of this year, and should work with USDA to improve the accuracy of data on farm-to-retail price spreads.

February 12, 1999

REPORT
OF NATIONAL ECONOMIC COUNCIL TASK FORCE ON HOG INDUSTRY STRUCTURE AND PRACTICES

The recent sharp decline in prices paid to hog producers, and the failure of wholesale (packer) or retail prices to reflect that decline has led to concerns, by producers and others, that wholesale and retail hog/pork markets are not functioning properly, because of increased concentration and the exercise of market power by packers in their dealings with producers, or because of unfair or anticompetitive practices by packers or retailers. This report was prepared at the request of the National Economic Council. Its preparation was coordinated by the Office of the White House Counsel with the participation of the U. S. Department of Agriculture, and in consultation with the Antitrust Division of the Department of Justice and the staff of the Federal Trade Commission. The report describes how pork is produced and marketed in the United States; analyzes concentration at both the packer and retail levels; evaluates capacity constraints at the packer level and the impacts of the trend toward greater use of forward contracting by packers in purchasing hogs for slaughter; and discusses the reasons for the recent increases in the spread between retail prices and the prices received by hog producers. Finally, the report sets forth some initial recommendations.

I. Hog Production and Marketing in the United States

Hog production, measured by number of head slaughtered, was 101 million head in 1998. This is the first time slaughter exceeded 100 million head and represented a 10 percent increase from 1997. Pork production in 1998 was 19 billion pounds, up 10 percent over 1997. Per capita pork consumption increased from 48.7 pounds in 1997 to an estimated 52.8 pounds in 1998. (See Appendix 1.) The total hog and pig inventory in December 1998 was 62.2 million head, 2 percent more than a year earlier. Because of the large inventory, USDA is projecting that slaughter levels and pork production during the first half of 1999 will exceed levels observed in the first half of 1998. Year-over-year declines are expected in the second half of 1999 so that annual pork production is forecast to be marginally smaller, at 18.9 billion pounds.

A. Hog Producers

Over the last three decades the structure of hog production has evolved toward fewer and larger operations, mirroring the general trend in the structure of American agriculture. In 1967 there were 1.047 million hog operations. This fell to 667,000 in 1980 and to 114,000 in 1998. (See Appendix 2). Our most recent data show that between 1997 and 1998 the number of operations fell by 8,000 or 6.4 percent.

Commercial hog production traditionally consisted of small to medium size farrow-to-finish operations. In such operations, the farmer owned sows that produced pigs, which were then raised to market weight, often using grain produced on the same farm.

Marketing was primarily on a cash-market basis. These farrow-to-finish systems are still common, especially in the traditional Cornbelt hog production region.

Today, larger operations dominate the supply of hogs. Operations with more than 1,000 hogs accounted for only 5.9 percent of the operations in 1998 but 63.5 percent of total inventory. In just the past 6 years the percentage of total inventory accounted for by these large operations has grown from 28 percent to 63.5 percent. There were 1,915 operations with over 5,000 head on inventory.

While large operations dominate hog supply, operations with fewer than 100 head still account for 62 percent of all operations. These small producers account for only 2 percent of the U.S. hog inventory. Small hog operations are of insufficient size to provide a livelihood for their owners. As a result, they are usually operated in conjunction with other farm enterprises such as grain production and/or off-farm employment.

Hog production continues to be concentrated in the north central states. Iowa, Illinois, Minnesota, Indiana, Missouri, and Nebraska are major producers. Hog production has spread to other areas, notably North Carolina, now the second largest hog producer, Oklahoma, and Colorado. Growth in these and a few other states has been characterized by relatively few but very large operations.

Hog production in the United States has become more efficient in general, with larger operations tending to have higher litter rates and more litters per year than smaller operations. For example, operations with more than 5,000 hogs in 1998 had 24 percent more pigs per litter than operations with less than 100 head. Feed conversion to useable meat has been improving and the quality of hogs marketed has also improved. Producers are using improved genetic stock to produce more standardized hogs with carcass characteristics desired by meat packers and consumers. The growth in large operations can be attributed to efficiencies from economies of scale and pecuniary economies that come from bulk purchases of inputs at lower unit prices.

B. Meatpacking

Press reports and many in the industry have blamed recent low hog prices, in part, on a lack of competition in hog slaughter and insufficient slaughter capacity. While the hog slaughtering industry has undergone consolidation in recent years, its current level of concentration is below the threshold level usually viewed by antitrust enforcement agencies as "concentrated". In 1994, insufficient slaughter capacity also was blamed for low prices and low returns to producers. However, as a result of plant openings and expansion of existing plants, total hog slaughter capacity has increased since 1994 in spite of the closing of three large plants in 1997 and 1998. The data indicate there was excess capacity prior to these recent plant closings and the large increase in hog production in

late 1998.

The number of hog slaughter plants operated by firms purchasing $500,000 or more of livestock annually has declined since 1980, while average plant size has increased. The number of small and medium size plants slaughtering 1,000 to 1,000,000 hogs per year also declined, from 393 in 1980 to 201 in 1996, the latest year for which data are available. Similarly, the number of large plants (over 1,000,000 head per year) declined, from 41 in 1980 to 32 in 1997, but has remained constant since 1990. The average size of these large plants doubled from 1.4 million head in 1980 to 2.8 million head in 1997. Over half of the increase in the size of the large plants occurred since 1990 as slaughter firms moved to achieve economies of scale. The slaughter plants that closed were generally older, less efficient plants.

The four-firm concentration ratio for commercial hog slaughter has increased from 34 percent in 1980 to 54 percent in 1997, and the eight-firm ratio increased from 51 to 73 percent. By comparison, the four largest firms accounted for 80 percent of steer and heifer slaughter in 1997, and the eight largest accounted for 88 percent. (See Appendix 3.)

The Herfindahl-Hirschman Index (HHI) is a measure of concentration used by the Department of Justice and the Federal Trade Commission as one tool in evaluating mergers. The HHI value for hog slaughter firms in 1996 was below 1,000, which is generally interpreted as indicating a relatively unconcentrated industry. (While precise HHI figures are not yet available for more recent years, other available data indicate that the HHI value has, if anything, decreased since then.)

On a regional basis, there are fewer hog slaughter firms in the Southeast (NC, SC, VA), Southwest (TX, OK, NM), and West (CA, UT). A large share of the hogs produced in these regions is produced by packer-owned production units or through contracts with hog farmers. However, a 1996 USDA study of Concentration in the Red Meat Packing Industry found that this higher regional concentration in hog slaughter was not reflected in prices paid for hogs; it found that geographic pricing patterns were consistent with a single national market for slaughter hogs.

