Approved: 3-10-99
Date

MINUTES OF THE SENATE COMMITTEE ON AGRICULTURE.

The meeting was called to order by Chairperson Steve Morris at 10:00 a.m. on March 8, 1999 in Room 423-S of the Capitol.

All members were present except:

Committee staff present: Raney Gilliland, Legislative Research Department
Jill Wolters, Revisor of Statutes
Nancy Kippes, Committee Secretary

Conferees appearing before the committee:
Rich McKee, Kansas Livestock Association
Steven Hunt, U.S. Premium Beef Ltd.
Warren Wiebert, Oberlin, Kansas
Bill Hogan, Hitch Feeders II
Jim Keller, Pioneer, Inc.
Bill Fuller, Kansas Farm Bureau
Jere White, Kansas Corn Growers Association and Kansas Grain Sorghum Producers Association

Others attending: (See Attached)

SB 258 - **concerning livestock; relating to regulating certain livestock transactions; protection of producers against retaliation; prescribing damages therefor - Opponents**

Rich McKee, Kansas Livestock Association, testified in opposition to **SB 258** (Attachment 1). He stated this bill would replace the current voluntary price reporting system with mandatory government price reporting for slaughter livestock, which none of the surrounding states have, so a buyer could simply purchase livestock in any of the surrounding states; would require meat processors at the beginning of each day to post all the prices they will pay for livestock on that given day, which would invite collusion between meat processors; and would require meat processors to offer the same bid to all potential sellers with livestock of the same quality (based on carcass merit and transportation), which would likely have a negative effect on livestock prices.

Senator Greta Goodwin introduced Steven Hunt of U.S. Premium Beef Ltd (USPB). Mr. Hunt through a slide presentation provided a background of U.S. Premium Beef, Ltd. and detailed facts concerning beef packer and processor margins, beef and pork production levels, consumption and demand for beef, and how USPB is attempting to reward small producers from all segments (Attachment 2).

Warren Wiebert, Oberlin, Kansas, provided oral testimony opposing **SB 258**, stating that innovation is the most important thing in assisting cattlemen out of the economic problems they are presently experiencing(Attachment 3).

Bill Hogan, Hitch Feeders II, advised **SB 258** would assure a lack of competition in the beef industry and would be further government intervention in private enterprise. Mr. Hogan stated the majority of livestock producers would rather focus their efforts on improving quality and demand for beef through efficiency, technology and competition (Attachment 4).

Jim Keller, Pioneer, Inc., opposed **SB 258** with written and oral testimony (Attachment 5).

Bill Fuller, Kansas Farm Bureau, provided testimony in opposition to **SB 258**, stating that he felt this would be unenforceable on the state level but that Kansas Farm Bureau supports a national system of mandatory price reporting (Attachment 6).

Jere White, Kansas Corn Growers Association and Kansas Grain Sorghum Producers Association, provided testimony in opposition to **SB 258**, stating this bill raises more questions than giving answers. He stated both organizations support price reporting on the federal level and feel that help can come from the alliances rather than the government (Attachment 7).

Written testimony was provided by Kansas Agricultural Alliance (Attachment 8), and Farmland Industries, Inc. (Attachment 9).

The next meeting will be March 10, 1999.

SENATE AGRICULTURE COMMITTEE GUEST LIST

DATE: 3-8-99

NAME	REPRESENTING
Marty Vanier	KS Ag Alliance
GINA BOWMAN-MORRILL	FARMLAND
Marty Hogan	KLA - Hitch Feeders
Hank Ernst	Kansas Farmer
BILL HOGAN	HITCH FEEDERS
Alan Hess	KLA
SCOTT A. BURKDOLL	KLA
Larry Otte	"
Dee Likes	KLA
Gary Rieck	self employed Kansas Farmer & Stockman
STEVE HUNT	U.S. Premium Beef
D. Warren Neibert	Decatur Co. Feedyard
Leslie Kaufman	Ks Farm Bureau
Mike Jensen	Ks Pork Council
Mike Beam	Ks Livstk. Assn.
Jim Allen	Seaboard

KANSAS LIVESTOCK ASSOCIATION

Since 1894

Testimony

presented by

Rich McKee
Executive Secretary, Feedlot Division

regarding

Senate Bill 258

before the

SENATE COMMITTEE ON AGRICULTURE

March 8, 1999

The Kansas Livestock Association (KLA), formed in 1894, is a trade association representing over 7,300 members on legislative and regulatory issues. KLA members are involved in all segments of the livestock industry, including cow-calf, feedlot, seedstock, swine, dairy and sheep. In 1997, cash receipts from agriculture products totaled over $8.9 billion, with nearly fifty-five percent of that coming from the sale of livestock. Cattle represent the largest share of cash receipts, representing ninety percent of the livestock and poultry marketings.

****

The Kansas Livestock Association **opposes** Senate Bill 258. This bill has three major components and while well intended, each would be harmful to the livestock industry. The following is a brief summary of the major components.

Senate Agriculture
3-8-99
Attachment 1

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

1. Mandatory Price Reporting - Lines 2 through 6 on page 2 and lines 25 through 30 on page 2.

- This bill would replace the current voluntary price reporting system with mandatory government price reporting for slaughter livestock. The Grain Inspection, Packers and Stockyards Administration (GIPSA) recently completed an investigation of cattle procurement. The report found more cattle sold below the reported low than above the reported high. This suggests mandatory price reporting would have a negative effect on livestock prices.

- None of the surrounding states have mandatory price reporting. If this bill passed and a buyer wanted to purchase livestock at a higher price without having the price reported, buyers would simply purchase livestock in any of the surrounding states...denying Kansas producers an opportunity for that market.

- Last year Congress funded a research project to judge the effect of mandatory price reporting. The study is underway and scheduled to be completed early next year. It would be prudent to wait for the results of that report before considering state legislation that would require mandatory price reporting.

- There would be a cost associated with implementing and enforcing this legislation. Who would be responsible for this new expense?

2. Posting Prices - Line 43 on page 1 and lines 1 and 2 on page 2.

- SB 258 would require meat processors, at the beginning of each day, to post all the prices they will pay for livestock on that given day. That is like asking a stockbroker to list all the prices that will be paid for a given stock at the beginning of each day. Cattle prices, like the stock market, are highly volatile....and it is impossible to know what prices are going to be paid.

- If market forces moved the market higher than what was posted this bill appears to prevent purchasers from paying **more** than what was posted at the beginning of the day.

- Even if it were possible to know what prices would be paid....forcing purchasers to post these prices in a conspicuous place would **invite** collusion between meat processors.

<u>3. All sellers offered same price</u> - Lines 24 through 42 on page 1.

- The bill would require meat processors to offer the same bid to all potential sellers with livestock of the same quality (based on carcass merit and transportation). That would be like requiring someone purchasing a home to make the same offer to everyone with a home for sale of the same quality. Obviously this is not practical or enforceable.

- If passed, this provision would likely have a negative effect on livestock prices. Simply asked, if you were required to make the same offer to all potential sellers would this cause you to raise or lower the price?

- Livestock producers are working hard to create incentives for innovative management practices and for producing superior genetics. This effort would be impaired by this provision. For example, some livestock producers are working to maintain individual identity of livestock from conception to the retail counter, including records of when the animal was treated, etc. This bill forces purchasers to pay the same price for livestock based on carcass merit and ignores the value of individual identity.

- This bill also fails to recognize there are differences in the value of livestock other than the carcass. For example, this bill ignores the differences in the value of hides and would thwart producer efforts to be rewarded for producing livestock that are not branded. The measure also fails to recognize difference in mud that cattle carry.

The livestock industry has suffered significant financial losses during the last two years. State and federal government can help by continuing the fight to open foreign markets for livestock products, carefully weigh the effect of adding additional environmental regulations and phase out the state wide property tax levy . Thank you for considering our position and we urge to oppose Senate Bill 258.

Market Reporting Pilot Programs

The 1998 Agricultural Appropriations bill authorized USDA to conduct a 12 month pilot investigation of mandatory domestic price reporting. The Grain Inspection, Packers and Stockyards Administration (GIPSA) will require any person engaged in the business of buying, selling, or marketing domestic or imported cattle for immediate slaughter and fresh muscle cuts of beef, or domestic or imported sheep and fresh or frozen muscle cuts of lamb, to report the prices for the procurement of these items. Reporting requirements shall only apply to those marketing a significant share of the national market. P&S has yet to determine who would be included. Within six months of the conclusion of the investigation USDA will report their findings to Congress. No information collected under the pilot investigation is to be disclosed until the report is submitted. $250,000 was allocated to fund the pilot.

While no completion deadline was specified in the bill, P&S is under pressure to begin the pilot investigation soon. P&S continues to define the scope and is finalizing the framework for collecting the information. Data collection will likely begin in the next few weeks.

A similar 12 month investigation was authorized to electronically collect export data for fresh or frozen muscle cuts of meat food products in a timely manner (within two weeks). A report to Congress is also due within six months of completion.

1-5

Texas Fed Cattle Investigation

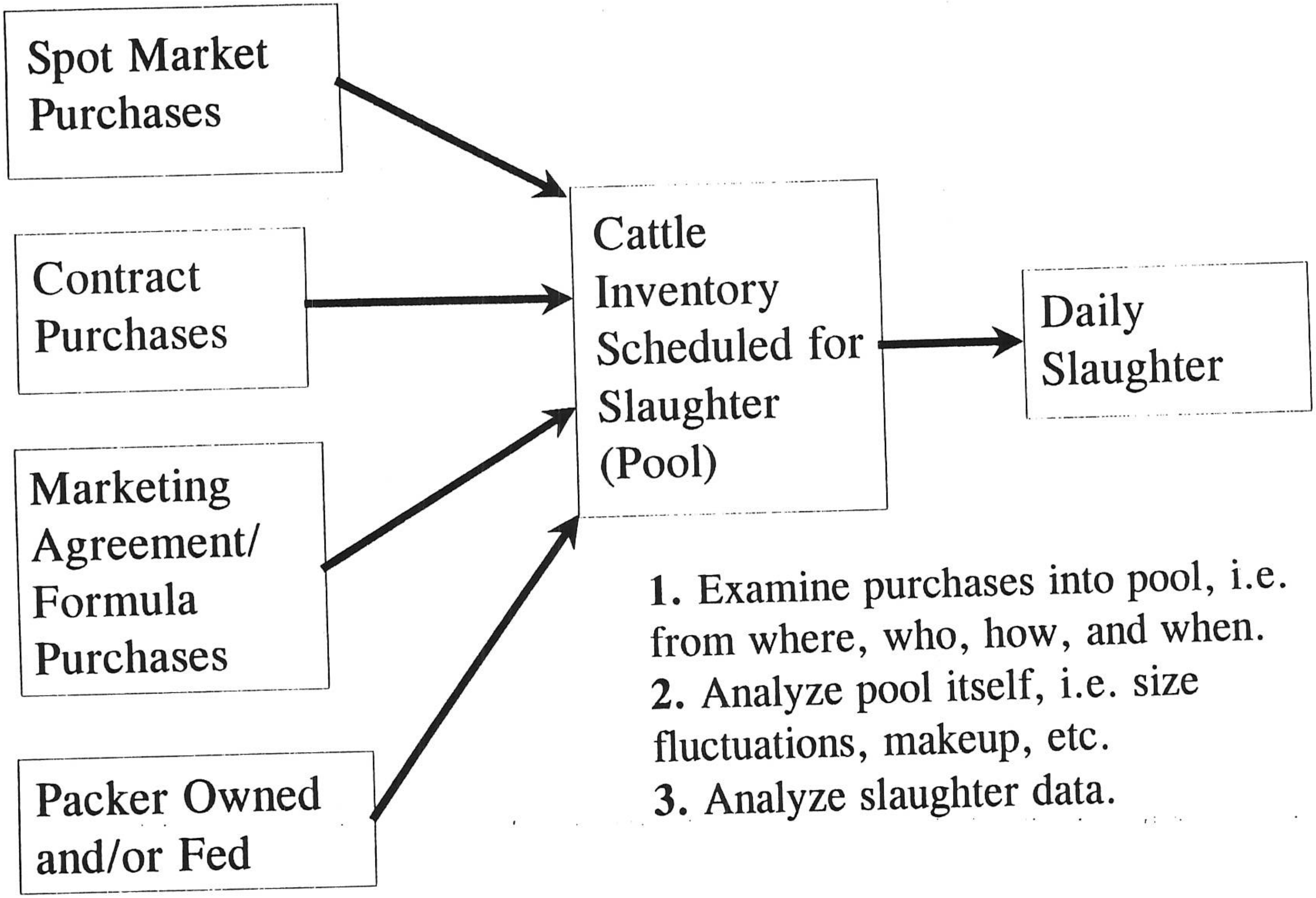
Grain Inspection, Packers and Stockyards Administration

Objectives

- Examine the procurement areas, procurement methods, and pricing methods in the Texas Panhandle region
- Examine the calculations for each formula purchase method, including base price determination and price spreads
- Interview feedyard managers and owners in the Texas Panhandle
- Determine if firms are using their inventories of purchased cattle or their procurement efforts to manipulate prices
- Determine the effects of marketing agreements, formula price arrangements, forward contracts, and packer feeding arrangements on cash market prices

1-7

Fed Cattle Procurement and Slaughter Sequence

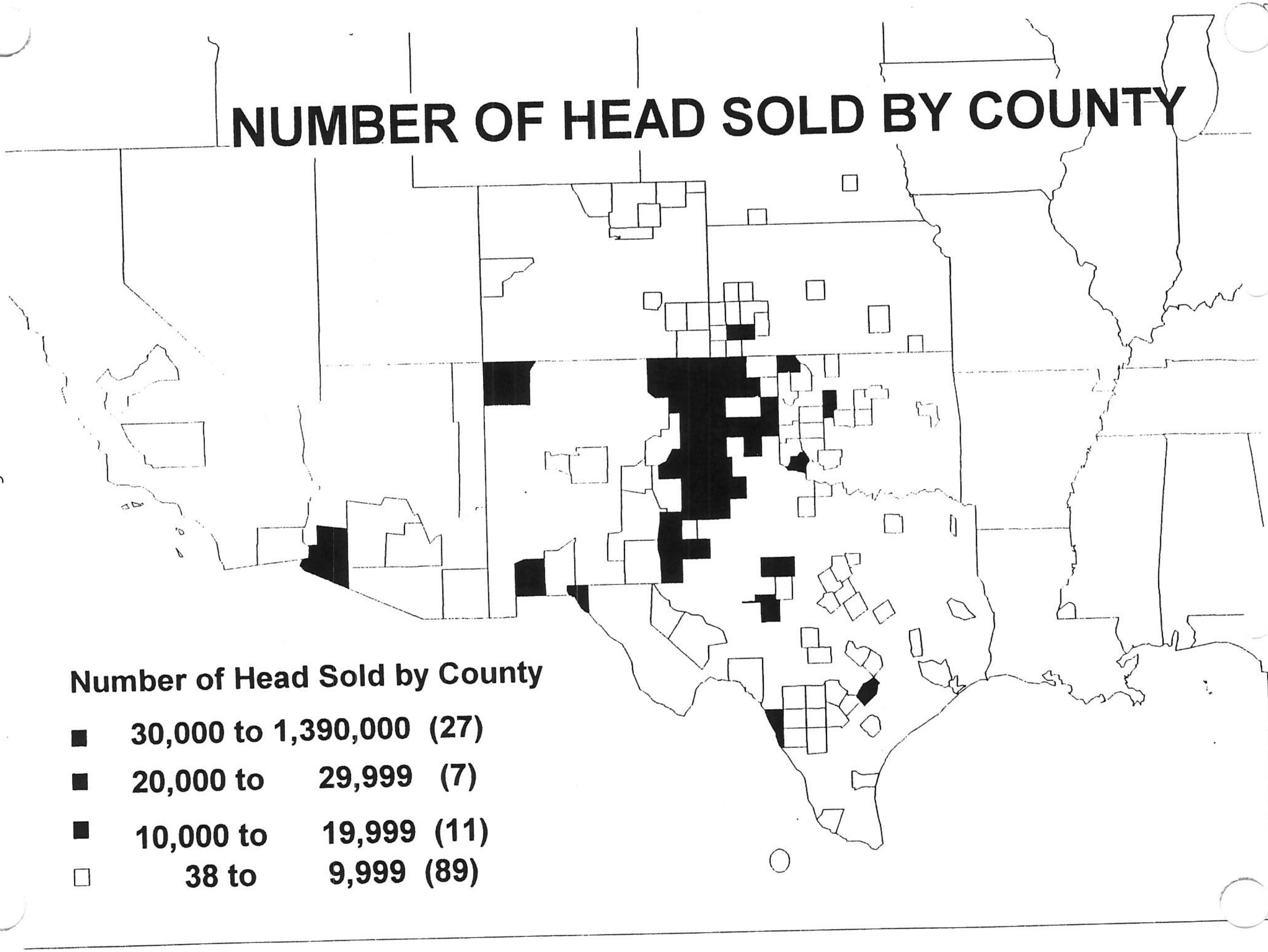


1. Examine purchases into pool, i.e. from where, who, how, and when.
2. Analyze pool itself, i.e. size fluctuations, makeup, etc.
3. Analyze slaughter data.