C. Retailers

The retail grocery segment supplies pork products, as well as other food items, directly to consumers. At the national level, the concentration of sales among chain and other grocery retailers has traditionally been relatively low, but has been increasing in the past few years. In 1997, for example, over two hundred grocery store chains operated in the U.S., along with several thousand independent grocers, and the four largest chains—Kroger, Safeway, Albertson's and American Stores—accounted for approximately 23

percent of all supermarket sales.[1] If all the recently announced grocery mergers are consummated, the five largest chains may account for 40 percent of sales. At the local level, where competition for consumer dollars occurs, concentration of sales is generally considerably higher, but varies across local areas and has not increased significantly since 1990. In 1996, for instance, the data in Appendix 4 indicate that the four largest supermarket operators accounted for 96 percent of sales in Miami but only 52 percent of sales in New York. The appendix also summarizes concentration for a sample of a few other large metropolitan areas.

The Federal Trade Commission reviews mergers among retail grocers, and from time to time has challenged mergers to protect competition in local markets in which the merger would have resulted in undue concentration among retail grocers. Typically, consent decrees have been reached allowing the merger to go forward once the parties agreed to divest a sufficient number of stores in the local markets where the merger would have otherwise threatened to harm competition.

A large volume of meat is consumed at hotels, restaurants and institutions (HRI) and is not sold by grocery stores. In 1992 (the latest data available), about 7 percent of meat packers' sales and 22 percent of meat wholesalers' sales were to HRI customers. Separate data are not available for pork products. The Government's farm-to-retail price spread series (see Appendix 5) includes prices at grocery stores but does not include prices paid by the HRI segment of the market.

Consumer demand for pork is relatively unresponsive to price changes (inelastic). A decrease in the price of pork will encourage some people to consume more meat products and encourage others to reallocate their meat budget from other meats to pork. However, the increase in pork consumption will not be proportionate to the fall in price. Economists have estimated that a 10 percent decrease in the price of pork at retail, holding other prices constant, will result in about a 7 percent increase in pork consumption.[2] Conversely, a 10 percent increase in the quantity of pork supplied would require about a 14 percent decrease in price to clear the market. As the quantity of pork increases, it would require proportionately larger reductions in price to clear the market.

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[1] These data were computed from information contained in the *Directory of Supermarket, Grocery & Convenience Store Chains, 1998*, and from statistics published by the Food Marketing Institute.

[2] S. H. Huang and R. Haidacher. 1989. "An Assessment of Price and Income Effects on Changes in Meat Consumption." In *The Economics of Meat Demand,* ed. R. C. Buse. Proceeding of the Conference on the Economics of Meat Demand, October 20-21, 1986, Charleston, South Carolina.

II. Issues

A. Slaughter Capacity

Recent press reports and comments by the National Pork Producers' Council attribute the current low hog prices in part to a marketing "bottleneck" created by insufficient slaughter capacity. USDA has been investigating plant closings to determine the reasons for the closings and their impact on overall capacity.

According to some industry members and market analysts, excess hog slaughter capacity existed in 1997 and was expected to continue beyond 1998.[3] That forecast underestimated the speed of the expansion in hog production that was already underway at the time. Ronald Plain at the University of Missouri said in February 1997 that it was likely the industry would reach slaughter levels of more than 100 million head per year within 5 years.[4] The expansion occurred faster than expected and slaughter volumes in late 1998 were equivalent to an annual slaughter rate of more than 100 million head.

Three plants closed by Thorn Apple Valley, Dakota Pork, and IBP in 1997 and early 1998 contributed to the shortage of slaughter capacity when hog supplies were very large in late 1998. However, the three firms claimed that their decisions to close the plants were based on inability to operate the plants profitably, based on price and cost relationships at those specific plants at the time they were closed. For the industry as a whole, openings and expansions of other plants have increased total slaughter capacity by about 66,000 head per week (about 3.4 million head per year) since 1994, the last time low prices were blamed on insufficient capacity.

Smithfield Foods has temporarily shelved plans for construction of a new plant in Utah, where the company is developing an integrated production system similar to the one it has in the Southeast. Smithfield purchased the Dakota Pork plant in Huron, South Dakota subsequent to the plant's closing in 1997, and also purchased a closed Georgia plant in 1996. Smithfield has given no indication it intends to reopen either plant. Seaboard has plans to build an additional plant in Kansas, and IBP reportedly is considering an additional plant in Kansas, but these firms do not appear to be actively implementing these plans.

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[3] For example, John Lawrence at Iowa State University said throughout 1997 and 1998 that packer capacity was expected to remain in excess of hog supplies for several years. John D. Lawrence, "What's Ahead for the U.S. Pork Industry: 1997," Iowa State University, paper presented at National Pork Producers Competitiveness seminars in 1997 and 1998.

[4] Ronald L. Plain, "Changing Structure of the U.S. Hog Industry -- U.S. and Abroad," University of Missouri-Columbia, February 6, 1997.

Hog slaughter capacity expansion has been affected to some extent by regulations and public resistance derived from environmental concerns. Several recent press reports have indicated that Smithfield Foods' Tar Heel, North Carolina plant is restricted to operating at 75 percent of capacity due to regulatory restrictions on the volume of wastewater it may discharge. Hog slaughter plant expansion may also be influenced by environmental constraints on hog production; packing firms will be less likely to initiate expansion plans if they believe hog production may be constrained or even reduced by environmental regulation. There have been and continue to be many instances of resistance to, and often regulatory denial of, producers' attempts to expand hog production. But it is difficult to quantify this impact.

Plant openings and closings have resulted in some geographic redistribution of U.S. slaughter capacity, resulting in smaller shares for the Corn Belt and Plains regions and larger shares for the Southeast and Southwest regions. Capacity increased during the last five years as a result of new plant construction and expansion of existing plants in the Southeast and Southwest, primarily by Seaboard and Smithfield Foods, packers that both rely heavily on packer feeding and contract hog production. Capacity in the eastern Corn Belt (MI, IN, OH, PA, and KY) and Plains states (ND, SD, NE, KS, CO) has declined. Capacity in the western Corn Belt (MN, WI, IA, IL, MO) has remained relatively constant, as construction, reopenings, and expansion of some plants has offset closings of others. (See Appendix 6.) As already noted, USDA's 1996 study of Concentration in the Red Meat Packing Industry found that geographic hog pricing patterns were consistent with a single national market for slaughter hogs.