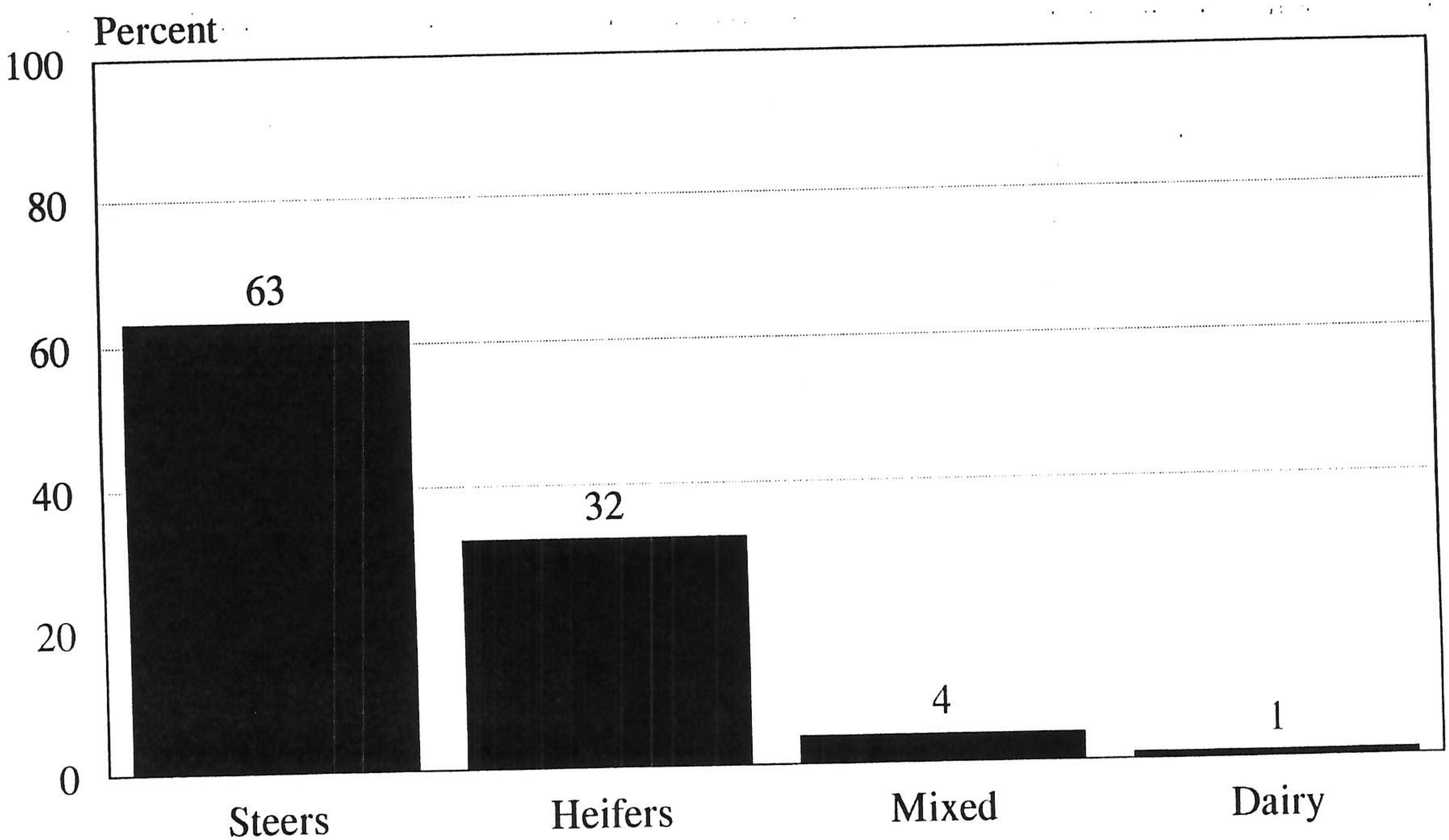
Texas Fed Cattle Investigation

- Four steer and heifer slaughter plants (average daily S/H slaughter of 15,730 head)
  - Monfort, Inc. - Dumas, TX
  - IBP, inc. - Amarillo, TX
  - Excel Corp
    - Friona, TX
    - Plainview, TX
- Investigation period, 2/6/95 to 5/18/96
- 392 kill days
- 37,112 transactions
- 6,217,313 head