In summary, recent low hog prices were likely influenced by limited slaughter capacity, in the face of rapidly expanding production. While some existing slaughter plants are expanding capacity, three other large slaughter plants were closed in 1997 and 1998. As the number of hogs available for slaughter varies with the swings in the production cycle, there are likely to be future periods when the slaughter capacity will be insufficient. Likewise, there will likely be periods of excess capacity when less efficient plants may be under considerable pressure.

B. Contracting Practices

A large and growing proportion of hogs—more than half—is marketed under some form of contractual arrangement between the producer and packer. Production contracts often specify production practices and genetics that help assure that hogs will conform to a packer's product requirements. Contract producers provide packers a steady supply of hogs, which leads to slaughter efficiencies. Most contracts and other marketing agreements provide for delivery of a specific number of hogs on a regular schedule, the increased certainty of which benefits both the producer and the packer. Contract arrangements have often enabled producers to obtain credit to enter or expand hog production and to reduce some price risks for hogs and feed. Because these contractual

arrangements are premised on volume and consistency of supply, they are generally not as available or accessible to smaller producers.

Producers are concerned that hog production will follow the path of contract poultry production, and that they will lose their independence. Poultry production is heavily vertically integrated with poultry processors owning the chicks and contracting with growers for the finishing of the birds. The processor/integrator also provides the feed. The term of poultry contracts is very short, usually covering a single flock, which is about six weeks. Growers are compensated for the use of their facilities, their time and their management of the flock. Grower payments are based, in part, on a grower's performance (for example, feed conversion efficiency) relative to the performance of other growers who receive birds at the same time.

At least to date, the pattern of contracting in the hog market is very different. In contrast to contract poultry production, hog farmers normally own the pigs and sell the finished animals to the packer under a marketing agreement or contract arrangement. Payment terms under the contracts vary, and contracts may have a term of several years. Some contracts pay on the basis of costs of production, but most pay on a formula with a basis of spot market hog prices or futures market prices. Hog contracts generally do not include payment provisions that link a producer's payment to the performance of other producers.

Many hogs are sold through long-term contractual arrangements that provide price guarantees to producers and packers if market prices fall outside a specified range or window (for example $40 to $45 per cwt). If market prices fall within the price window, the packer pays the market price. If market prices fall below the window ($30 per cwt, for example), the packer is obligated to pay a price that is above the market price but usually less than the lower window price ($35 for example). Conversely, if market prices exceed the upper limit ($55 for example), the packer pays less than the market price but usually more than the upper window price ($50 for example). Most of these contracts were initiated when market prices were considerably above current levels. Producers who entered into the contracts gave up some opportunity for high prices in return for a guarantee against very low prices. Packers in turn provided the price guarantee to assure a steady supply of hogs and protect against very high prices.

With some marketing contracts, called ledger contracts, some or all of the difference between the market price and the guaranteed price is recorded as a debit or credit. When market prices are low, producers accumulate debt to the packer and the packer incurs above-average procurement costs. When market prices are high, packers enjoy low procurement costs but will owe money to the producers. At the time the contract expires, either party may have an outstanding balance in the ledger account that is owed to the other party. These contracts differ in the way the outstanding balance is handled, but frequently limit the choice to either paying off the balance or extending the contract.

Producers and packers who rely heavily on these ledger contracts may face considerable financial exposure, depending on market price fluctuations.

According to a recent study, about 57 percent of hogs were marketed under some type of marketing contract with a packer in 1997.[5] This is up dramatically from 11 percent in 1993. The study also showed that large producers rely on contracts more. About 24 percent of the hogs sold by farmers producing 1,000 to 2,000 head per year were sold under a marketing contract, while some 92 percent of hogs sold by producers marketing more than 500,000 head per year were sold under such contracts.

Many producers have expressed concern that forward contracts and marketing agreements are, as a practical matter, not available to smaller producers, putting them at a significant competitive disadvantage in terms of their ability to manage risk from price variability. Small producers are particularly vulnerable in a sharply falling market, where spot prices are much lower than prices under contracts negotiated before the market dropped. Available data indicate that many mid-size and small producers (as well as large producers) have forward marketing arrangements with packers. However, the smallest producers (100 animals or fewer) are not able to contract unless they cooperate with other producers to meet packer quantity and assured supply requirements. This has not yet happened to any significant extent.

Historically, livestock producers have been less likely than dairy or crop producers to use cooperative marketing strategies. This has been attributed to livestock producers' preference for independence. The importance of cooperative marketing by livestock producers can be assessed by cooperatives' shares of products marketed. According to data collected by USDA's Rural Business Cooperative Services for 1997, cooperatives marketed 12 percent of the livestock and wool marketed off the farm, compared with 87 percent of the milk and 42 percent of the grains and oilseeds. Data do not provide sufficient information to report volumes or values segregated by species.

Despite the lack of detailed national level data, we know that cooperatives play a role in all aspects of production, marketing, and slaughter of hogs and the sale of pork products. The Nation's largest agricultural cooperative, Farmland Industries, owns and operates four hog slaughter plants and five additional facilities that further process pork into consumer-ready products. Farmland was the first major hog slaughtering firm to begin voluntary daily reporting of individual plant prices on the Internet. Farmland also established a $15 per cwt base-price floor for hogs in December 1998 to help producer owners when spot market prices fell below $10 per cwt, and ten regional livestock marketing cooperatives have hog sales operations.

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[5]John Lawrence, Glenn Grimes and Marvin Hayenga, "Production and Marketing Characteristics of U. S. Pork Producers, 1997-1998", Staff Paper 311, Department of Agricultural Economics, Iowa State University, December 1998.

A number of producer cooperatives have recently investigated opportunities for cooperatively owned hog slaughter facilities with the objective to increase net returns to producers through value-added pork marketing activities. These groups, however, face substantial hurdles related to economies of size and scale and capital requirements associated with the operation of slaughter facilities. The loss of equity among hog producers because of recent low prices only exacerbated the difficulties of producers to raise sufficient capital to meet minimum equity requirements to finance cooperative hog slaughter operations.

There may be other opportunities for hog producers to form cooperatives to improve their efficiency and marketing opportunities. The most practical opportunities may lie with the formation of hog breeding and marketing cooperatives. Such cooperatives might help smaller operators share in the advantages that large producers enjoy from access to improved genetic stock preferred by meat packers and to marketing arrangements which generally call for more deliveries than small and mid-sized operators can provide. USDA's Rural Business Cooperative Service works aggressively with farmers to develop and successfully manage cooperatives.

As the volume of hogs traded on the spot market has significantly declined, concerns have arisen about the accuracy and reliability of reported prices. A USDA investigation of the range of procurement and pricing arrangements for hogs in the western Cornbelt indicated that reported prices generally are lower than prices actually paid for hogs because the base hog for which prices are publicly reported did not reflect the characteristics of typical carcasses. Improvements are being made in USDA's reporting system to more nearly reflect current hog characteristics.

In sum, forward contracting can provide substantial economic advantages to both packers and producers, in particular by protecting both parties against extreme price swings in the spot market. But smaller producers find it very difficult to participate in the contract market and find themselves relegated to a thinner and more volatile spot market.

C. Increasing Price Spreads

Hog producers have expressed concern about the significant recent increase in the farm-to-retail "price spread" for pork—the difference between the price paid by the packer to the producer and the price paid by the consumer to the retail grocer. This concern is often stated in terms of the producer getting a diminishing share of the consumer's dollar, with the rest going to processing and marketing middlemen. The concern expressed is that these increasing price spreads may be a product of anticompetitive practices on the part of the packers or retailers. In recent weeks, hog producers have specifically questioned why retail prices for pork products have not declined more substantially in the face of the sharp declines in hog prices during the last few months in 1998. (See Appendix 7 for hog and pork price changes since 1970.)

The farmer's decreasing share of the retail commodity price is a phenomenon that has occurred not just in hogs or livestock, but throughout agriculture. The farm-value share for all domestically raised foods declined from 41 percent in 1950 to 23 percent in 1996. As touched upon below, this decline appears to be largely attributable to productivity gains as well as conditions that make it more difficult for farmers to leave their occupation in times of economic hardship than it is for people in other walks of life.

In analyzing price spreads, it is important to look at spreads over the long term as well as over the short term, and to focus on constant-dollar figures that, unlike nominal prices, control for the effect of inflation. It is also useful, in considering whether spreads may be suggestive of anticompetitive activity, to separate the farm-to-retail price spread into its farm-to-wholesale and wholesale-to-retail segments. And it is important to keep in mind that, because the farm price is significantly lower than the retail price, a drop in farm value price, even if fully reflected at the retail level, will appear to have a proportionately smaller effect. For example, if the farm-value share for hogs is 25 percent of the prevailing retail price, then a 40 percent plunge in the farm price for hogs would translate into only a 10 percent change in the retail price.

These distinctions are important because, if anticompetitive activity were distorting prices, price-distorting effects would be expected to show up in long-term increases in the farm-to-retail price spread, beyond any increase attributable to overall inflation, and to show up in a way that indicates that those engaged in the anticompetitive activity are benefitting at the expense of others up or down the marketing chain.

Long-term price spread changes

These hallmarks of possible anticompetitive activity have not been evident with pork. As Appendix 8 shows, if the effects of inflation are removed, the long-term farm-to-retail price spread for pork, expressed as an annual average, has remained fairly constant since at least as far back as 1970—with the notable exception of 1998. Moreover, analysis indicates that the farm-to-wholesale segment of the price spread has declined over this 29-year period, while the wholesale-to-retail segment has increased; this is the opposite of what would be expected if the packers were engaged in anticompetitive activity.

At the retail level, although there has been an increase in the wholesale-to-retail segment of the long-term price spread over this 29-year period, the surrounding circumstances suggest that factors other than anticompetitive activity at the retail grocer level account for this increase.

First, if market power at the retail grocer level were causing the increase in the wholesale-to-retail price spread, one would expect the increase to be far more pronounced in the most concentrated local markets, rather than a generally observable phenomenon. And if undue consolidation at the retail grocer level were the culprit, one would expect the price

spread increases to be discrete jumps that track mergers in specific markets, rather than an overall steady trend. We are not aware of data that show that either of these is the case.

Second, if market power at the retail grocer level were causing the increase in the wholesale-to-retail price spread, one would also expect to hear the same complaints for all other items that grocery stores sell almost exclusively. Again, this is not the case.

Third, concentration in major local retail markets has remained virtually unchanged in recent years. An increase in retail margins because of retail grocer market power would have to be explained by an increase in retail grocer concentration, and could not be explained by high but unchanged levels of concentration.

If the price statistics are looked at in a slightly different way, they show that, while all three price levels—farm, wholesale, and retail—have steadily declined in constant dollar terms during the last 23 years, the wholesale-to-retail price spread has kept up with inflation, while the farm-to-wholesale price spread has not. This does not mean that the packers have been suffering, for they have realized significant cost savings as a result of innovations in production and marketing.

Likewise, although farm prices have also not kept pace with inflation, there are cost savings at work at the farm level as well—for example, increased yields per sow and specialization within the "farrow-to-finish" process. As mentioned earlier, retail grocers have many other cost inputs, which have risen significantly over this period. There have not been the same kinds of cost-reducing innovations at retail as there have been in hog production and pork packing.

Moreover, there is another reason why hog prices have not paralleled increases in retail prices. Family hog farmers may be subject to the predicament faced by family farmers in general: they are, to an unusual extent, tied to their occupation, even when the pay from that occupation falls very low. With steady gains in productivity, there is a natural tendency toward oversupply. Family farmers can, in theory, respond by leaving the farm to pursue other occupations, just as occurs in other occupations where there is an oversupply. But they face hurdles not generally found in the other occupations. For one thing, a family farmer generally owns the capital—the land and the equipment—and often has the family's personal finances tied up in that capital, having incurred debt to obtain or increase it. For another, a family farm is generally passed on from one generation to the next, much more so than in other occupations, with a corresponding emotional pressure on the next generation to maintain it. Indeed, more than most occupations, farming is considered not just an occupation, but a way of life. These factors reinforce a tendency toward oversupply that makes it difficult for producers to keep pace with overall price increases in the economy.

Our society has strong reasons for wanting to help as many family farmers as possible

who so desire to remain profitably engaged in their livelihood, and for most of this century this has been a central farm policy goal. While pursuing this policy goal has benefitted our society in important respects, policymakers also need to be cognizant of the effects this may have on supply.