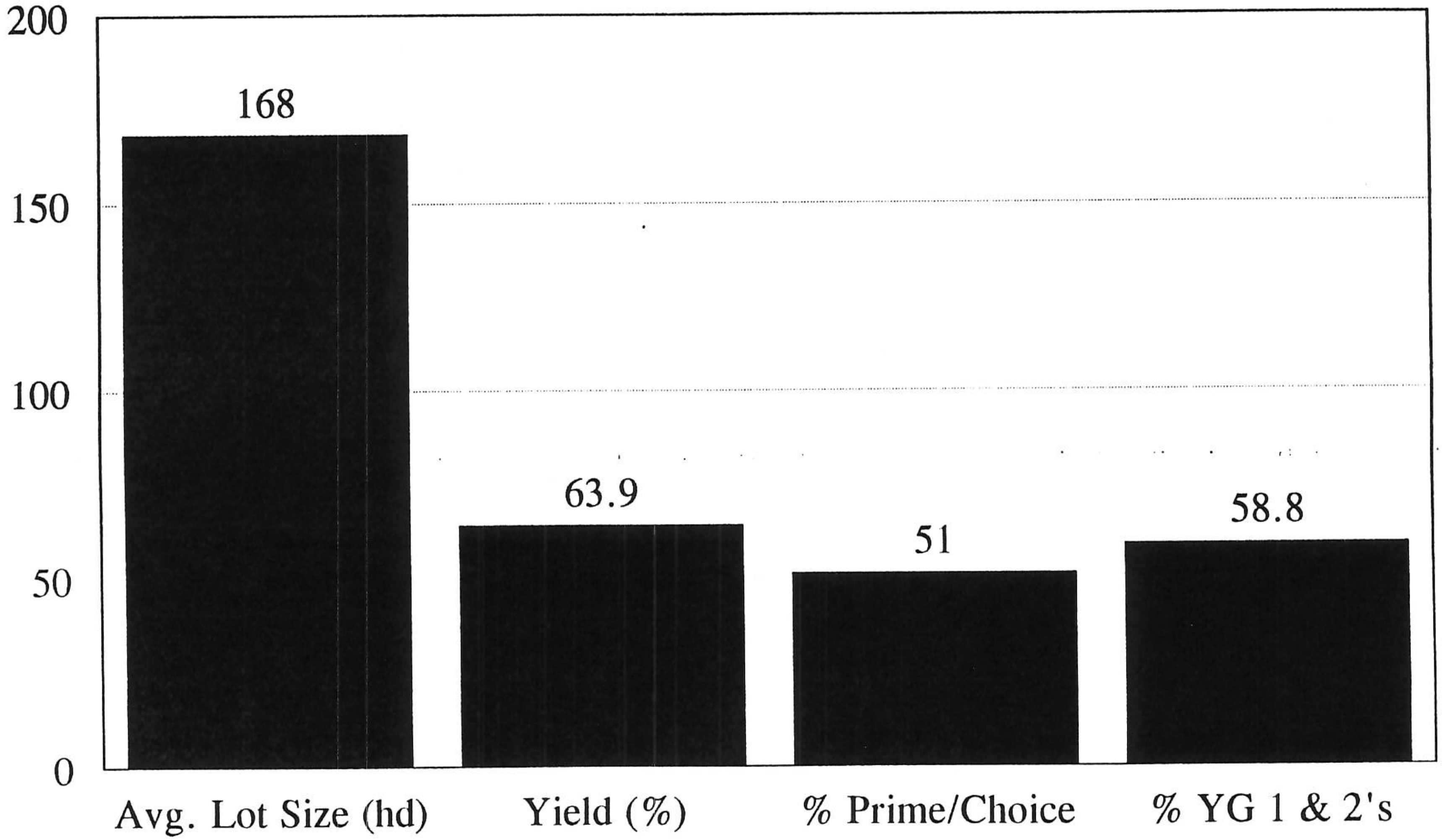
NUMBER OF HEAD SOLD BY COUNTY



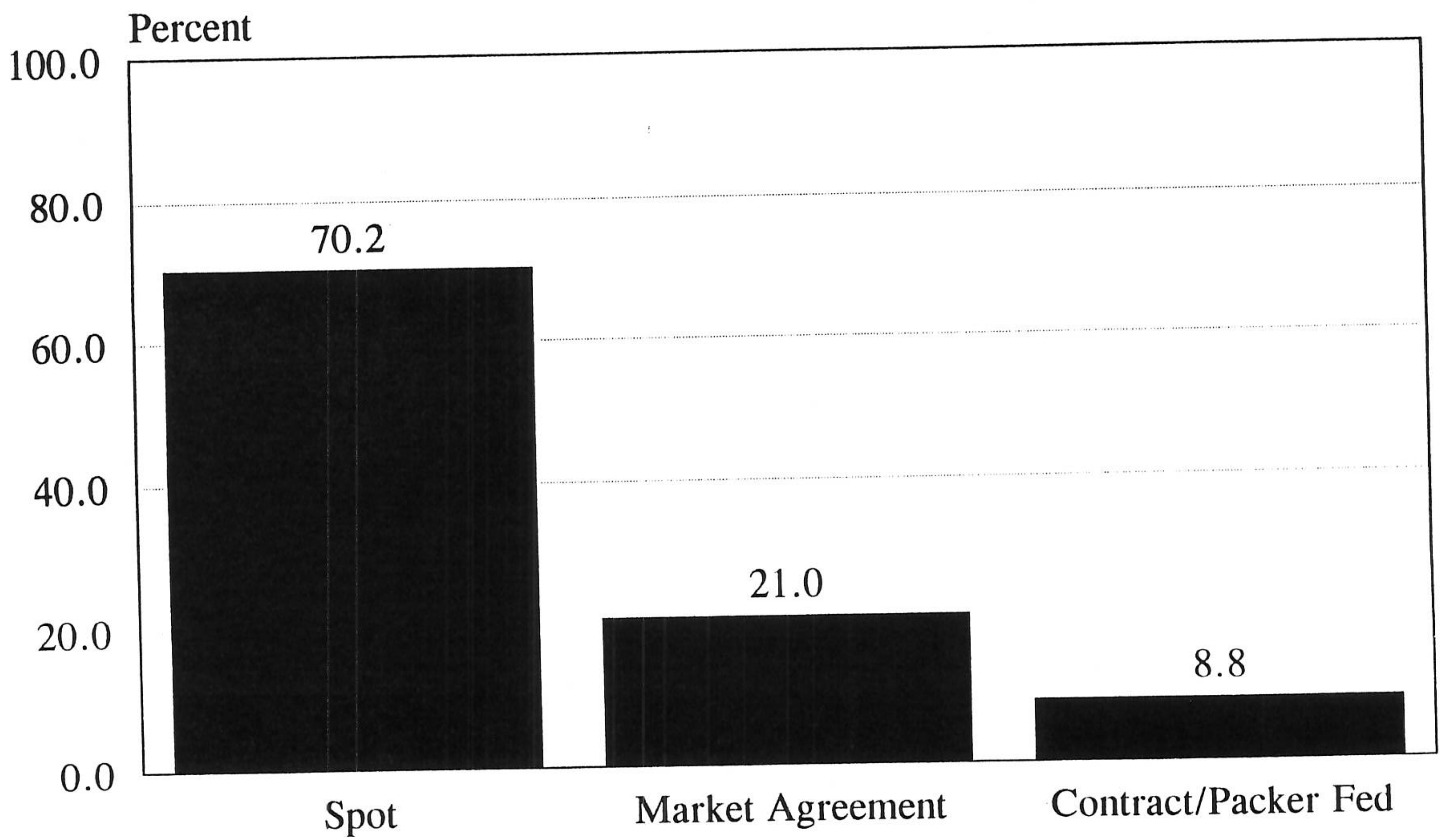
Type of Cattle Purchased



Average Lot Performance Characteristics



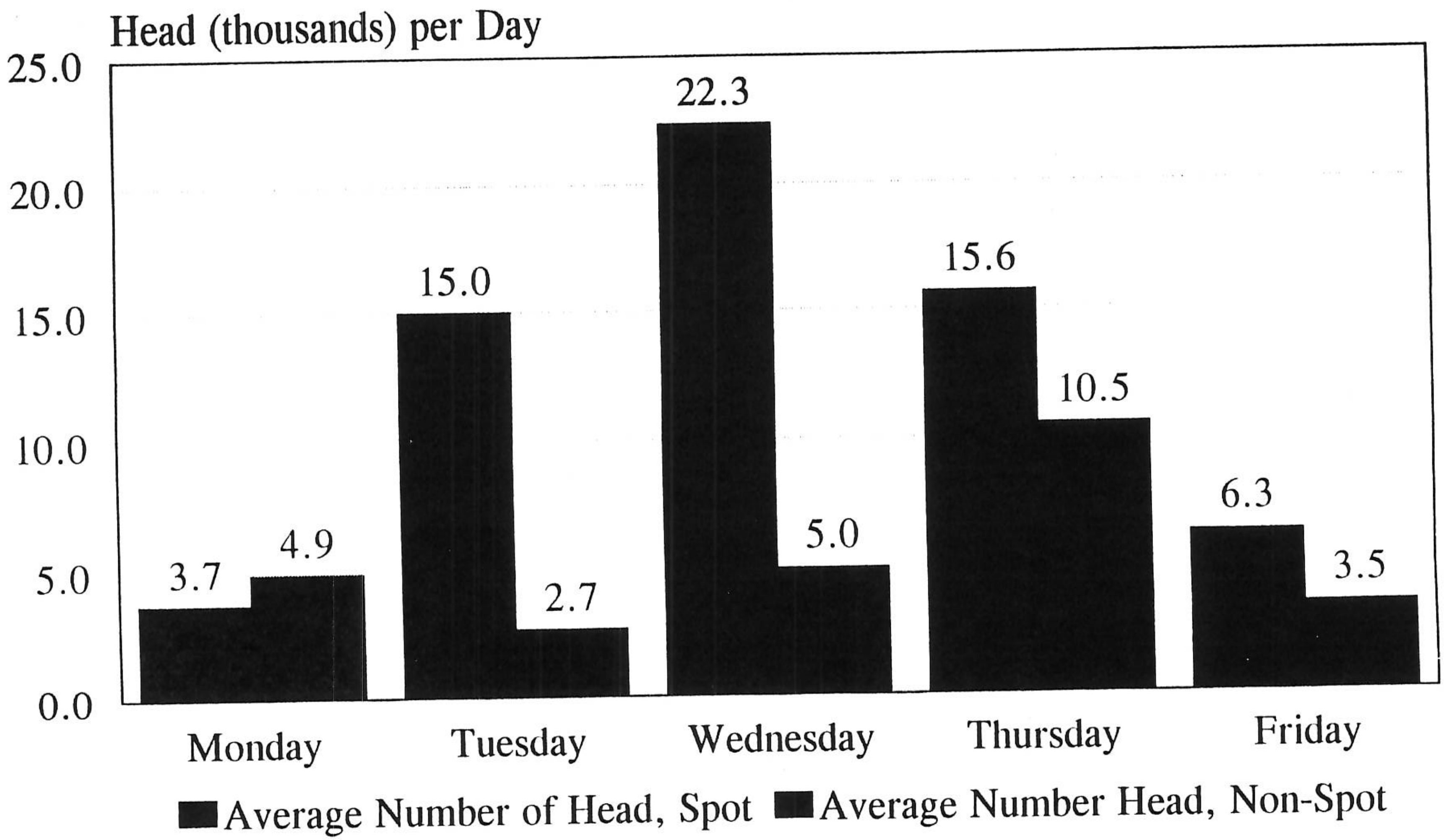
Procurement Method Summary



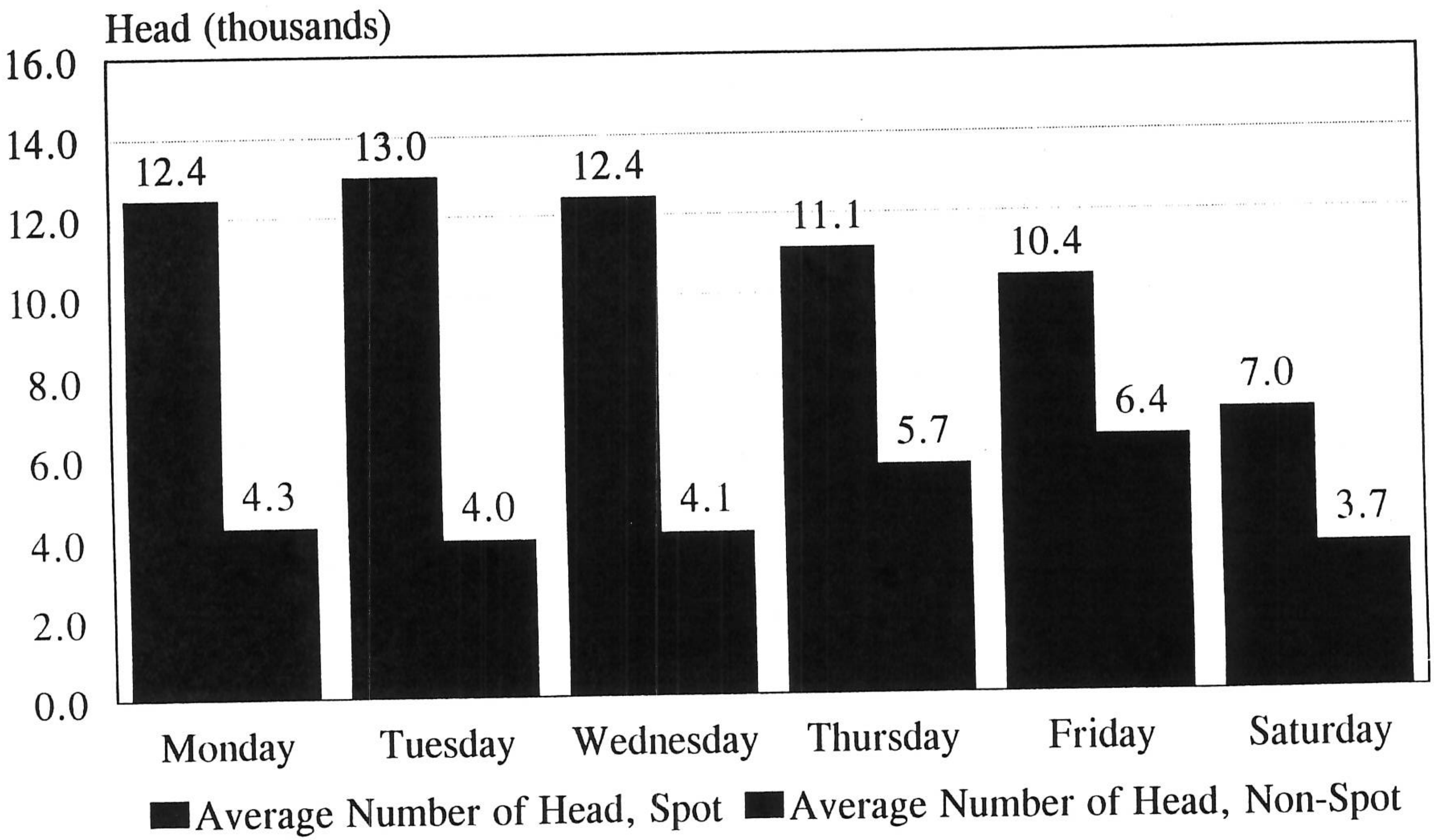
1-12

Average Spot and Non-Spot Purchases by Weekday

1-13

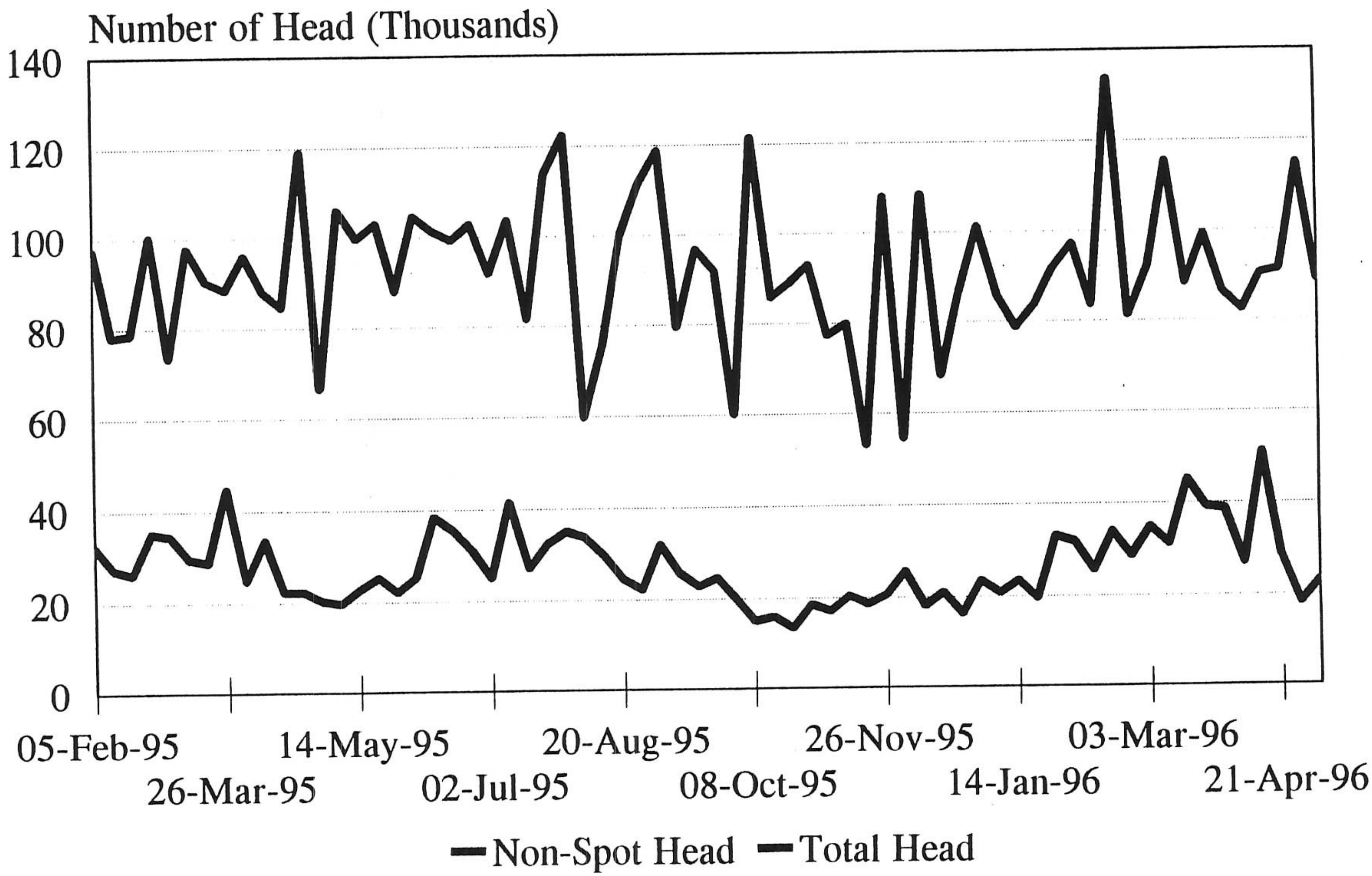


Average Spot and Non-Spot By Day of Slaughter

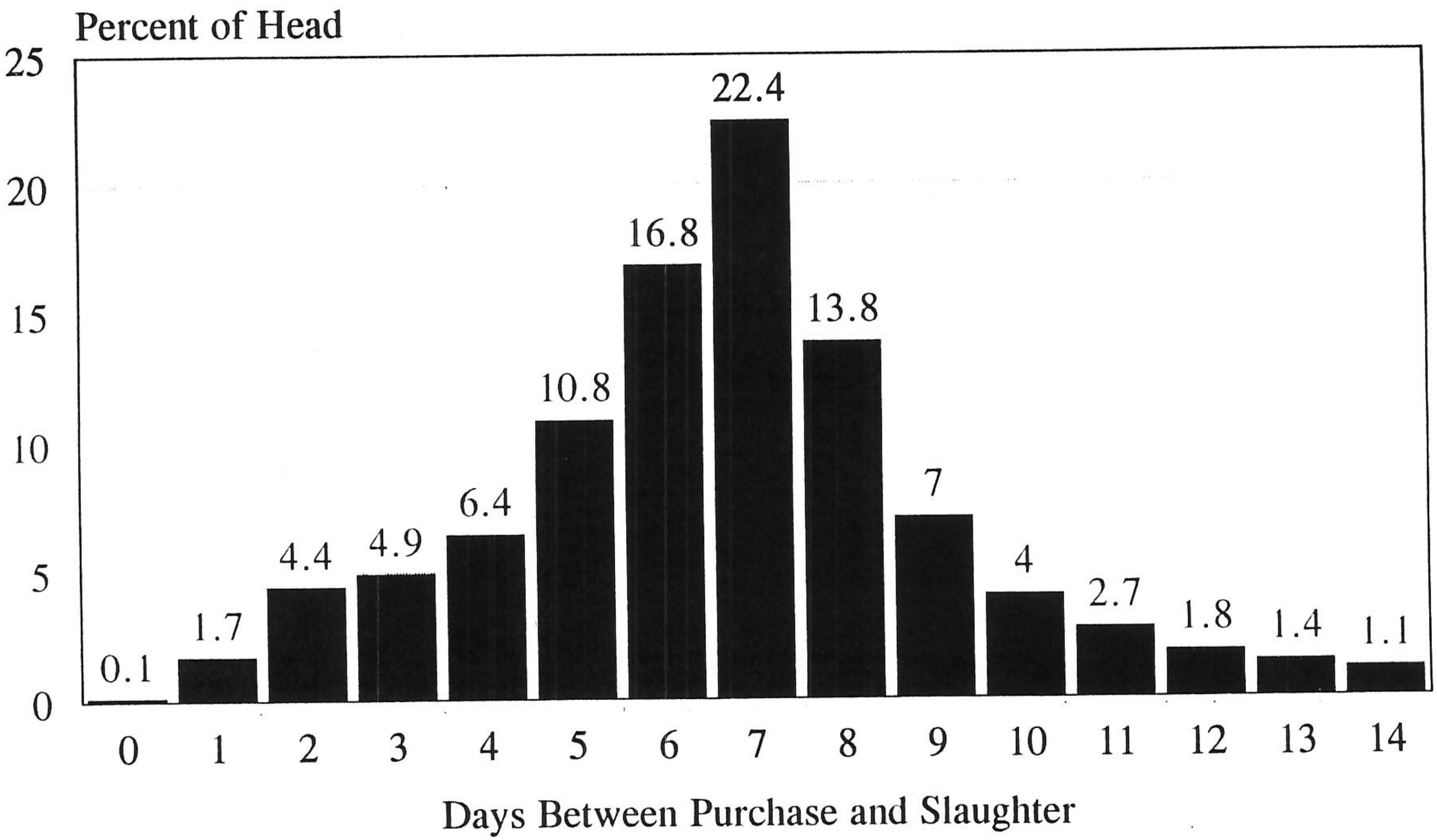


1-15

Procurement Method by Week



Number of Days Between Purchase and Slaughter



67% purchased within 7 days
32% purchased 8-14 days

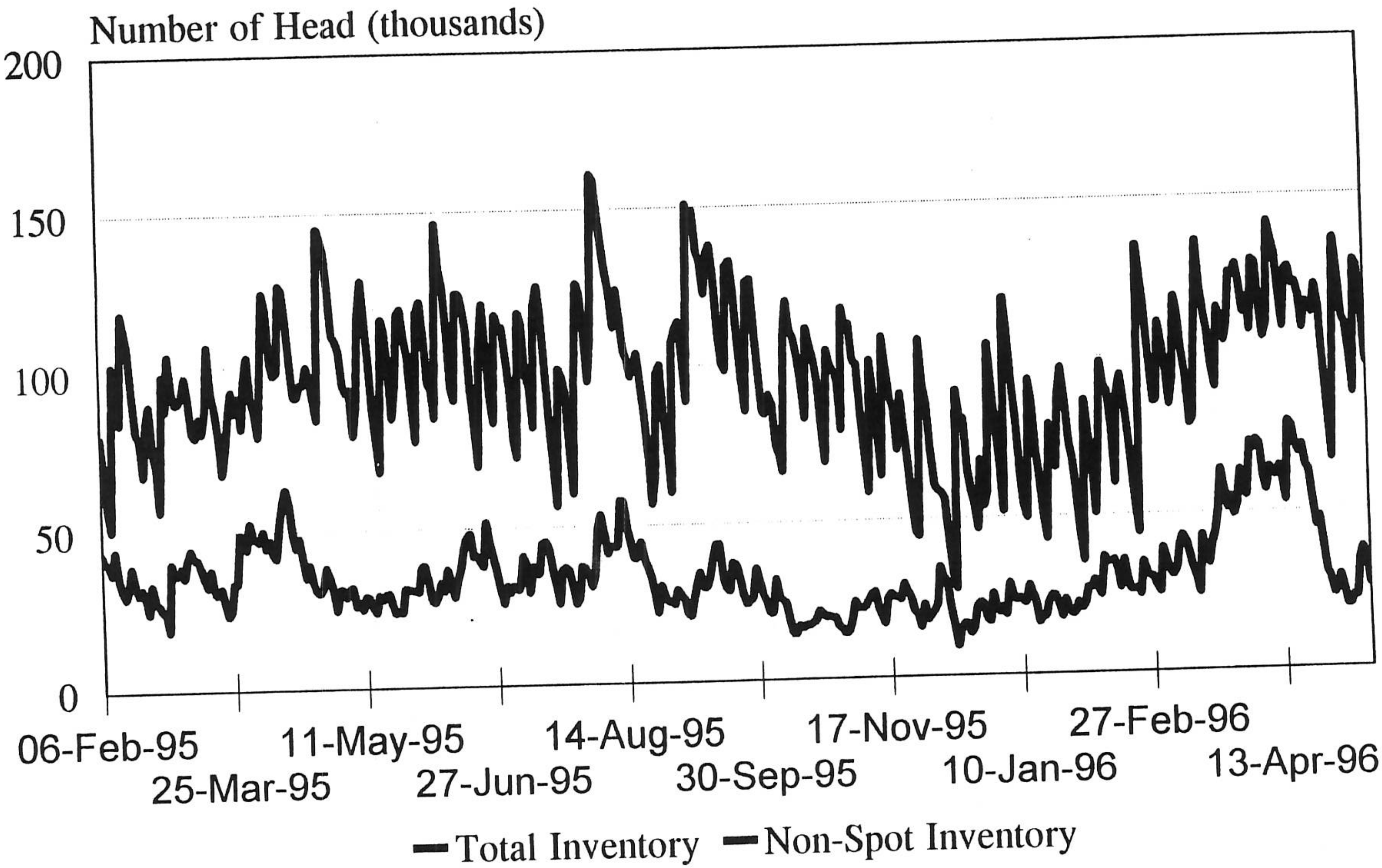
Spot Market Purchases Only

13

1-16

1-17

Overall Running Inventory

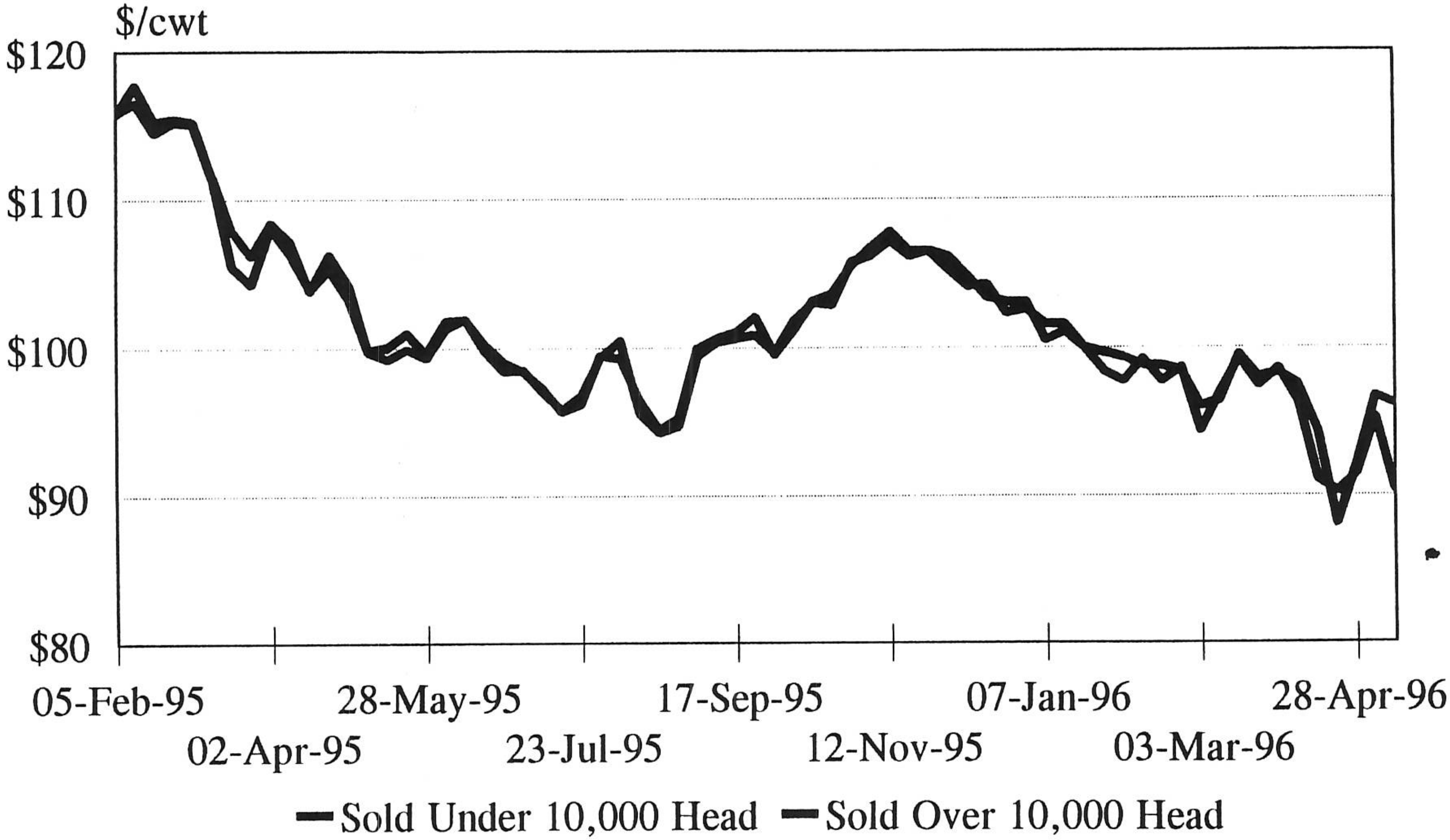


Avg.days of total inventory = 6.1