Short-term price spread changes

While long-term price spread data do not suggest anticompetitive activity, there clearly has been a recent increase in the farm-to-retail price spread. The suddenness and magnitude of the recent increase warrants examination.

Short-term fluctuations in the price spread—even dramatic ones—do not by themselves demonstrate anticompetitive activity. In a competitive market where supply and demand fluctuate, one would expect to see corresponding fluctuations in price, and price spread, over the short-term. There is considerable evidence, in studies going back over a few decades, that this is the case for many agricultural commodities, including pork.

In the theoretical model of a perfectly competitive market, one would expect to see price changes at one level quickly transmitted up and down the marketing chain, with short lag times that should be similar for increases and decreases alike. The actual experience is somewhat different: price increases at the farm and wholesale level influence prices at the retail level more quickly than do price decreases.

There are reasons explaining this asymmetry that are entirely consistent with competitive retail markets. Retail grocers are generally reluctant and slow to lower retail food prices in response to short-term wholesale price reductions for numerous reasons. First, for perishable commodities such as fresh meat, grocers are already under some pressure to move the product that has been in their stores or refrigerators the longest period first, before it spoils. In order to lower the retail price of the new, lower-cost pork, the grocer would also have to lower the retail price of the older, higher-cost pork, taking a loss or a lower profit on it. This problem does not arise when the newer cuts are priced higher than the older cuts.

Second, against a backdrop of an overall economy in which price levels tend to increase over time, wholesale price reductions, because they go against the trend, are regarded as more transitory than wholesale price increases. A retail grocer who marks down prices expects to be reversing course shortly, especially since other input costs are generally rising with inflation, regardless of short-term trends in the wholesale price of the commodity. On the other hand, a retail grocer who marks up prices does not expect to be reversing course. Grocers often express concern that their consumers will remember price increases more clearly than price decreases. While this will not prevent a grocer from eventually marking down a product in response to an enduring wholesale price

reduction, it does slow down the grocer's response.[5]

Third, in the particular market situation of the last three months of 1998, there was a surge in the number of hogs brought to the market that may have strained the capacity of pork packing plants. As mentioned above, there are indications that packing plants have recently been operating near or at full capacity. Such a short-term bottleneck at the packer level could be expected to result in price declines for hogs that might significantly outpace price declines at the retail level, at least until the supply of hogs adjusts or capacity constraints at packing plants no longer limit pork production.

Fourth, because many retailers have contracts with suppliers, it may take several weeks for contracts to reflect lower prices.

Fifth, because pork is just one of many products sold by a typical retail grocer, one would not expect as much pressure on such a grocer to immediately lower the retail pork price in order to preserve market share.

Price-spread data problems

There are also data problems at both the farm price and retail price levels that probably exaggerate the size of the price spread.

At the retail price level, the reported prices, which are usually based on unweighted averages published by the Bureau of Labor Statistics, probably do not adequately take into account the specials that grocers often run to move product at a reduced price, and the tendency of consumers to buy extra quantities during specials and stock up their freezers at home. Retail grocers maintain that pork product prices have declined by as much as 19 percent in the last year, even though BLS data record declines of only 2-3 percent.[6] There are real limitations on the usefulness of BLS data on prices of retail meat products. BLS is currently examining ways to improve that data, and is undertaking a pilot project to examine the use of retail grocery scanner data to improve the measure of price responses.

At the farm price level, the precipitous decline reported in hog slaughter prices in the last few months overstates what has happened in the overall hog slaughter market. This is because the reported prices are spot market prices, and do not include sales under longer-term contracts. As noted above, spot sales historically constituted the lion's share of the

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[5]See "Meat Price Spreads: What Do They Indicate", *Agricultural Outlook,* December, 1997, p. 14.

[6] See David Barboza, "The Great Pork Gap", *New York Times,* January 7, 1999.

market; that has changed dramatically over the last year or two, and contract sales now constitute more than 50 percent of all sales. Although some types of forward contracts—such as "window contracts"—adjust to partially reflect changes in the spot market price, long-term contracts are insulated from market fluctuations to a significant degree.

Accordingly, the volatility in the market is concentrated in the smaller spot market. As a result, recent events that have led to substantial oversupply relative to demand for hogs have depressed spot market prices far more than the forward contract market could have anticipated even as late as last summer.

Moreover, the quoted spot market price tends to understate even the actual prevailing spot market price. This is because, as mentioned above, the base hog for which prices are publicly reported does not reflect the characteristics of typical hog carcasses which lead to somewhat higher prices.

In sum: While price-spread statistics implicate important farm policy concerns and warrant further study, they are not inherently suspect from a competition perspective.

III. Recommendations

While this report has focussed on hog markets because of the severity of the recent price declines suffered by hog producers, the following recommendations apply as well to other livestock sectors, which are experiencing similar problems.

1. The Administration should promptly propose legislation to give the Secretary of Agriculture authority to require packers to report to USDA information on (a) prices paid by packers to livestock producers or others for animals for slaughter, either on the spot market or by contract; and (b) the terms of any such contracts. The Secretary could tailor the reporting requirements to assure that they do not impose an undue reporting burden on the industry. Such legislation should also authorize the Secretary, with appropriate protections for proprietary or competitively sensitive information, to publish data and information on prices and contract terms.

2. USDA should give a high priority to its efforts to educate small livestock producers about the functioning of the spot and contract markets, the formation of marketing cooperatives, and other collective action that small producers can take to pool their resources, reduce their risks, and participate in the contract market. The Department should develop one or more pilot programs to test the feasibility of programs to educate producers on participation in the contract market and/or to pool their resources to bargain more effectively with buyers.

3. USDA should continue its active monitoring and review of contracting practices, other marketing practices, and plant closures by packers, to assure compliance with the Packers and Stockyards Act. Pending investigations in these areas should be completed, and any resulting enforcement actions initiated, as promptly as possible.

4. USDA should promptly analyze the views expressed and data presented at its forthcoming Conference on Consolidation in the Meat Sector, and should use that analysis in developing a continuing program to monitor and evaluate structural changes

in the livestock and meat industries.

5. The NEC should designate a small task force of economists to discuss ways in which the estimates of farm-to-retail price spreads for meat products can be made more accurate. The task force should consult with the staff of the Bureau of Labor Statistics about efforts to improve retail price reporting.

6. The NEC should lead an inter-agency task force to monitor the functioning of the livestock markets for the remainder of 1999 and to make additional recommendations as appropriate.

Appendix 1

Meat: Per capita consumption 1/

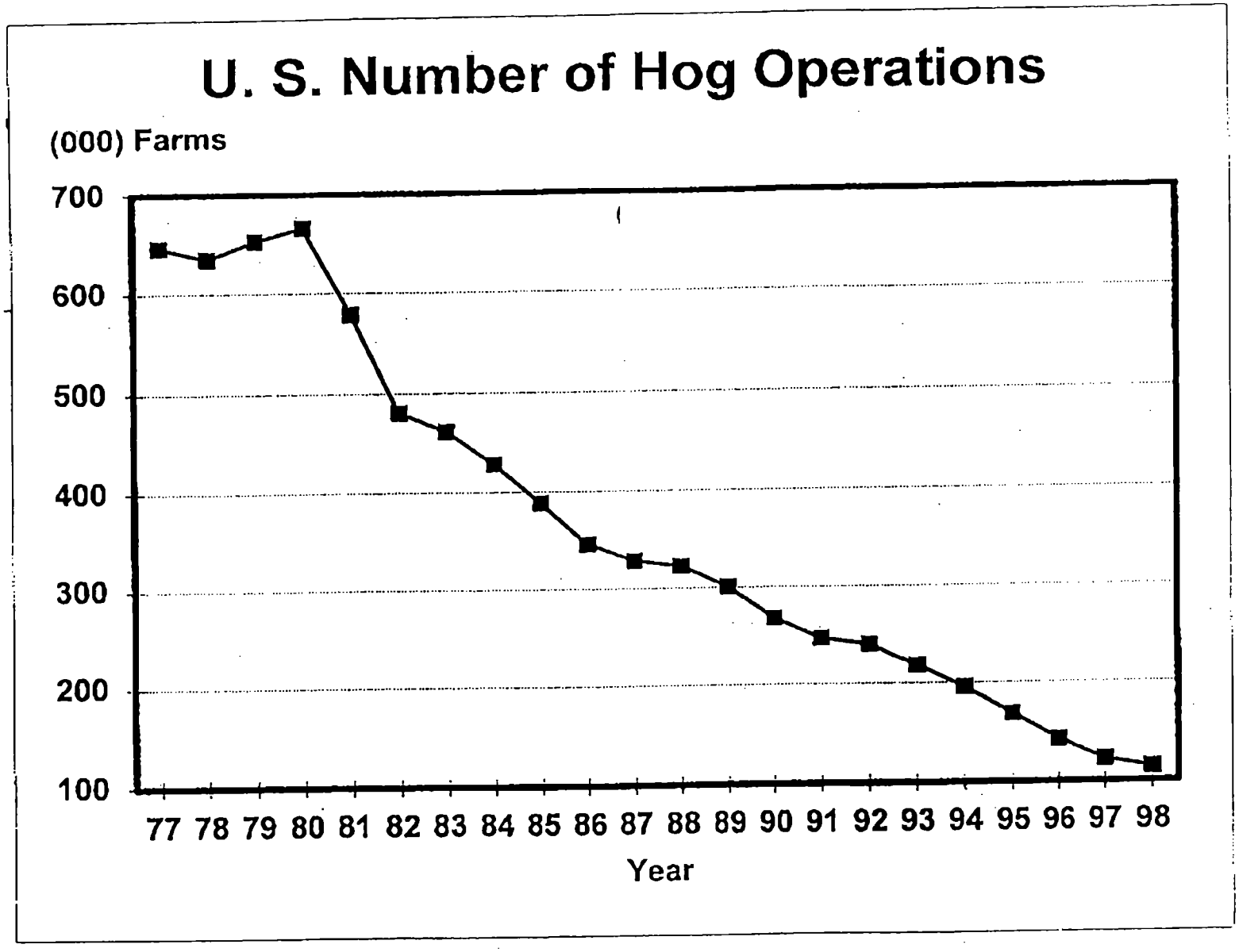
ITEM	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998 F*	1999 F*
					Pounds						
Beef	69.3	67.8	66.8	66.5	65.1	67.0	67.4	68.2	66.9	68.2	63.9
Veal	1.2	1.1	1.0	1.0	0.9	0.9	1.0	1.2	1.0	0.8	0.8
Pork	52.0	49.8	50.4	53.1	52.3	53.0	52.4	49.1	48.7	52.7	53.4
Lamb and mutton	1.4	1.4	1.4	1.4	1.3	1.2	1.2	1.1	1.1	1.1	1.0
Red meat	123.9	120.1	119.6	121.9	119.7	122.1	122.0	119.5	117.8	122.8	119.1
Broilers	67.2	69.5	62.1	65.9	68.5	69.6	68.8	70.8	72.7	74.2	78.8
Other chickens	2.1	2.0	1.9	1.9	1.8	1.8	1.5	0.9	0.5	0.4	0.5
Turkeys	16.8	17.6	17.9	17.9	17.7	17.8	17.9	18.5	17.8	18.0	17.5
Meat	199.8	199.2	201.5	207.6	207.7	211.0	210.2	209.6	208.6	215.5	215.1

F* = Forecasts. 1/ Retail weight basis.

Source: ERS - USDA

Cattle balance sheet

Appendix 2


U. S. Number of Hog Operations
(000) Farms
700
600
500
400
300
200
100
77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98
Year

Concentration of 4 and 8 largest hog, and steer and heifer slaughter firms, selected years, 1980-97[1]

Year	Top 4 firms	Top 8 firms	HHI index[2]
	------Percent------		
Hogs[3]			
1980	34	51	436
1985	32	51	456
1990	40	58	593
1995	46	69	754
1996	56	73	961
1997	54	76	NA
Steers and heifers[4]			
1980	36	51	561
1985	50	64	999
1990	72	82	1661
1995	79	86	1982
1996	79	86	1935
1997	80	88	NA

[1] Concentration is percentage of total commercial slaughter. Numerator values are number of head procured for slaughter during each firm's reporting (fiscal) year for 1980-95, and number of head slaughtered during the calendar year for 1996 and 1997.

[2] The HHI (Herfindahl-Hirshman Index) equals the sum of each firm's squared percentage share of total commercial slaughter.

[3] The eight largest hog slaughter firms in 1997, in alphabetical order, were ConAgra, Excel, Farmland, Hormel, IBP, Seaboard Farms, Smithfield Foods, and Thorn Apple Valley.