Avg. days of non-spot inventory = 1.9

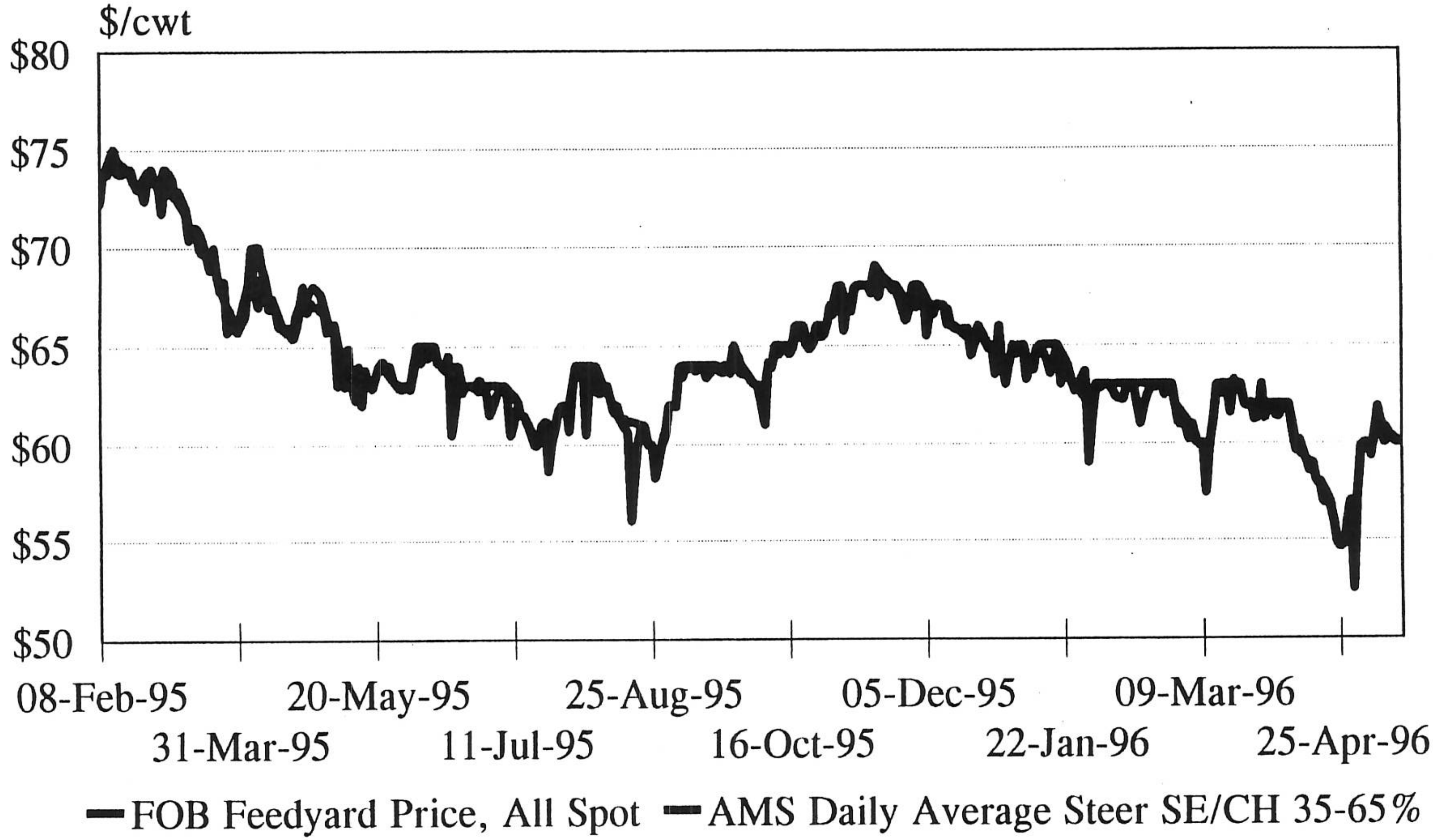
1-18

Average Hot Cost by Seller Size
(By Purchase Week)



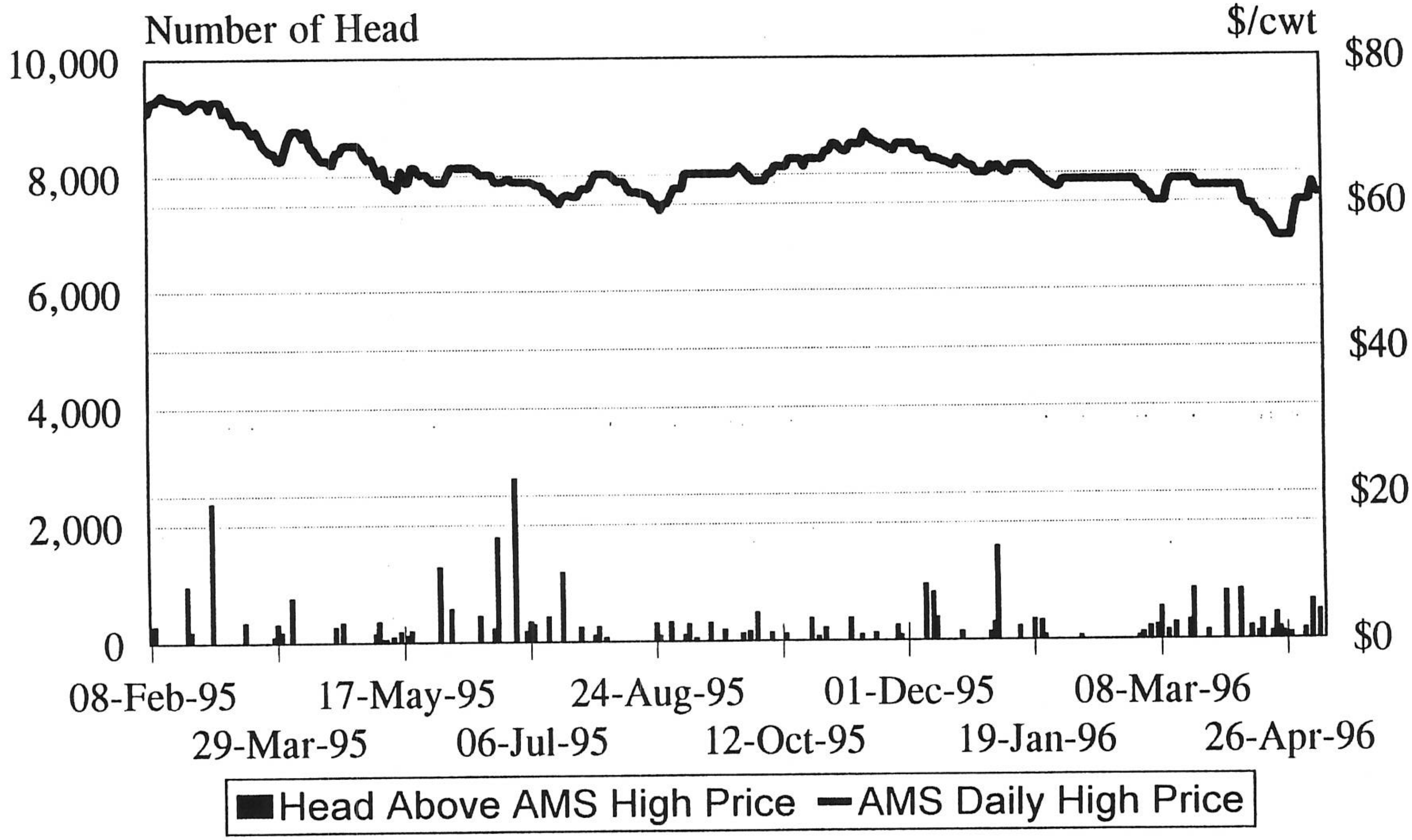
15

Average Live Prices



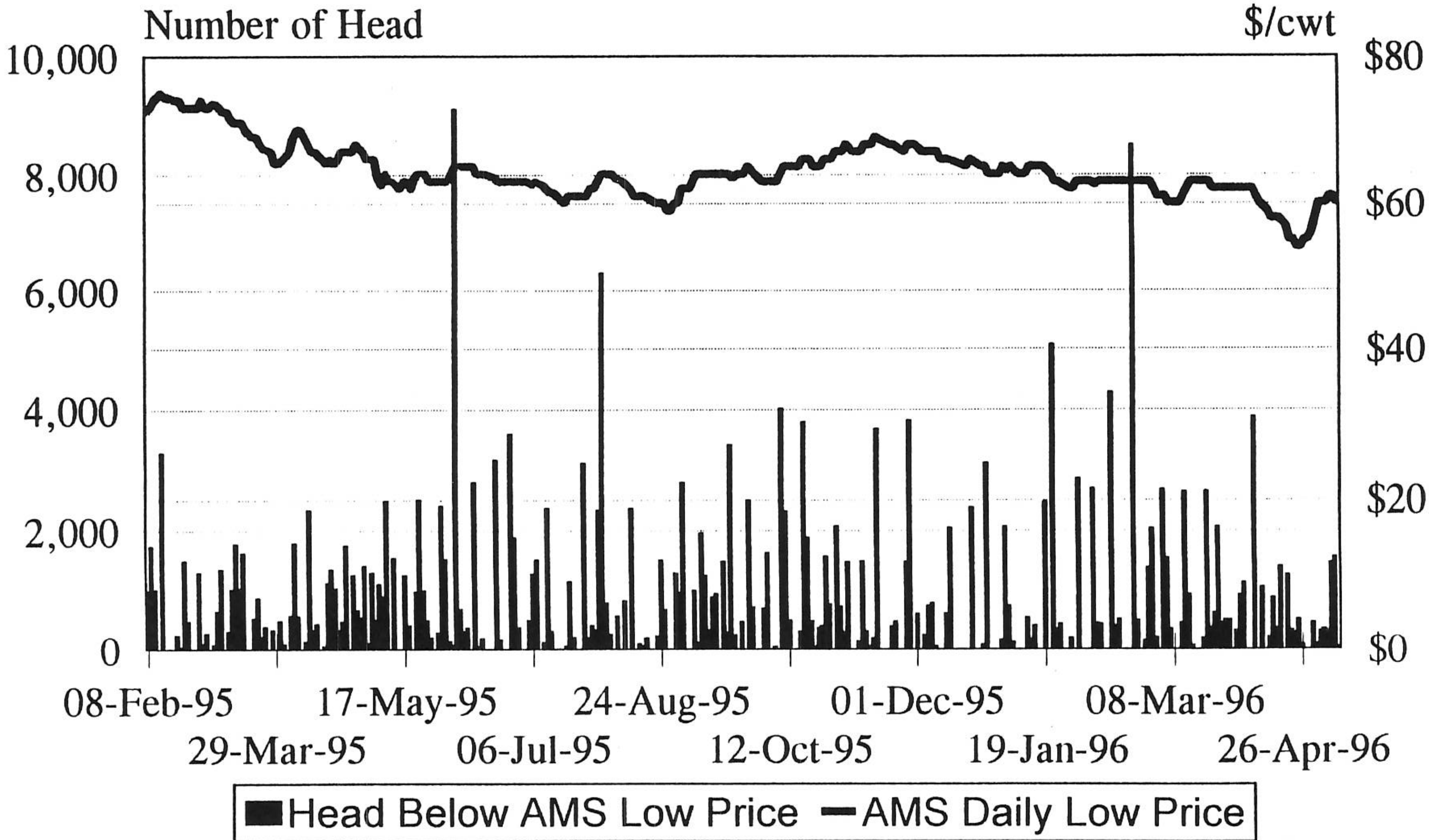
1-19

Number of Spot Market Steers Above the Reported AMS Daily High Steer Price



FOB Feedyard for SE/CH 35-65% and AMS SE/CH 35-65%, Amarillo, TX   91 days

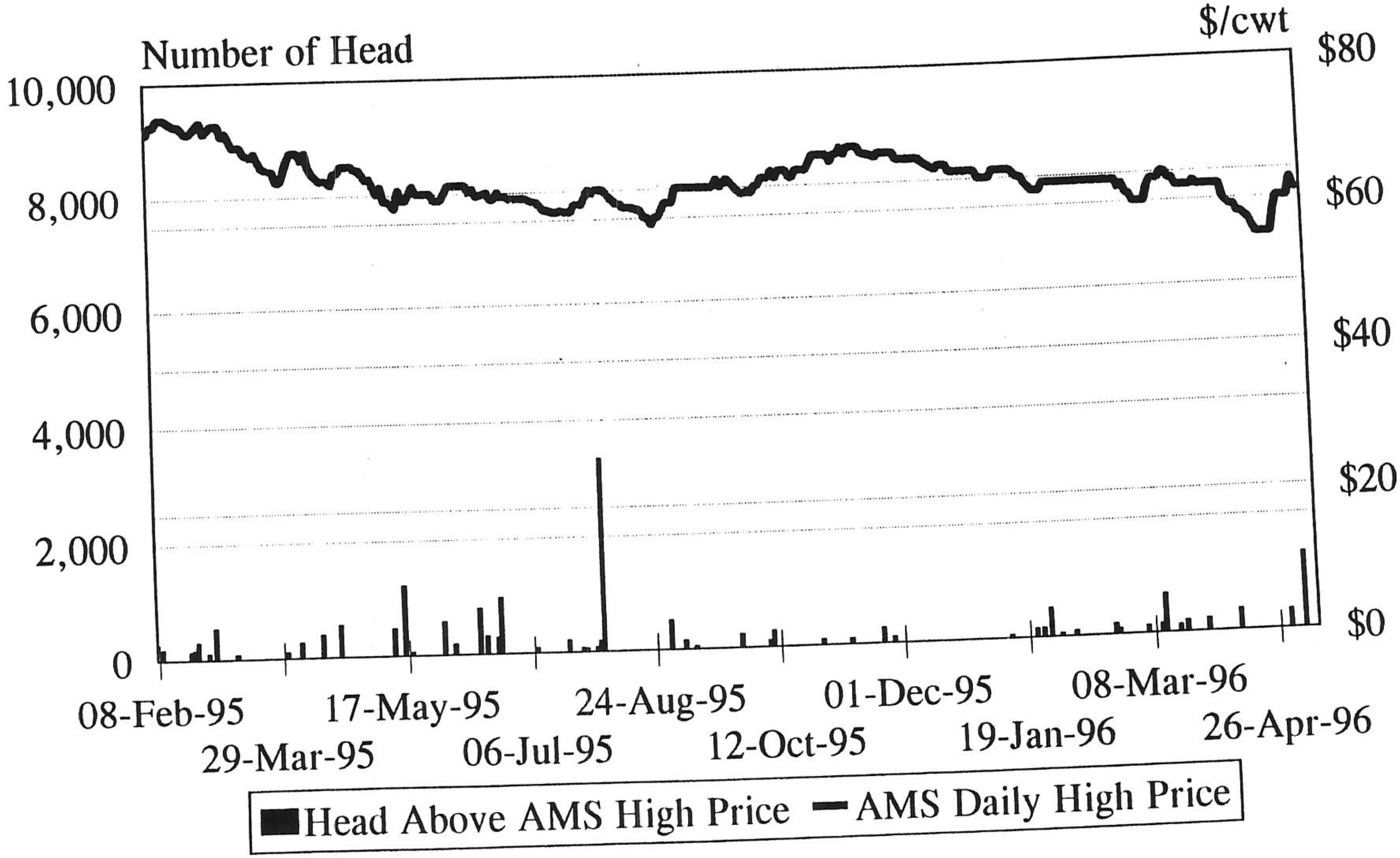
Number of Spot Market Steers Below the Reported AMS Daily Low Steer Price



FOB Feedyard for SE/CH 35-65% and AMS SE/CH 35-65%, Amarillo, TX 219 days

1-21

Number of Spot Market Heifers
Above the Reported AMS Daily High Heifer Price



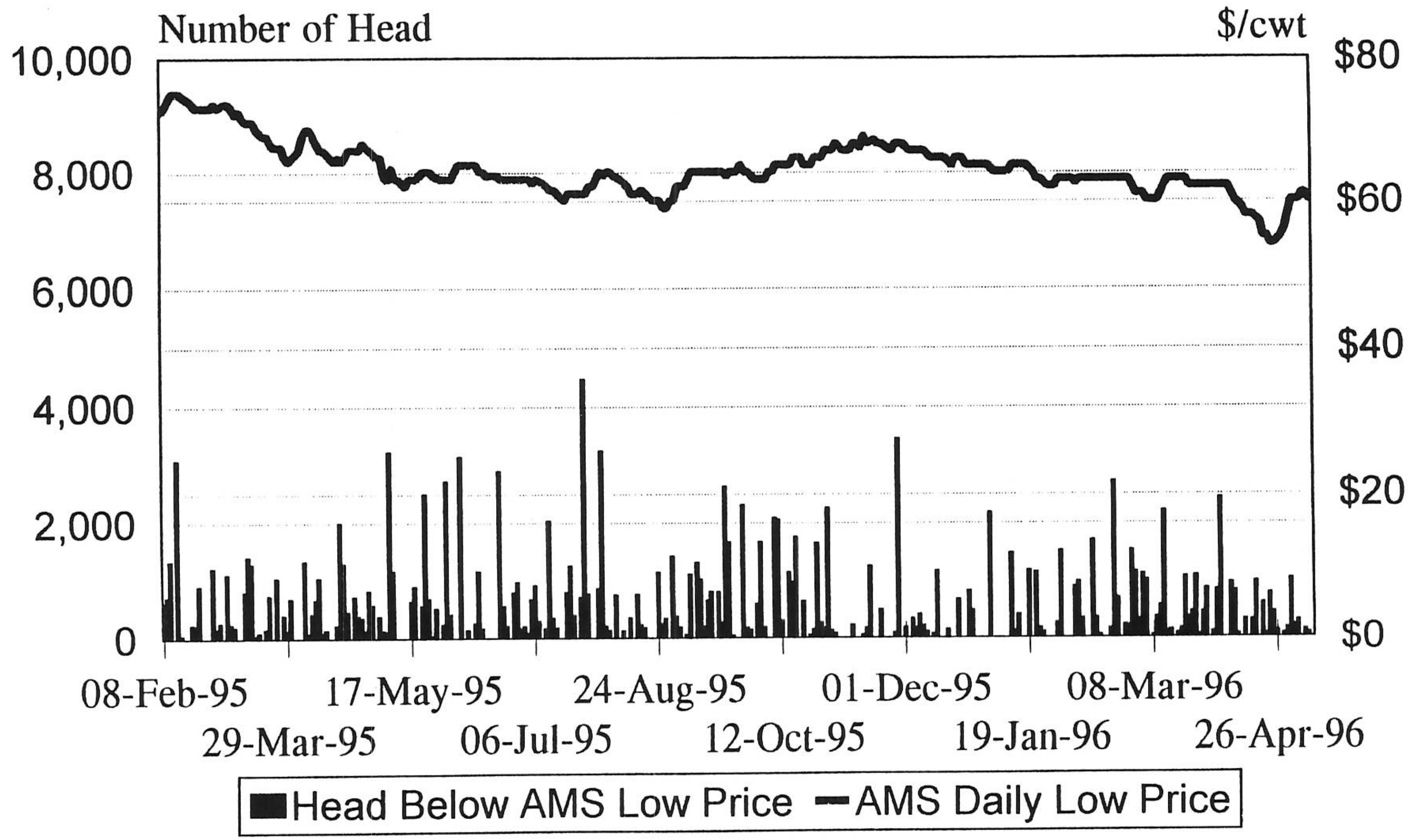
FOB Feedyard for SE/CH 35-65% and AMS SE/CH 35-65%, Amarillo, TX 54 days

19

1-22

1-23

Number of Spot Market Heifers Below the Reported AMS Daily Low Price



FOB Feedyard for SE/CH 35-65% and AMS SE/CH 35-65%, Amarillo, TX 213 days

1-27

Texas Investigation Summary

- Examine the procurement areas, procurement methods, and pricing methods in the Texas Panhandle region
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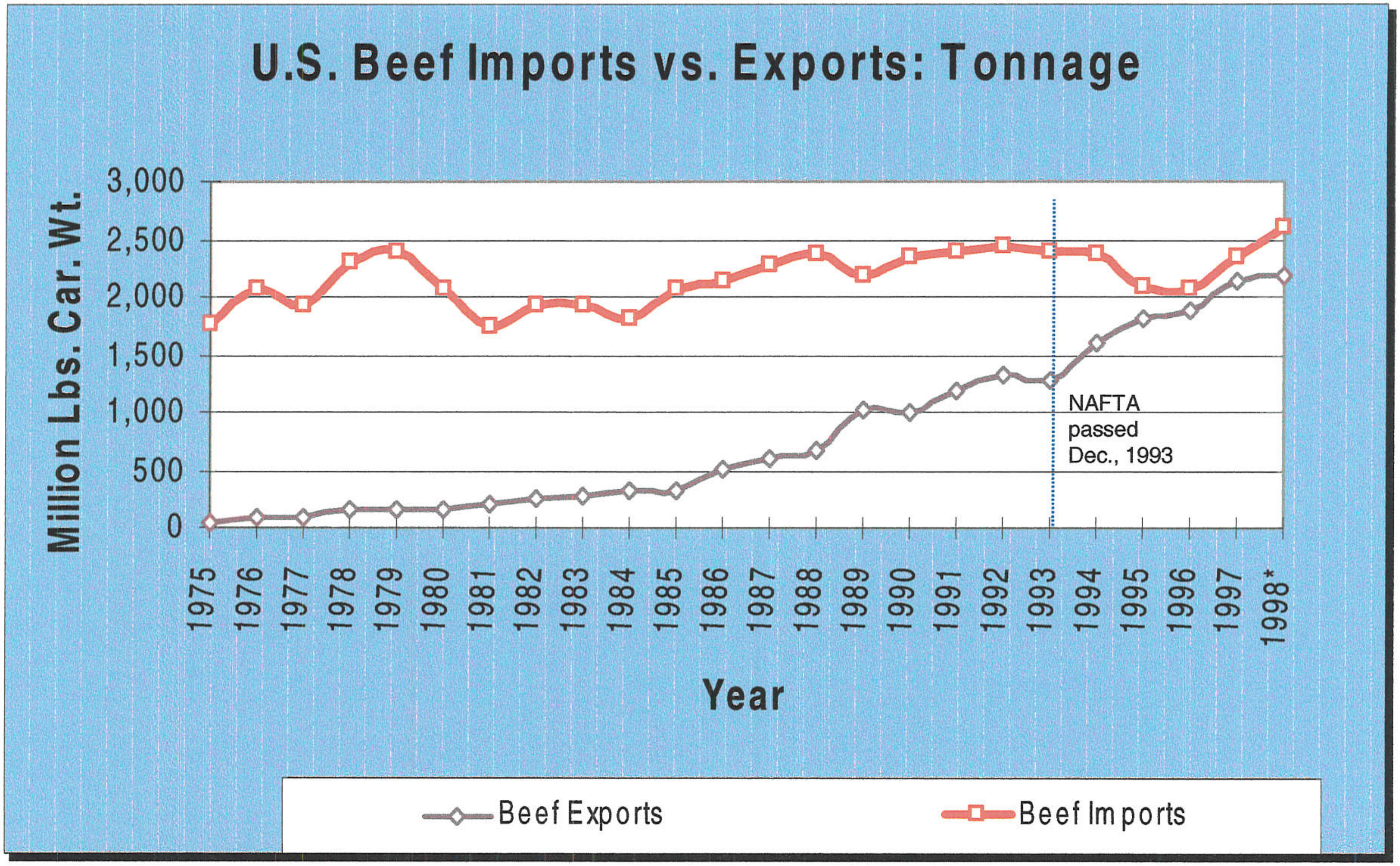
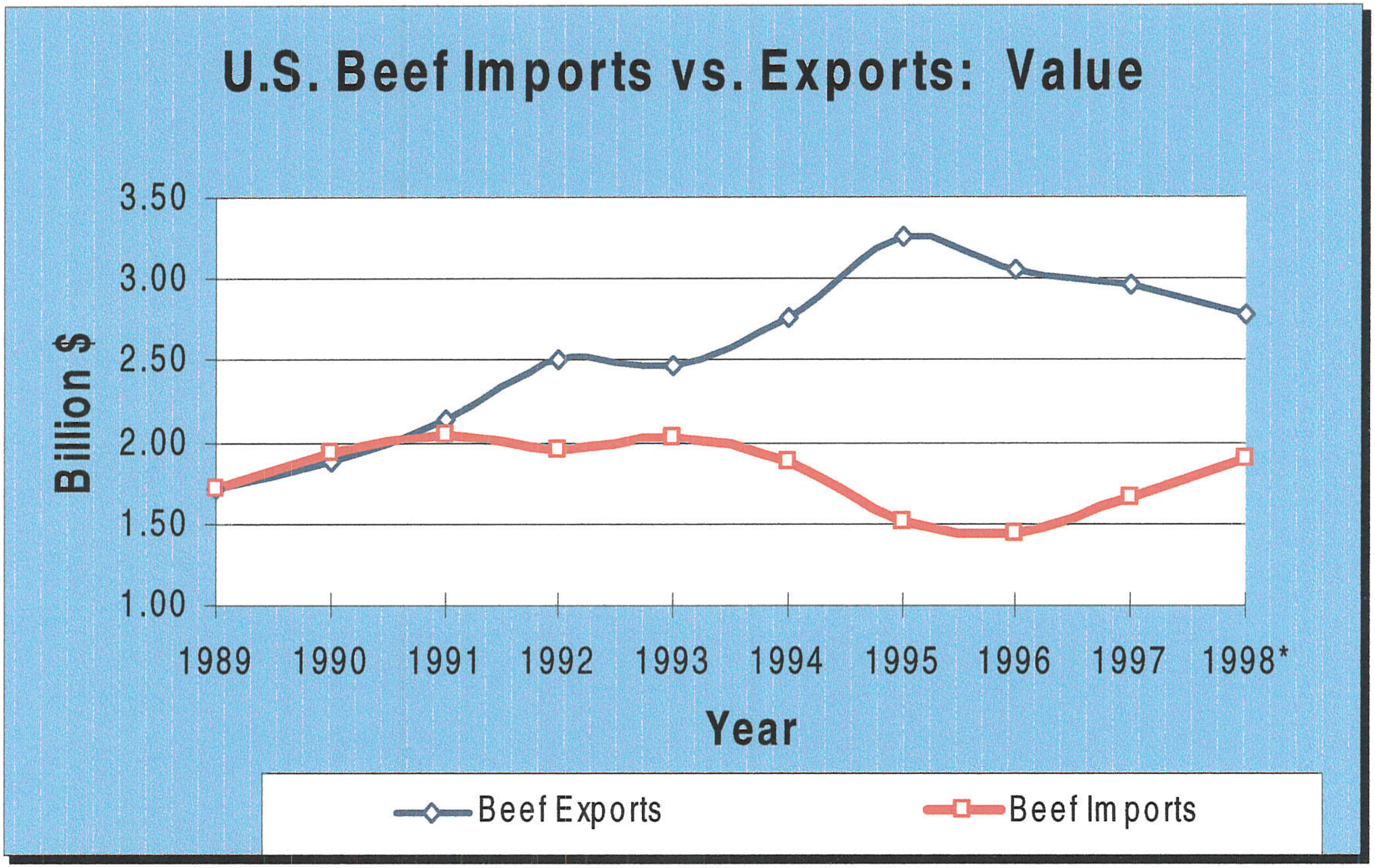
1-25

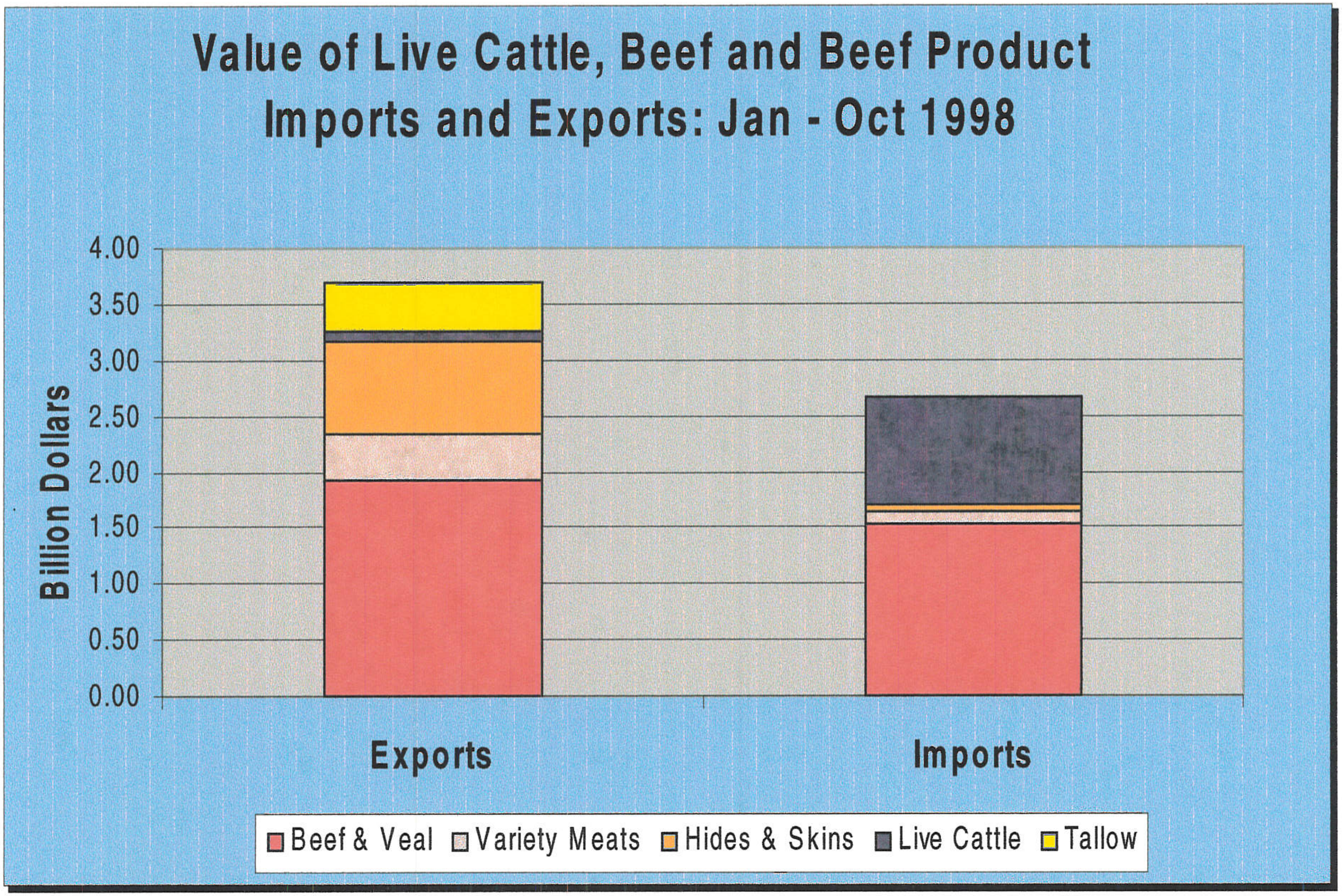

U.S. Beef Imports vs. Exports: Tonnage
Million Lbs. Car. Wt.
3,000
2,500
2,000
1,500
1,000
500
0
NAFTA
passed
Dec., 1993
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998*
Year
Beef Exports
Beef Imports

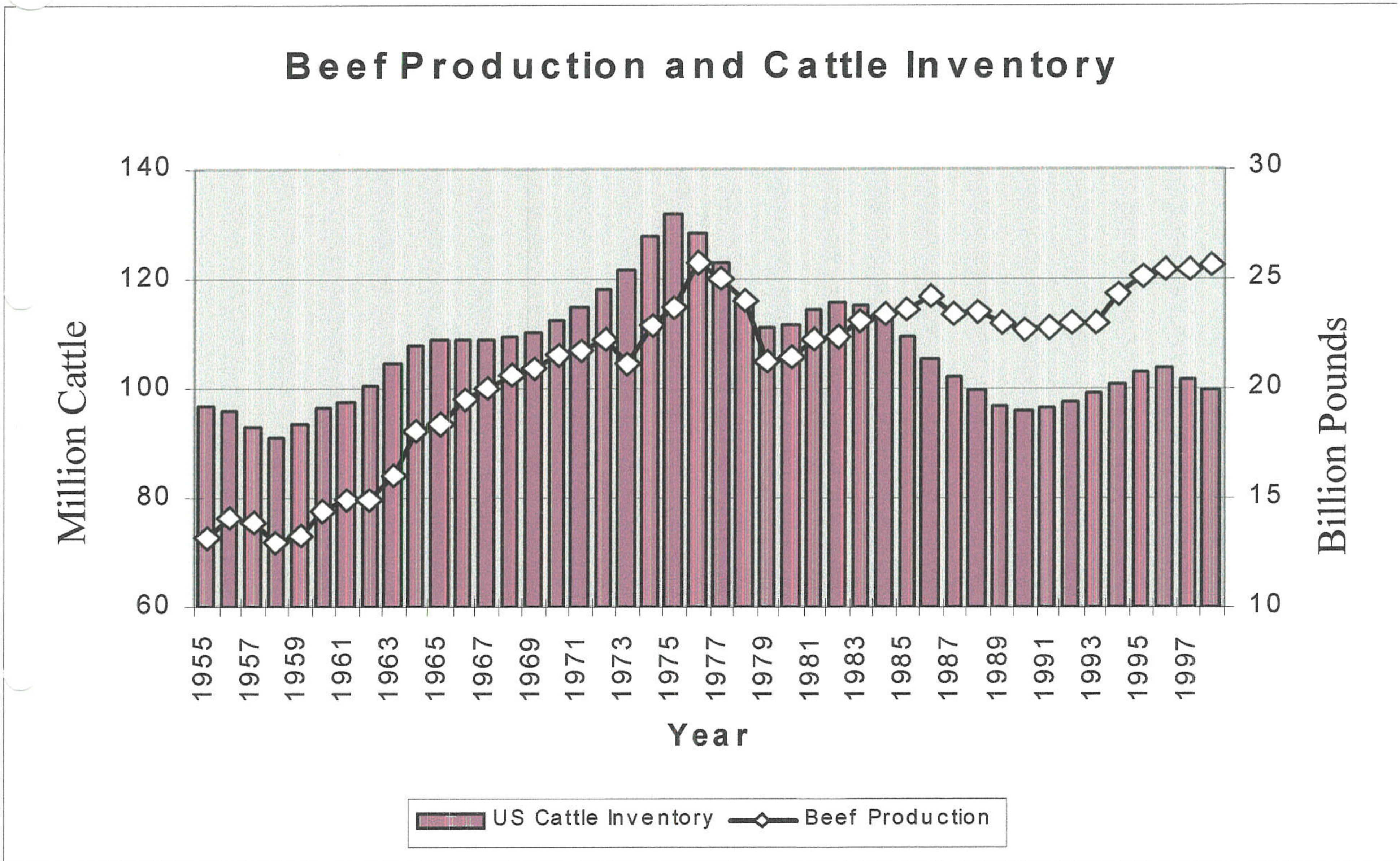
1-26



U.S. Beef Imports vs. Exports: Value
Billion $
3.50
3.00
2.50
2.00
1.50
1.00
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998*
Year
Beef Exports
Beef Imports