[4] The eight largest steer and heifer slaughter firms in 1997, in alphabetical order, were BeefAmerica, ConAgra, Excel, Farmland, Greater Omaha, IBP, Nebraska Beef, and Packerland.

Four-Firm Concentration of Supermarket Sales by Metropolitan Area for 1990 and 1996

Metropolitan	1990	1996
Boston	63.0	80.2
Chicago	85.4	82.4
Cleveland	83.2	85.9
Dallas	71.5	71.1
Detroit	85.0	77.5
Kansas City	86.7	85.2
Los Angeles	79.8	75.5
Miami	96.2	96.0
Minneapolis-St.Paul	98.5	99.5
New York	52.7	52.0
Philadelphia	75.5	68.5
Washington D.C.	81.9	82.8

Source: 1991 and 1997 Editions of *Market Scope*.

Table 2- Pork:Prices, Values

Year	Retail price	Whsle. value	Gross farm value	By-prod. allow-ance	Net farm value	Farm-ret ll			Share of retail price			5&6-mkt. hogs
						Total	Whsle. retail	Farm whsle.	Whsle. retail	Farm whsle.	Farmers' share	
					Cents/lb.				Percent	Percent	Percent	$/cwt
1996												
Jan	201.1	102.1	71.9	4.8	67.1	134.0	99.0	35.0	49	17	33	42.26
Feb	208.2	105.7	79.0	4.9	74.1	134.1	102.5	31.6	49	15	36	46.47
Mar	209.7	108.3	82.9	5.2	77.7	132.0	101.4	30.6	48	15	37	48.76
1st qtr.	206.4	105.4	77.9	4.9	73.0	133.4	101.0	32.4	49	16	35	45.83
Apr	208.6	111.1	85.6	5.3	80.3	128.3	97.5	30.8	47	15	38	50.34
May	213.6	120.6	98.0	6.3	91.7	121.9	92.8	29.1	43	14	43	57.62
June	222.5	116.9	95.4	6.5	88.9	133.6	105.6	28.0	47	13	40	56.13
2nd qtr.	214.9	116.3	93.0	6.0	87.0	127.9	98.6	29.3	46	14	40	54.70
July	225.7	122.8	100.8	6.9	93.9	131.8	102.9	28.9	46	13	42	59.30
Aug	231.4	126.6	101.5	7.1	94.4	137.0	104.8	32.2	45	14	41	59.72
Sept	234.2	120.8	92.6	6.7	85.9	148.3	113.4	34.9	48	15	37	54.44
3rd qtr.	230.4	123.4	98.3	6.9	91.4	139.0	107.0	32.0	48	14	40	57.82
Oct	233.0	121.7	93.8	6.5	87.3	145.7	111.3	34.4	48	15	37	55.15
Nov	231.8	123.9	93.2	6.4	86.8	144.8	107.7	37.1	47	16	37	54.81
Dec	231.2	126.2	93.5	6.4	87.1	144.1	105.0	39.1	45	17	38	55.01
4th qtr.	231.9	123.9	93.5	6.5	87.0	144.9	108.0	36.9	47	16	38	54.99
1996												
Annual	220.9	117.2	90.7	6.1	84.6	136.3	103.7	32.6	47	15	38	53.33
1997												
Jan	232.7	118.6	90.6	6.2	84.4	148.3	113.1	35.2	49	15	36	53.30
Feb	231.3	117.6	87.4	6.1	81.3	150.0	113.7	36.3	49	16	35	51.43
Mar	228.9	115.7	82.1	5.8	76.3	152.6	113.2	39.4	49	17	33	48.27
1st qtr.	231.0	117.7	86.7	6.0	80.7	150.3	113.3	37.0	49	16	35	51.00
Apr	228.5	120.8	92.7	5.9	86.8	139.7	105.7	34.0	47	15	38	54.50
May	229.0	124.6	97.7	6.2	91.5	137.5	104.4	33.1	46	14	40	57.47
June	233.7	123.0	97.5	6.3	91.2	142.5	110.7	31.8	47	14	39	57.37
2nd qtr	229.7	122.8	95.9	6.1	89.8	139.9	106.9	33.0	47	14	39	56.45
July	232.7	123.4	100.0	6.7	93.3	139.4	109.3	30.1	47	13	40	58.82
Aug	236.0	123.3	91.6	6.5	85.1	150.9	112.7	38.2	48	16	36	53.89
Sept	234.7	117.4	84.2	5.9	78.3	156.4	117.3	39.1	50	17	33	49.53
3rd qtr.	234.5	121.4	91.9	6.3	85.6	148.9	113.1	35.8	48	15	36	54.08
Oct	234.9	110.5	78.9	5.7	73.2	161.7	124.4	37.3	53	16	31	46.41
Nov	231.3	107.9	75.3	5.4	69.9	161.4	123.4	38.0	53	16	30	44.33
Dec	228.8	101.5	67.0	4.9	62.1	164.7	125.3	39.4	55	17	27	39.40
4th qtr.	231.0	106.6	73.7	5.3	68.4	162.6	124.4	38.2	54	17	30	43.38
1997												
Annual	231.5	117.1	87.1	6.0	81.1	150.4	114.4	36.0	49	16	35	51.23
1998												
Jan	234.8	98.2	61.5	4.1	57.4	177.4	138.6	38.8	59	17	24	38.20
Feb	234.5	94.0	58.4	3.8	54.6	179.9	140.5	39.4	60	17	23	34.38
Mar	229.8	91.4	58.2	3.9	54.3	175.5	138.4	37.1	60	16	24	34.24
1st qtr.	233.0	93.8	59.3	3.9	55.4	177.6	139.2	38.4	60	16	24	34.93
Apr	225.0	91.0	59.7	4.0	55.7	169.3	134.0	35.3	60	16	25	35.12
May	226.7	89.8	71.0	4.7	66.3	160.4	126.9	33.5	56	15	29	41.77
June	228.9	98.0	70.7	4.9	65.8	163.1	130.9	32.2	57	14	29	41.60
2nd qtr	226.9	96.3	67.1	4.6	62.8	164.3	130.6	33.7	58	15	28	39.50
July	231.0	94.9	61.7	4.1	57.6	173.4	136.1	37.3	59	16	25	36.32
Aug	230.9	96.4	59.3	3.8	55.4	175.5	134.5	41.0	58	16	24	34.88
Sept	231.2	93.2	51.2	3.3	47.9	183.3	138.0	45.3	60	20	21	30.13
3rd qtr.	231.0	94.8	57.4	3.8	53.6	177.4	136.2	41.2	59	18	23	33.77
Oct	230.2	91.1	45.0	3.0	42.0	188.2	139.1	49.1	60	21	18	26.51
Nov	226.9	84.6	30.2	2.1	28.1	198.8	142.3	56.5	63	25	12	17.75
Dec	223.5	80.1	23.4	1.6	21.8	201.7	143.4	58.3	64	26	10	13.77
4th qtr.	226.8	85.2	32.6	2.2	30.6	196.2	141.6	54.6	62	24	13	19.34
1998												
Annual	228.5	92.6	54.2	3.6	50.6	176.9	136.9	42.0	60	18	22	31.89