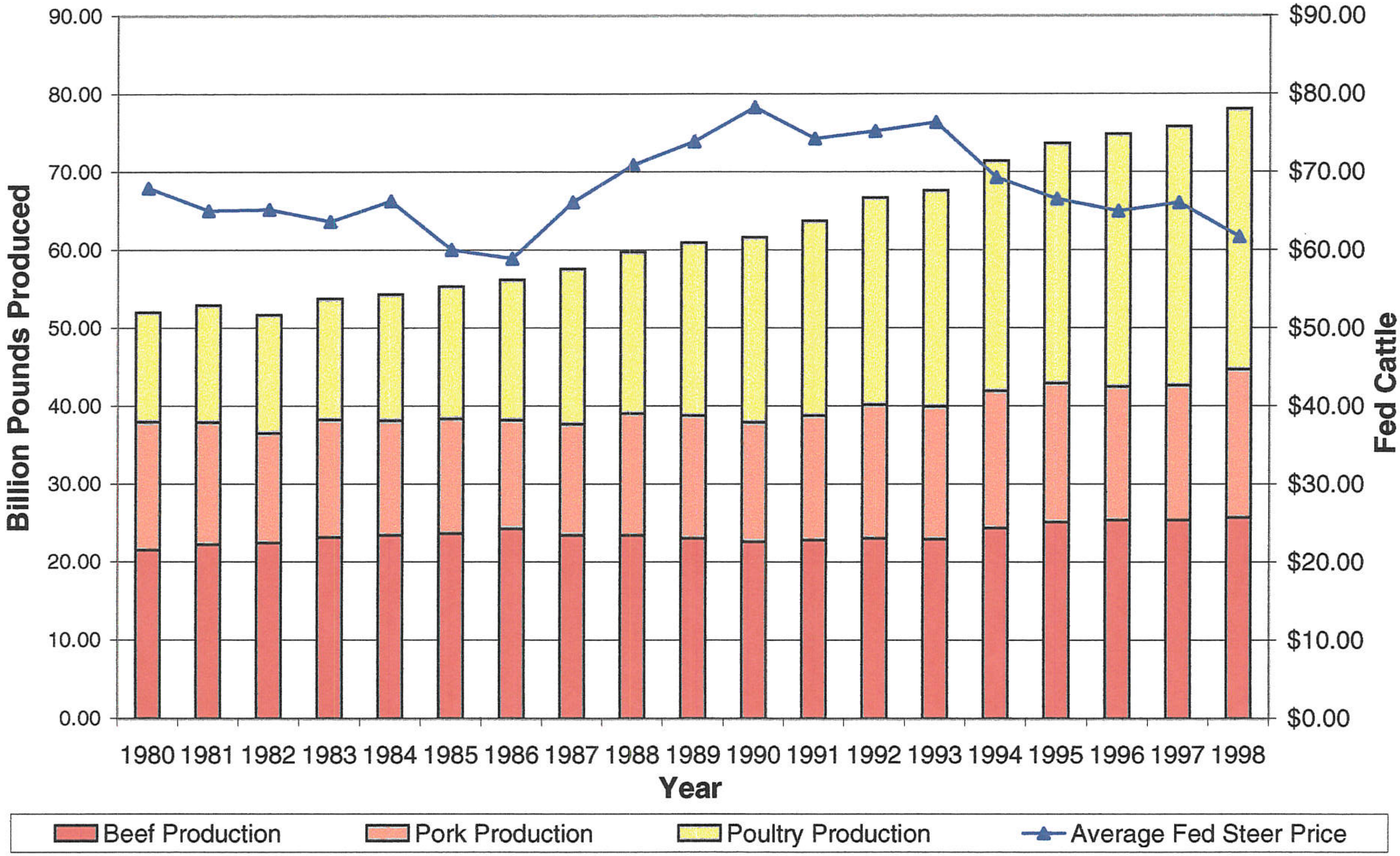
1-27


Value of Live Cattle, Beef and Beef Product
Imports and Exports: Jan - Oct 1998
Billion Dollars
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
Exports
Imports
Beef & Veal
Variety Meats
Hides & Skins
Live Cattle
Tallow


Beef Production and Cattle Inventory
Million Cattle
Billion Pounds
140
120
100
80
60
30
25
20
15
10
1955
1957
1959
1961
1963
1965
1967
1969
1971
1973
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
Year
US Cattle Inventory
Beef Production

1-29

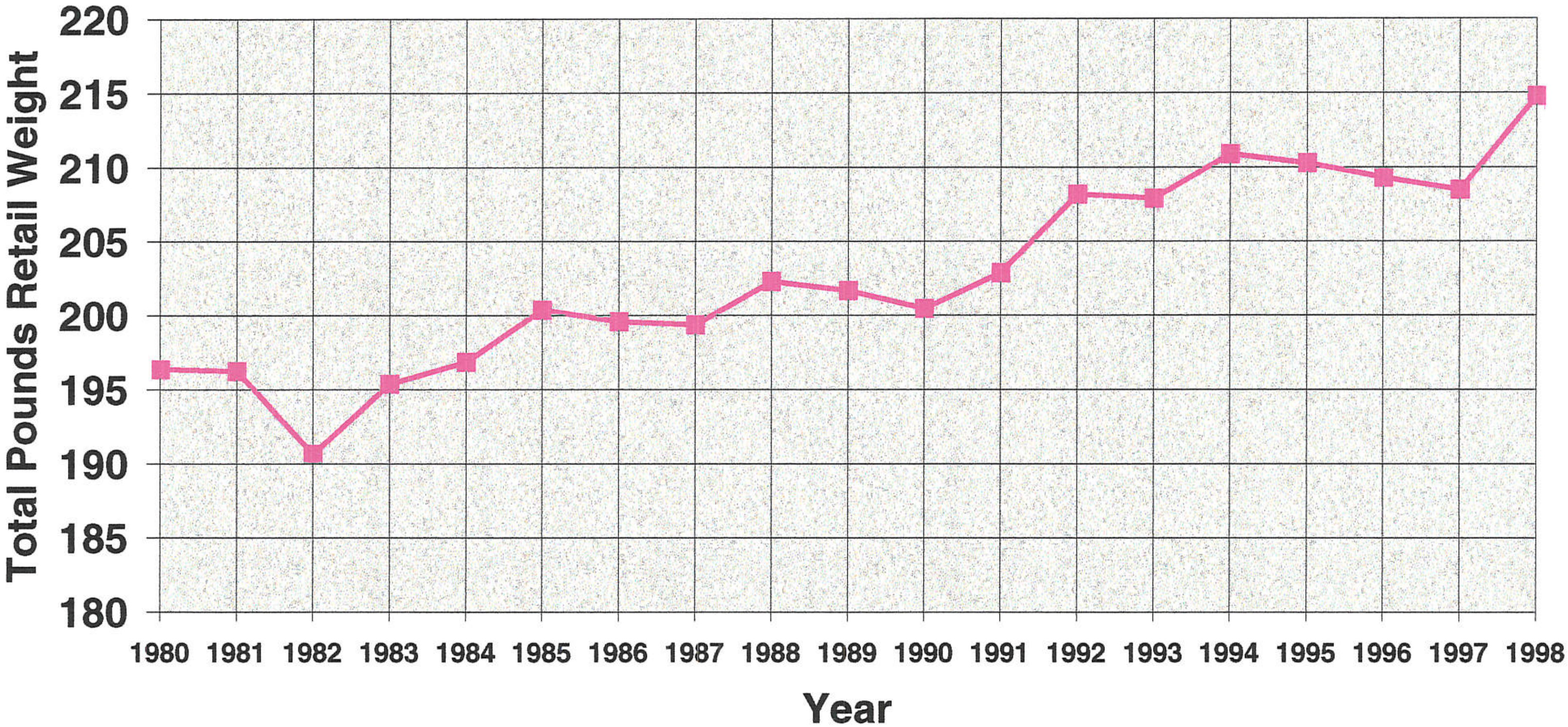
Total Meat Production vs. Fed Steer Price



Source: USDA Cattle Fax

1-30

Average Annual Per Capita Supply of Meat



Source: U.S.D.A.

FEDERAL RESERVE BANK OF KANSAS CITY

ECONOMIC REVIEW

Fourth Quarter 1998

Volume 83, Number 4

1-31

From the Plains to the Plate: Can the Beef Industry Regain Market Share?

By Russell L. Lamb and Michelle Beshear

Over the past several decades, the beef industry has seen a sharp drop in its share of the retail meat market. While per capita *meat* consumption has grown, per capita *beef* consumption has plunged. Explaining the drop in beef's market share has become a favorite pastime of industry analysts. In fact, a family feud of sorts has broken out in the industry between those who think the decline largely reflects increases in beef's price relative to competing meats and those who stress nonprice factors such as lifestyle changes, health concerns, and so forth as causes of decline. Regardless of the cause, however, the solution to the problem is likely the same.

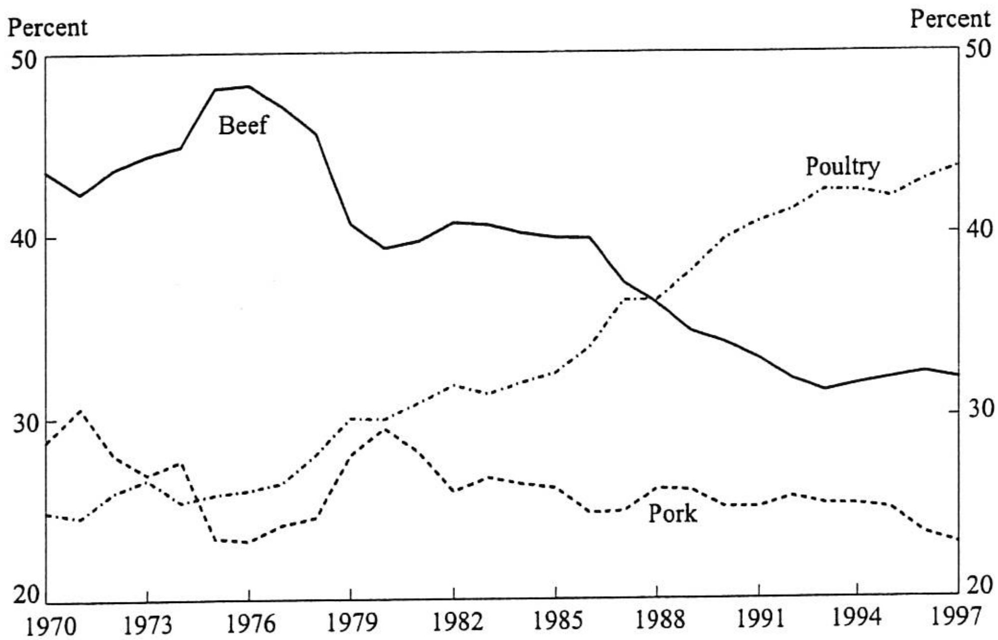
Whatever the cause of beef's declining market share, the pork and poultry industries have clearly benefited. Poultry, in particular, has seen its market share soar in recent years as per capita consumption boomed. Most analysts attribute the success of the poultry and pork industries to their ability to achieve a high degree of vertical coordination between different links in the production chain. In particular, vertical coordination has allowed them to become consumer-product driven industries while achieving significant cost reductions that have lowered retail prices.

Russell L. Lamb is a senior economist at the Federal Reserve Bank of Kansas City. Michelle Beshear is a research associate at the bank. This article can be accessed on the bank's Website at ***www.kc.frb.org****.*

For the beef industry to recapture its lost market share it must become a consumer-driven industry. A critical step in the process is achieving a greater degree of vertical coordination across the production chain. Vertical coordination in beef production may take many different forms. In fact, three alternative forms of vertical coordination in the beef industry seem possible, from modest changes in how beef is priced, to marketing cooperatives and producer alliances, to the most radical change—developing a supply-chain structure for beef production. Which path of change the industry will follow is unclear.

The first section of this article discusses why the beef industry has lost market share to poultry and pork. The second section explains how the structure of the beef industry has contributed to its failure to achieve greater vertical coordination. The third section discusses various forms of vertical coordination the industry might pursue, and the relative merits of each. The article concludes by arguing that marketing cooperatives offer the best chance for the industry to recapture market share.

Chart 1
MARKET SHARES OF BEEF, POULTRY, AND PORK



Source: U.S. Department of Agriculture, Red Meat Yearbook.

I. WHY HAS BEEF LOST MARKET SHARE?

The beef industry has lost its competitive advantage against the pork and poultry industry over the past two decades. Where beef was once the meat of choice for consumers, it has seen a steady decline in market share since the 1970s. In 1975 beef accounted for roughly 48 percent of consumption of meat products (including poultry). By 1997, that share had plunged to 32 percent (Chart 1).

Beef's decline in market share has prompted analysts to propose a number of explanations for the American consumer's waning interest in beef. Analysts disagree as to whether the decline in beef consumption represents the effect of price or nonprice factors such as consistent quality, lifestyle changes, or health concerns. Regardless of the cause, overcoming beef's inability to compete with other meat products is the critical challenge facing the industry.

Perhaps the key to meeting the competitive challenge posed by other meats lies in understanding the success of the other segments of the meat industry. Many analysts believe that the poultry and pork industries have been successful by transforming themselves into consumer-driven industries, a move that has both driven down costs and enhanced the consumer appeal of their products. A key in accomplishing the transformation was achieving a high degree of coordination between different links in the production chain, or vertical coordination. Beef's failure to achieve greater vertical coordination, and thus transform itself into a more consumer-driven industry, may explain its declining market share.

The failure of the beef industry to achieve greater vertical coordination may reflect the fundamental nature of beef production and the underlying structure of the industry, a structure that has changed little in the last decade. The three links in the beef production chain differ dramatically in structure, from a highly concentrated meat packing industry to highly competitive feedlot and cow-calf segments of the production chain. This structure makes coordination between ranchers, feeders, and packers difficult to achieve; moreover, it has contributed to a high degree of mistrust between segments of the industry. The failure of industry structure to adapt to the changing demands of the food industry is at the root of its declining share of the consumer food dollar.

Price vs. nonprice factors

Beef's declining market share has been attributed to a number of factors. Among factors cited for the decline in beef's popularity over the years, it is useful to distinguish between price and nonprice sources of decline. Nonprice factors include the lack of consistent quality, lifestyle changes, and health concerns. In fact, both price and nonprice factors likely play some role in the decline in consumer demand for beef.

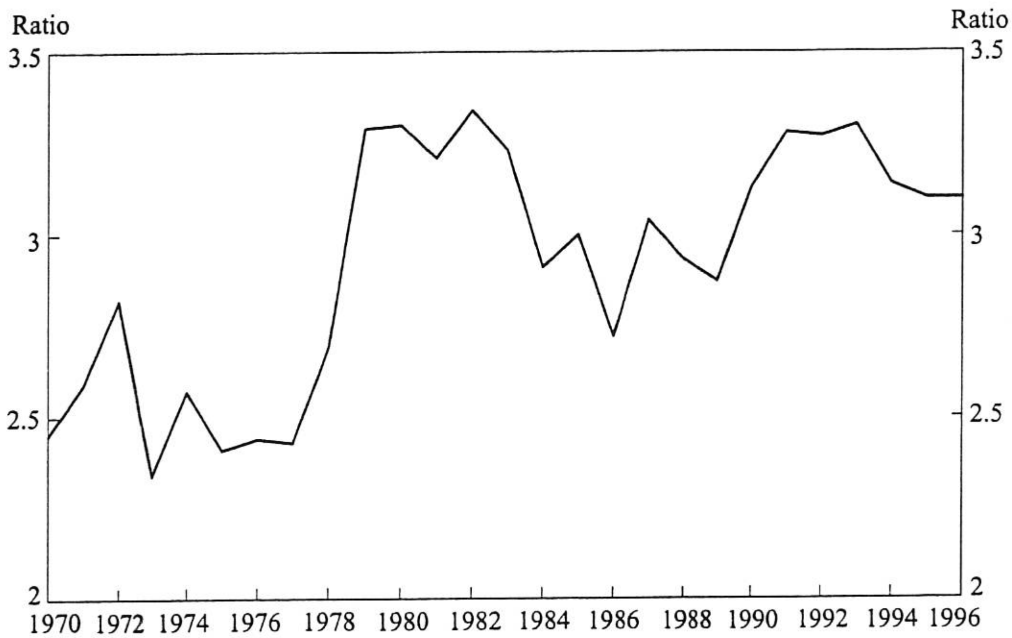
Price factors. Many analysts believe that the price of beef relative to competing meats is a primary cause of declining market share. Beef is often the most expensive meat at the meat counter. The inflation-adjusted price of beef has declined for several decades, as prices in the rest of the economy rose more quickly. But when beef prices are compared with prices for other sources of protein, the picture changes. The price of beef relative to poultry has trended higher since the mid-1970s, because poultry prices have declined more quickly than beef prices (Chart 2). For example, beef prices relative to poultry were 38 percent higher in 1993 than in 1975. Since 1993, however, the price of beef relative to poultry has declined. But beef's share of the consumer meat dollar has not risen, calling into question the ability of price movements alone to explain problems with beef demand.

Nonprice factors. While price likely explains some of beef's declining share, nonprice factors play a role as well. In particular, the beef industry has done a poor job of developing products that meet the changing demands of consumers. For example, many analysts point to the lack of consistent quality in beef. Consumers want a high average level of quality, but they also value consistency in their meat products. Wide variations in the quality of beef make consumers leery of purchasing it, especially given its relatively high cost. For example, if the family is looking forward to steaks on the grill, the disappointment of cutting into a tough T-bone may leave a lasting impression that causes them to choose barbecued chicken instead of steaks for their next cookout.

Another nonprice factor that has contributed to the decline in beef demand is the change in lifestyles on the part of most consumers. In particular, the high incidence of dual-income families means that time has become a more precious commodity. Consumers are reducing the time they are willing to spend preparing a meal, raising the demand for conveniently prepackaged, preseasoned food products. For example, the poultry industry has been very successful in developing products that are precut and preseasoned so they can be cooked with no preparation. Moreover, they have developed products that can be prepared in microwave ovens, cutting cooking time dramatically. In contrast, the beef industry has lagged behind in developing new products.

Closely related to lifestyle changes have been changes in the type of diet American consumers

Chart 2
BEEF-BROILER RETAIL PRICE RATIO



Source: U.S. Department of Agriculture, Red Meat Yearbook.

want to eat. Consumers are concerned about the levels of fat and cholesterol in beef, and recommendations by health organizations to limit the consumption of red meat have adversely affected beef demand. In contrast, the pork industry has promoted itself as "the other white meat" and reduced the fat in its product to meet changing consumer demands. The beef industry has been far less successful in meeting the health concerns of most Americans. In fact, the current grading system used in evaluating carcasses actually rewards higher degrees of fat content, since they are generally believed to enhance tenderness and taste.

Whether price or nonprice factors are mostly responsible for the decline in beef's share of the meat market, a more important question is: How does the beef industry solve the problem of declining market share? The common thread running through all explanations of beef's loss of market share is that both the poultry and pork industries have done a better job of producing the products that consumers demand, while achieving significant gains in efficiency. A key in reclaiming lost market share for the beef industry lies in understanding the competitive success of poultry and pork.

How have the pork and poultry industries been successful?