Major hog slaughter plant openings, expansions, and closings since 1994

Plant	Location	Year	Weekly capacity
Openings			
Farmland[1]	Dubuque, IA	1996	60,500
Seaboard Farms[2]	Guymon, OK	1995	82,500
IBP[3]	Logansport, IN	1995	73,700
Premium Standard	Milan, MO	late 1994	38,500
Total			255,200
Expansions			Weekly capacity increase
Excel	Ottumwa, IA	1998	24,750
IBP	Waterloo, IA	1998	5,500
Indiana Pack	Delphi, IN	1996	22,000
Smithfield[4]	Tar Heel, NC	1996	44,000
		1995	41,250
Hormel	Austin, MN	1995	16,500
Hormel	Fremont, NE	1995	9,350
Total			163,350
Closings			Weekly capacity
Thorn Apple Valley	Detroit, MI	1998	77,000
Dakota Pork	Huron, SD	1997	41,800
IBP	Council Bluffs, IA	1997	40,150
Fisher	Louisville, KY	1997	16,500
Premium Pork	Moultrie, GA	1996	25,850
Worthington Pack	Worthington, IN	1996	25,850
FDL	Dubuque, IA	1995	60,500
Total			287,650

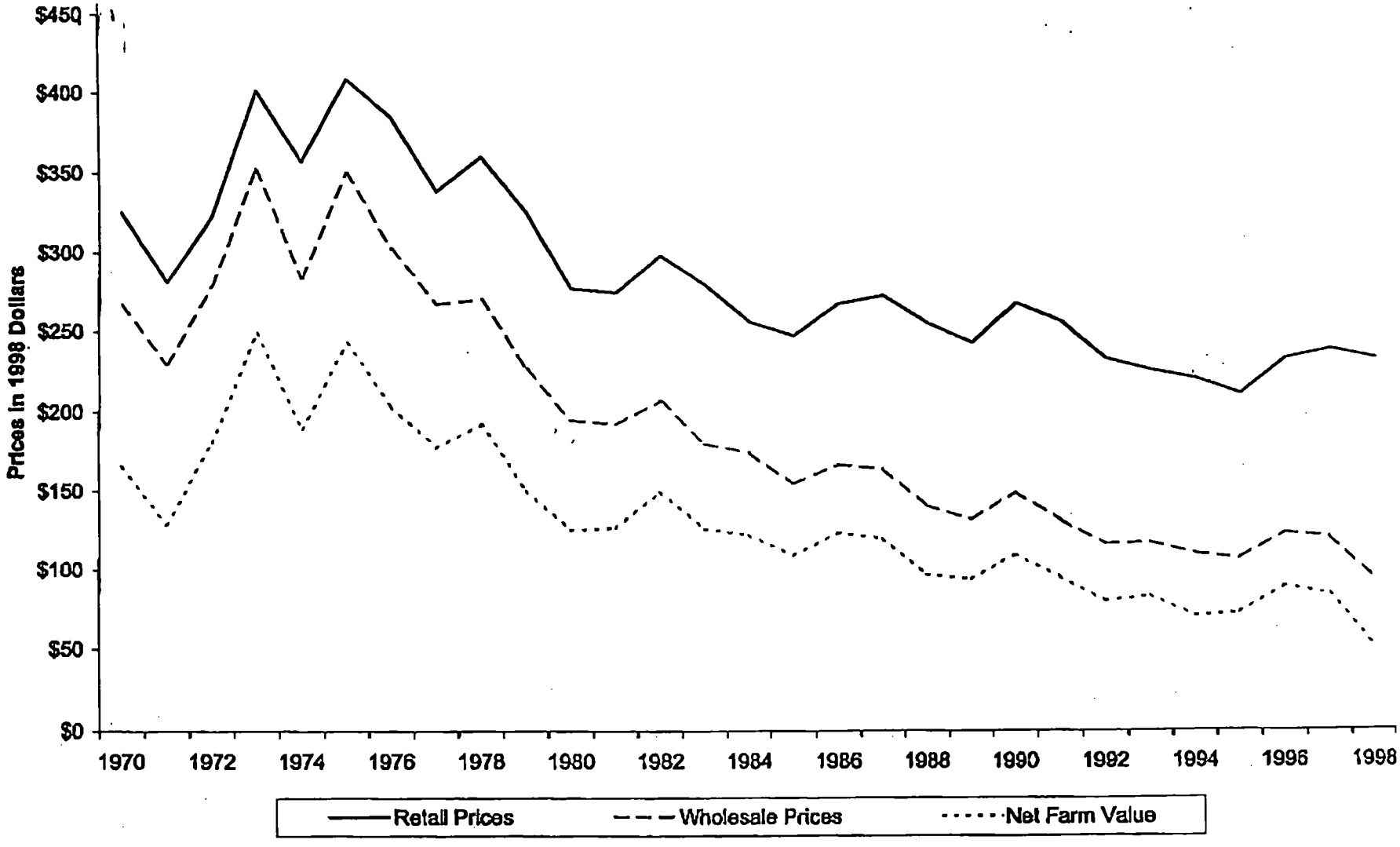
[1] Farmland purchased and re-opened the plant in 1996, which FDL had closed in 1995.

[2] Seaboard opened the plant in 1995 and doubled its capacity in 1998 to the volume indicated.

[3] IBP purchased and re-opened the former Wilson plant in 1995 and doubled its capacity in 1996 to the volume indicated.

[4] Smithfield originally opened this plant late in 1992 and increased its capacity by the amounts indicated in 1995 and 1996. The plant is currently operating at approximately 75 percent of its estimated 176,000 head per week capacity due to environmental restrictions.

Annual Pork Prices



Source: USDA-Economic Research Service and Bureau of Labor Statistics

Annual Pork Price Spreads (1970 to 1998)