A key element of the success in the pork and poultry industries has been their ability to transform their production processes from commodity-driven marketing and pricing to a highly coordinated production process in which each step of the production chain is aimed at producing a final consumer product. The transformation has taken place by creating a high degree of communication across different links in the production chain. Through such vertical coordination, each link is able to communicate to the previous link those aspects of consumer demand that are important for the production process. The power of vertical coordination lies in producing consumer-driven products while at the same time achieving cost reductions that reflect more efficient production.

A useful example of how vertical coordination has transformed the poultry industry serves to illustrate the point. Marketing research has helped large poultry firms, which market their own branded products, to determine that U.S. consumers favor chicken breast meat for its low fat content. However, most consumers dislike the relative dryness of the meat, so they prefer a seasoning that adds moisture and flavor. In response the poultry industry has developed, for example, precut, preseasoned chicken strips and marinated chicken breasts preseasoned with Oriental spices.

The challenge for the production chain is to produce this consumer-friendly product at a competitive price. In the case of the poultry industry, this usually means that the company controlling production, the *integrator*, contracts broiler production to smaller family farms. The integrator supplies chicks to these producers, who are responsible for delivering a predetermined quantity of live broilers at the end of a specified production time. The integrator has bred the chicks to maximize breast size and has developed its own spices after extensive marketing research. Even the wrapping is designed to maximize eye appeal in the meat case. The end result is a finely developed consumer product. And tight control over the process helps keep the final cost low.

It is useful to distinguish between two forms of vertical coordination. With full *vertical integration*, a single firm owns successive stages of the food production chain. An alternative to full vertical integration is *contracting*. If contracting is used to achieve vertical coordination, then different stages of the production process are owned by different firms (e.g., different ranchers, feeders, and packers), but the activities of each firm will be linked by the contract to successive steps in the process.

Whether integration or contracting is used, the most complete form of vertical coordination is the *supply chain* model. In a supply chain, one integrator controls all stages of production, including processing and distribution (Drabenstott). Production is driven by demand for a particular consumer product, which the firm develops in response to market analysis of consumer trends. With a fixed idea of the consumer product to be produced, the firm then determines which part of the production process may be changed to produce that product at least cost.

Vertical coordination has proved hugely successful for the poultry and pork industries. The poultry industry has had a supply chain type of structure for several decades. In 1960, the share of broilers produced under contract was 93 percent (Barkema, Drabenstott, and Welch). Recently, however, full vertical integration has become more prominent, with 14 percent of total broiler production being undertaken by fully integrated firms.

In contrast, vertical coordination in any form has come late to the pork industry. In 1980, for example, less than 2 percent of pork produced was under contract or full vertical integration (Barkema, Drabenstott, and Welch). But this share has jumped to 32 percent in the 1990s (Drabenstott). The shift in production techniques has allowed the pork industry to focus on changing genetics to cut fat, producing the lean meat favored by health-conscious consumers.

1-36

Moreover, producers are able to cut production costs even further by tightly controlling feeding and handling. This transformation of pork production has probably been responsible for the industry's ability to maintain market share over the past two decades.

Why hasn't beef adopted a supply chain structure?

In contrast to the pork and poultry industries, the beef industry has not evolved toward any form of vertical coordination. Production is still characterized by several distinct stages, with little coordination between the stages of production. The final stage in beef production is still geared toward producing a commodity-based product. This lack of coordination between links in the production chain, from cow-calf operators to cattle feeders, meatpackers, and the retail outlets, makes it impossible for the beef industry to convey consumer preferences from the retail market place to each link in the production chain. Transforming beef production into a consumer-driven industry is the central problem to be overcome in recapturing market share for beef. A crucial step toward accomplishing this may be achieving greater vertical coordination.

In part, the failure of the beef industry to achieve vertical coordination reflects the unique structure of beef production. The structure of the beef industry is summarized by three links in the production chain: ranchers, feeders, and meatpackers (Figure 1). The three links in the production chain differ dramatically in structure. The cow-calf industry is a classic example of a competitive marketplace, with a large number of relatively small producers. The feedlot segment is also highly competitive, but has become more concentrated recently, and also is faced with few buyers for its product. The final link in the chain, the meat packing industry, is highly concentrated with a few large producers. In fact, the differences in industry structure between ranchers, feeders and packers are an important obstacle standing in the way of the growth of the industry.

The large numbers of producers and wide geographical dispersion in the beef industry may pose problems for further vertical coordination, if the experiences of the pork and poultry industries are a guide. The rise of both contract production and full vertical integration in the poultry and pork industries has mirrored a move to more concentrated production, with fewer, smaller firms. For example, the top 15 hog producers now own 22 percent of the breeding stock in the United States (Drabenstott). The large numbers of individual beef producers, both ranchers and feedlot operators, likely hinder the growth in vertical coordination. If there are large fixed costs to negotiating any single contract, for example, a large number of producers makes it more costly to move toward contract production. Experience suggests that some sort of consolidation may be a necessary precondition to achieving high levels of vertical coordination.

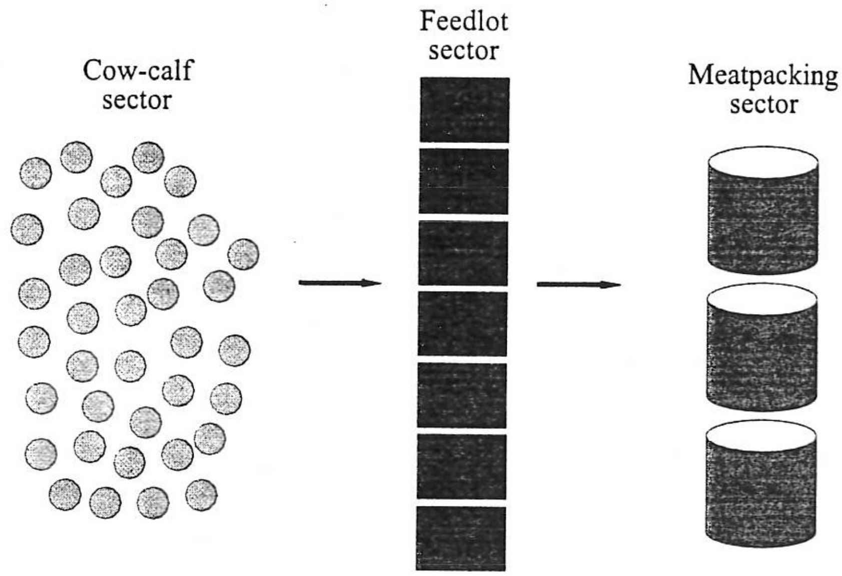
Few scale economies for ranchers

The first link in the production chain, the cow-calf sector, has remained open and competitive, with a huge number of producers varying greatly in terms of herd size. Moreover, there is little indication that this link in the production chain is moving toward greater consolidation. Producers with less than 100 head still produce nearly half of the calves raised in the United States, compared with roughly 55 percent in 1988 (Table 1). In contrast, operations with greater than 500 head account for 14 percent of total inventory in the cow-calf sector, although they are only 1 percent of total operators. The cow-calf sector has not seen substantial consolidation in production.

The lack of consolidation in the cow-calf sector is not accidental. It reflects, at least in part, the absence of significant economies of scale. Standardized Performance Analysis (SPA) data available from the National Cattlemen's Beef

1-37

Figure 1
STRUCTURE OF THE BEEF INDUSTRY



Association (NCBA) program summarize economic performance of 483 herds across the United States between 1990 and 1997. The size of herds sampled ranged from 7 to 15,905, accounting for huge differences in scale of operations. There is not a clear downward trend in production costs across herds of different sizes. Rather, production costs appear to fall into three overall groups (Chart 3).

The smallest producers have the highest costs. Producers with fewer than 50 animals have production costs around $125 per hundredweight of calf produced. Producers with more than 50 animals, but less than 500, have lower production costs, averaging around $95 per hundredweight of output. So the smallest herds appear to be much less efficient than slightly larger herds. But this difference likely captures the effect of "hobby farms," which are not generally run with economic profit as their primary motive.

The largest producers, those with more than 500 animals, have production costs around $85 per hundredweight, only a bit below the middle group of producers. But, the decline in production costs is not consistent. For example, producers with 300 to 500 animals reported average production costs of about $95 per pound, greater than costs reported by producers with 200 to 300 animals. The study showed that production costs did vary by the size of operation, but the relationship is not linear and not strong beyond the smallest herd size.

The lack of scale economies likely reflects the nature of beef production. Exploiting beef's comparative advantage—its ability to convert forage into pounds of meat—requires extensive production methods. Herd cows are fed on pas-

Table 1

STRUCTURE OF RANCHING INDUSTRY

Number of operations and share of inventory (percent)

	1988		1997	
	Share of operations	Share of output	Share of operations	Share of output
Size of operation				
Less than 50 head	83	34.9	80	30.3
50-100 head	10	19.3	12	19.5
100-500 head	7	45.8	8	36.2
Greater than 500 head[1]	N/A	N/A	1	14.0

[1] In 1988, the largest reported size class was "greater than 100 head."

Source: U.S. Department of Agriculture, *Cattle*, various issues.

ture supplemented with hay, with essentially no grain in their diet. Cattle raised for slaughter are kept on grass as long as possible before being placed on feed because feeding represents a much more expensive way of adding pounds than grazing. Beef cannot be produced efficiently in confinement facilities.

Little coordination between ranchers and feedlots

The highly competitive nature of the ranching sector has made greater coordination between ranchers and cattle feeders difficult, if not impossible. While there has been considerable consolidation in cattle feeding, it is still characterized by a large number of individual producers, making coordination more difficult. Moreover, current marketing arrangements make it difficult to design better pricing mechanisms for feeder cattle. These problems in achieving vertical coordination across the first links in the production chain set the stage for many of the beef industry's problems.

Like the cow-calf sector, the feedlot sector has remained quite competitive, but there has been some movement toward larger feedlots. In 1980, small farm feedlots with less than 1,000 head accounted for 25 percent of fed cattle sold; by 1997 these feedlots made up only 15 percent of the fed cattle sold (Table 2). At the same time, the share of cattle in medium and large commercial feedlots increased from 43 percent in 1980 to nearly 60 percent in 1997. In fact, the largest increase in share occurred in large commercial feedlots with more than 32,000 head of cattle. These large operations now account for 35 percent of cattle on feed, compared with only 22 percent in 1980. Cattle feeding appears to be heading toward greater consolidation.

The ranching and cattle feeding sectors serve to illustrate the difficulties in achieving vertical coordination in beef production. Currently little coordination takes place between feedlot owners and the cow-calf sector. While there are fewer feedlot operators than in previous years, the number is still huge, about 110,000. At the same time, more than 900,000 farms reported some inventories of cattle on January 1, 1998. The coordination problem between such a large number of producers is staggering. Moreover, feedlot operators require uniform lots of cattle of

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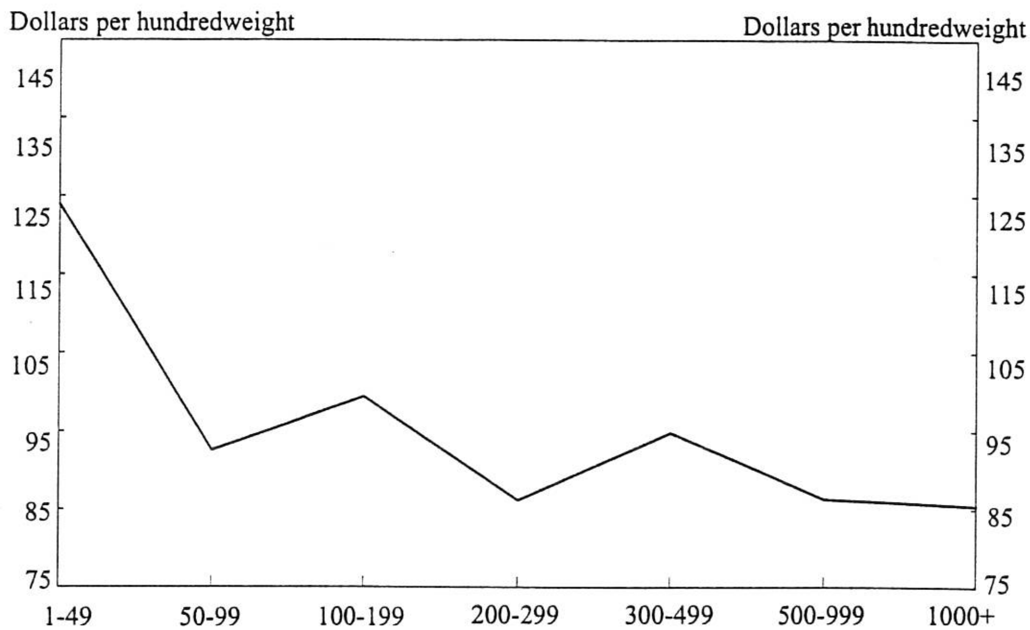
Chart 3
COW-CALF PRODUCTION COSTS



Source: National Cow-Calf SPA, National Cattlemen's Beef Association.

the same gender, meeting strict weight and frame requirements, to be delivered at prespecified times of the year. Only the very largest ranchers can deliver enough lots of cattle reliably to make coordination with feedlot operators feasible.

Moreover, current marketing techniques for feeder cattle make it difficult to design a pricing mechanism for cow-calf producers that accounts for most of the characteristics of calves produced. Since ranchers are generally paid when feeder cattle are sold, it is impossible to detect characteristics of the carcass at sale time, or even how the carcass will develop. Given the great degree of heterogeneity in the U.S. cowherd, it is important to control for genetic differences in feeder cattle.

A highly concentrated meatpacking industry

The meatpacking industry differs substantially from other links in the production chain. It is highly concentrated and has been most successful at achieving cost reductions. And meatpackers have made the first steps toward vertical coordination in the industry by developing closer relationships with cattle feeders.

In contrast to the other links in the beef production chain, meatpacking is among the most concentrated industries in the United States, rivaling the auto industry in terms of concentration (Chart 4). Presently, four major meatpacking operations are responsible for processing the

1-40

Table 2
STRUCTURE OF CATTLE FEEDING INDUSTRY
Share of feedlot cattle sold (percent)

	1980	1988	1997
Farm feedlots			
Small (less than 1,000 head)	25.0	16.3	15.1
Medium (1,000 to 16,000 head)	32.3	33.5	27.9
Commercial feedlots			
Medium (16,000 to 32,000 head)	20.4	18.7	21.9
Large (more than 32,000 head)	22.3	31.6	35.1

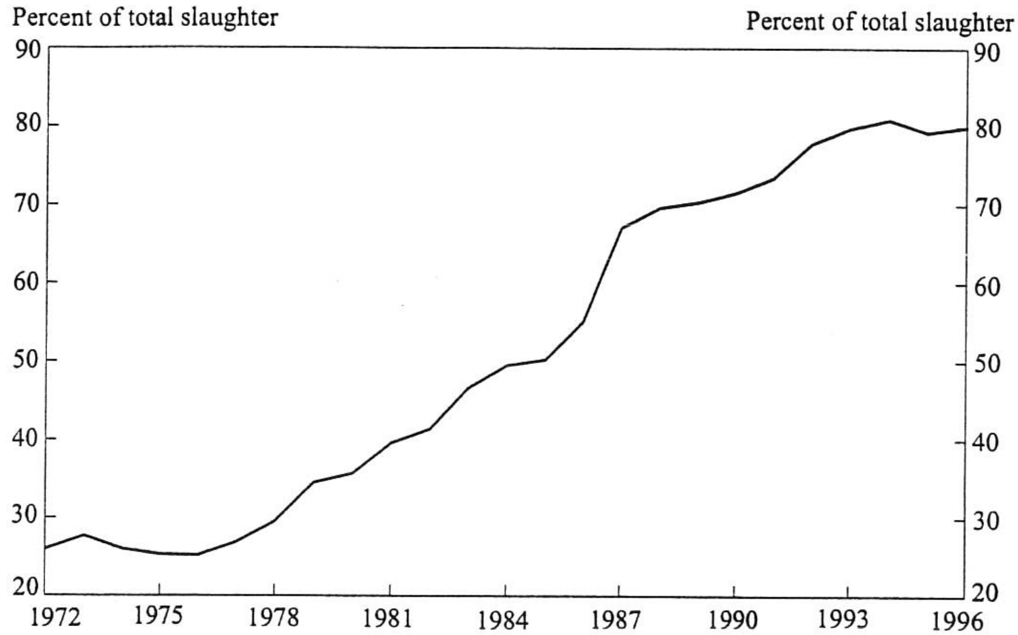
Source: U.S. Department of Agriculture, *Cattle on Feed*, various issues.

majority of beef in the United States. IBP, Excel, ConAgra, and Farmland currently account for approximately 80 percent of the fed cattle slaughtered. The driving force behind consolidation in the meatpacking industry has been cost. Larger plants have been better able to capture efficiency gains generated by technological improvements. For example, data available on production costs across different groupings in the meatpacking industry suggest that operating expenses account for 14.2 percent of total revenues for the four largest firms, but 17.1 percent of revenues for the 40 largest firms (Table 3). Since the four largest firms are included in the 40 largest firms, this actually understates the cost advantages enjoyed by large packers.

In contrast to upstream producers, meatpackers have been successful at achieving some coordination in the form of market arrangements for fed cattle with cattle feeders. These marketing agreements have developed to provide the constant supply of cattle needed to keep meatpacking plants running at full capacity, optimizing economies of scale. Cattle purchased or contracted by the packer well in advance of slaughter are referred to as *captive supplies*. Captive supplies can take on several forms: (1) packer feeding of cattle in either packer-owned facilities or custom feedyards, (2) cattle purchased by packers from feeders using forward contracts, or (3) cattle purchased by packers using exclusive marketing agreements with feedlots (Schroeder and others). Captive supplies make up approximately 23 percent of total slaughter for the four largest packers (Packers and Stockyards Administration). Forward contracts and marketing agreements are the most commonly used methods of capturing supplies, comprising nearly 20 percent of total slaughter. Packer-owned cattle make up a smaller proportion of captive supplies, generally 3 to 4 percent of total slaughter.

In spite of the substantial share of fed cattle now under this form of vertical coordination, this effort falls short of providing the needed links between packers, feeders, and ranchers for several reasons. First, these marketing agreements and forward contracts deal almost exclusively with the volume and pricing of cattle to be delivered at a specific date. They do not specify detailed characteristics of the carcasses.

Chart 4
PACKER CONCENTRATION
Four firm concentration ratio



Source: Packers and Stockyards Administration, U.S. Department of Agriculture.

Moreover, since they do not include ranchers in the coordination, they fail to control a critical part of the production process. And since it is difficult to determine the quality of feeder cattle based solely on visual characteristics, there is no way to control adequately for quality.

In spite of the modest movement toward vertical coordination between cattle feeders and packers, the beef industry still lacks a significant degree of vertical coordination. The ranching industry is too large and competitive to allow for significant coordination with cattle feeders or other downstream links in the production chain. And the moderate link between feeders and packers fails to convey appropriate incentives back to either feeders or, perhaps more importantly, to ranchers. Moreover, there has been essentially no link with retailers, which is surprising, since concentration in the packing industry could facilitate greater coordination. In short, the beef industry currently has no clear path toward greater vertical coordination.

II. HOW CAN THE BEEF INDUSTRY MOVE TOWARD GREATER VERTICAL COORDINATION?

To recapture market share, the beef industry must achieve greater vertical coordination in order to lower costs and convey rapidly changing consumer preferences across the production

Table 3
COST STRUCTURE FOR MEATPACKING FIRMS
Expenses as a share of sales, 1995

	Top 4 firms	Top 40 firms
Total operating expenses	14.15	17.05
Manufacturing	8.49	8.50
Operating and selling expenses	.33	2.70
General and administrative	1.92	2.03
Depreciation and amortization	.48	.64
Interest	.53	.62
Other	2.40	2.57
Operating income	3.33	3.69

Source: Packers and Stockyards Administration, U.S. Department of Agriculture.

chain. The difficulty of achieving further vertical coordination in the beef industry raises an important question: How can the industry change to both lower costs and communicate consumer preferences across the production chain?

Currently, three options for achieving greater vertical coordination and communicating consumer preferences across different segments of the production chain are being tested or considered within the industry. They differ dramatically in terms of structure, the role of economic incentives, and the use of direct production controls. Moreover, at least one option for the beef industry would involve radical change in industry structure. At one end of the spectrum, innovative pricing "grids" would give producers more explicit incentives to alter the type of fed cattle they produce. A more structured and wide-reaching alternative would be the organization of marketing cooperatives and producer alliances to mix pricing incentives and nonprice controls on cattle produced. A final, radical option is a supply chain structure for beef production similar to the pork and poultry industries. Which path of change the industry will follow is unclear.

Pricing innovations

One option for conveying consumer preferences across the production chain lies in changing the way cattle are priced. The live-animal pricing system primarily used in the fed cattle industry fails to convey consumer preferences to cattle producers. Live-animal pricing is based on a price per hundredweight of cattle on the hoof, usually based on a pen of cattle. With this system, all the cattle in a pen have the same value regardless of quality. More importantly, though, values are determined before the quality of carcass is known; so it is impossible to base the value on the quality of beef produced. Rather, value is based on visual observation of live cattle. Innovations in pricing fed cattle have been explored as a way to communicate consumer preferences to producers of fat cattle, providing some coordination between packers and cattle feeders. Several alternative pricing systems for fed cattle have developed. The most prevalent is grid pricing.

Under grid pricing, fed cattle are graded on two dimensions. The *quality* grade measures the taste and palatability of the meat yielded from the carcass. Currently, four quality grades are given for fed cattle—Prime, Choice, Select, and Standard—where Prime is most desirable and Standard least desirable. Quality grades are determined by the amount of marbling, or intramuscular fat, and the maturity of the carcass. Marbling is a key contributor to quality as it affects the tenderness, flavor, texture and taste of beef. Marbling is often decreased, and overall quality of the meat produced is diminished, in an effort to make beef leaner. Maturity of the animal is also a major factor in the quality of meat produced, since older animals are generally thought to be tougher and have a less desirable taste.

The second dimension of the price grid is determined by the *yield grade*, which indicates cutability, or the amount of edible meat from the animal. Yield grades range from 1 through 5, with yield grade 1 having the greatest amount of cutability. Typically, carcasses with a yield grade higher than 3 are undesirable, since these carcasses yield a smaller percentage of boneless, trimmed retail cuts.

The interaction of yield grade with quality grade determines a two-dimensional scale on which to evaluate carcass value. With grid pricing, the base price is determined based on a Choice Yield Grade 3 (Choice Y3) carcass, with other quality and yield grades priced at premiums and discounts to this base price.

Grid-based pricing does have some drawbacks. The pricing system is complex and requires the reporting of meat prices in a timely manner to obtain the base price, quality and yield grade spread, and volume of meat traded. Independent producers have been wary of this type of pricing system due to the historically adversarial relationship between packers and producers. Producers are concerned that packers have an incentive to report a lower grade for a carcass, since that lowers the value of the animal. In practice, however, an independent USDA grader actually determines the grades for all carcasses.

Producer cooperatives and marketing alliances

An alternative means of communicating preferences across the production chain is *producer cooperatives and marketing alliances*. Producer cooperatives and marketing alliances are organizations comprised mainly of cow-calf producers who band together to market their cattle. The primary goal of these alliances and cooperatives is to enhance the flow of information to members to improve quality, reduce production costs, and increase profitability. A recent analysis by an industry research organization, Cattle-Fax, identified and summarized 25 marketing alliances and cooperatives, although more groups have developed since that analysis.

Cooperatives usually consist of producers at the same stage of the production chain—for example, ranchers—coordinating activities to lower costs, raise prices, or both. This is called *horizontal coordination*. In the case of the beef industry, producer cooperatives are developing to foster links between different stages of the production chain, which is a form of vertical coordination. In addition to pricing innovations, some cooperatives and alliances provide data on feedlot performance and carcass quality to cow-calf producers who are members of the alliance. The flow of information across the production chain will help communicate consumer preferences to each link of the production chain.

Almost all of the cooperatives or marketing alliances have specific pricing options. The pricing options vary among the producer groups and range from a simple grid pricing system based on quality and yield grades to more detailed pricing formulas. So marketing alliances retain the ability to communicate information from packers to feedlot operators, an important feature of the grid-pricing system, but alliances go a step further in passing along information to cow-calf producers. Since decisions by cow-calf producers are critical to the quality of beef produced,

1-44

GRID PRICING

With grid pricing, the base price is typically determined based on a Choice Yield Grade 3 (Choice Y3) carcass with other quality and yield grades priced at premiums and discounts to this base price. Premiums are paid for cattle with yield grades of Y1 or Y2, and for animals which have a quality grade of Prime. Discounts are incurred on carcasses which have less desirable yield grades of Y4 and Y5, and quality grades of either Select or Standard. The USDA Choice-Select spread typically determines the discounts for carcasses with a Select quality grade. Standard quality grade carcasses receive a more significant discount than Select carcasses, as they are considered nonconforming by meatpackers. Additional nonconforming discounts for under- or over-sized carcasses, advanced maturity carcasses, or those carcasses with bruising or unusually dark color are also incurred.

Table A-1 is an example of a pricing grid. Note that yield grades can be divided into subgroups such as YG-2A and YG-2B or 3A and 3B. For example, a SelectYield Grade 1 (SE-YG1) carcass weighing 975 would be valued at $95 per hundredweight of carcass with this example grid ($105 base -$5 for Select +$3 for Yield Grade 1 - $13 for oversize = $95).

Table A-1

DISCOUNTS AND PREMIUMS FOR PACKER PRICING GRID

	Adjustment per (cwt)
Quality grade:	
Prime	+$6.00
Choice	Base
Select	-$5.00
Standard	-$15.00
Dark Cutter	-$32.00
Yield grade:	
1	+$3.00
2A	+$2.00
2B	+$1.00
3A	Base
3B	-$2.00
4	-$12.00
5	-$18.00
Carcass weight:	
> 1,000 lb.	-$17.00
950-999 lb.	-$13.00
551-949 lb.	Base
500-550 lb.	-$15.00
< 500 lb.	-$20.00

Note: Base price is $105/cwt for Choice YG-3A in 551-949-lb. range.

Source: Smith, Rod. "Pricing Grids Should Encourage, Reward Producer for High-Value Cattle," *Feedstuffs*. October 1997.

this is a vital step toward achieving effective vertical coordination.

In addition to pricing innovations, producer alliances and cooperatives use various production controls to control the type of beef produced. Some cooperatives and alliances are breed specific, but many do not limit membership by breed. Some require specific management practices, while others have no restrictions on production practices. Most maintain carcass information to assist producers in modifying genetics and production practices to meet consumer preferences. In addition to the ability to convey information from packers to feedlot operators, alliances and cooperatives allow coordination between the feedlot operators and cow-calf producers.

Several cooperatives and alliances have also developed retail markets for their products, thereby connecting themselves with the retail sector. Most cooperatives have made an arrangement with retailers to market the product they produce, but in some cases they are developing branded products. A good example of a branded beef product is the Certified Angus Beef (CAB) product that has been produced for many years and has met with great retail success. The branded product is noted for its exceptional quality, and carcasses that meet its criteria are rewarded with price premiums. However, CAB is not linked exclusively with any producer cooperative or alliance but is being used by more than one to better market their product.

The unique feature of these producer organizations is that they allow for participation by all phases of beef production. Increased communication and information in the form of carcass information, for example, allows coordination between cow-calf producers and feedlots, an advantage not possible with only the grid-pricing system. And, some cooperatives and alliances also have linkages with retailers. Coordination between cow-calf producers, meatpackers, and retailers allows for consumer preferences to be transmitted to all links in the production chain—an important step if the industry is to compete with poultry and pork.

Supply chains

The most radical change in the structure of the beef industry would occur with a move toward a supply chain structure. A supply chain structure in the beef industry would enable a single firm to control each step of the beef production process, from ranching to retail. But control might come from either outright ownership or from a system of tightly knit contractual relationships. For example, the controlling party would be able to specify herd genetics, weaning weight, and vaccinations in the cow-calf sector. In the feedlot sector, the controlling party would specify feeding rations and timing of marketing. Specifications on how packers would fabricate or cut up the carcass would also be controlled by the owning operation. Finally, the manner in which retail beef is marketed would also be controlled.

Which form of vertical coordination will prevail?

It is unclear which form of vertical coordination will prevail in the beef industry; all three options have both advantages and disadvantages. Pricing innovations are certainly a good starting point for conveying consumer preferences to producers, because they reward producers for those characteristics of the carcass that are considered desirable. Moreover, pricing innovations require less radical change in industry structure. But pricing innovations alone may not be adequate to effect the change in production techniques needed. One critical question in the performance of pricing incentives is the link between the carcass quality, measured using quality grade-yield grade relationships, and the quality of consumer beef. If variations in carcass quality can explain a relatively small share of the total variation in the quality of consumer beef, then pricing innovations alone will not be successful in transforming the beef industry.

Producer cooperatives and marketing alliances may be able to overcome the sort of problems discussed above, since they provide much tighter control over the production process. Cooperatives appear to provide the greatest level of coordination among the segments of the industry, including cow-calf producers, cattle feeders, packers, and in some cases the retail sector.

1-46

EXAMPLES OF PRODUCER GROUPS

Of the three groups compared in Table A-2, there is considerable variation in the organizational structure and participation requirements of the groups. While all of the alliances have participation by the feedlot sector, only two have a definite relationship with the meatpacking sector. Moreover, Farmland Supreme is the only producer group of these three that has developed participation with the retail sector. In addition, two of the selected producer groups have specific participation requirements for producers while the third group has no stated requirements.

Table A-2

COMPARISON OF SELECTED PRODUCER GROUPS

	Farmland Supreme	Decatur Beef Alliance	Cenex/Land O' Lakes
Organizational goals	Increase and share the profit pool. Provide information to producers, so they can improve quality and reduce operating costs	To maximize net dollars per head	To provide carcass and performance data to producers; to relate carcass data to value-based marketing
Participation			
Feedlots	Supreme Feeders	Decatur County Feed Yard, Inc.	Selected feed yards are involved
Packers	National Beef	Monfort, Excel	None
Retailers	Yes	None	None
Participation requirements	50% black hides with marbling requirements	Specified weaning program, no breed specification	None
Participation fees	$2.50 per head	$10 per head	$10 per head
Marketing options	All cattle are marketed on a value-based formula	Cattle will be marketed on a value-based grid	All cattle are marketed on a value-based formula
Data	All carcass data and value information. Ribeye area, fat thickness, marbling and kidney, pelvic, heart data are available for an additional $1.50 per head	Individual animal feedlot and carcass performance data	All carcass data and value information

Source: Cattle-Fax.

1-47

Moreover, cooperatives typically promote the use of an efficient pricing system, such as grid pricing. Cooperatives may prove to be the superior method of transmitting consumer preferences across the links in the production chain. For example, carcass data can be conveyed to cattle feeders and cow-calf producers to help them improve the quality of cattle they produce. Data on the performance of cattle while on feed can help cow-calf producers make informed genetic changes in their herd and modify production methods, advantages that cannot be achieved by using only the grid pricing system.

The third option for the beef industry, a supply chain structure similar to the pork and poultry industries, also seems unlikely. The land requirements for cattle production are extremely extensive. In contrast, both the pork and poultry industries use confinement production. There is basically no land required for raising either hogs or broilers, except that required indirectly to raise corn. For the beef industry to ever be fully vertically integrated would require control of huge landholdings by a single entity.

Since both full vertical integration and grid-pricing seem to face insurmountable problems, producer cooperatives seem the most likely to succeed. Only by improving communication and information among the various links in the production chain will the beef industry be able to face the competitive price and consistent quality issues that currently plague it.

III. CONCLUSIONS

Demand for beef products has declined since the 1970s. The beef industry will likely continue losing market share until the industry adjusts to produce the type of meat that consumers demand at a competitive price. While other parts of the food sector have evolved into tightly knit production chains, the structure of the beef industry has not changed significantly in the last decade. Links between the sectors in the industry—vertical coordination—must develop for the beef industry to be competitive.

Vertical coordination could take three different forms in the beef industry – pricing innovations, marketing alliances, or a fully developed supply chain. The supply chain structure becoming popular in the pork industry seems unlikely in the beef industry, given the nature of beef production. Moreover, pricing innovations alone seem unlikely to achieve the kind of transformation needed in beef production. In particular, it is not clear that grid pricing can successfully convey changes in consumer preferences to cow-calf producers. Shortcomings of complete supply chains and pricing innovations suggest that marketing alliances may be the most successful form of vertical coordination for the beef industry.

Nonetheless, marketing alliances and producer cooperatives are not without their own pitfalls, and much remains to be seen about their effectiveness. In particular, the ability of these innovations to provide the appropriate signals back to cow-calf producers is crucial. And there is inadequate experience to date to ensure that they can do so. Moreover, problems of governance could prove to be serious in cooperatives, as they have in other cooperatives in the agricultural sector and elsewhere. In spite of these problems, marketing alliances and cooperatives provide the beef industry its best hope for transforming the structure of beef production.

1-48

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1-49

OPINION

Quick 'fixes' are not long-term solution

Market fluctuations are simply a matter of free enterprise

Many structural changes are taking place within U.S. agriculture. These changes are similar to those that have or are presently taking place in almost every other industry in the world, changes that businesses, industries and countries must make in order to compete in a borderless, global economy.

Of all industries, agriculture is the last to really come to grips with consolidation. Even so, many producers, policy-makers and populists oppose the consolidation of agriculture. In doing so, though, they are essentially working against agriculture's overall competitiveness.

The result of the opposition has been a renewed call for Congress and the Clinton Administration to take action aimed at curtailing market fluctuations and industry consolidation. There has even been talk of reopening the farm bill, a bill that allows producers the freedom to plant according to what the market dictates rather than what the government programs and quotas require.

All of these actions are understandable, and are basically natural reactions to major change. At the same time, though, it is important to realize they are certainly not part of a long-term solution for U.S. agriculture. When all is said and done, such actions simply would not be in the best interest of either U.S. agriculture or consumers.

Above all else, it is essential that U.S. agriculture retains its efficiency and ability to access brands, knowledge and technology. Only by doing so can U.S. agriculture retain its competitive advantage in the world marketplace.

In the case of the farm bill, the failure has not been in the law itself; it has been in the government's failure to expand exports and reduce regulations impacting U.S. agriculture. A return to supply management schemes is no solution to low prices and would do more harm than good to U.S. agriculture.

In the livestock segment, the meatpacking industry has long been a target, particularly when prices are poor. The hog packing industry has fielded much of the blame for the current hog industry price crisis. Is a consolidated packing industry really the cause of the hog industry's woes? No. The problem is a supply/demand imbalance — an oversupply of hogs causing market price weakness.

When production exceeds packers' capacity to kill and process the animals, packers have to add immense costs to run overtime, weekends, etc. These costs must be offset in lower animal prices and/or higher meat prices, the latter of which is not a desired option as demand would ultimately be disrupted.

Furthermore, larger, more concentrated packing/processing companies have more bargaining power with wholesalers and retailers to move meat supplies, especially excess supplies. The questions that policy-makers really need to ask is whether they want a lot of small packers, or a few large packers, going up against the large wholesale and retail systems and which system they believe is ultimately in the best interest of livestock producers. If they do their research correctly, they will find the larger packers much better positioned to negotiate prices with the powerful wholesale and retail systems.

Policy-makers also should reference past events to determine whether some of the "quick-fix" solutions currently being floated really could have changed the economic events that took place in late 1998 had they been in place. The fact of the matter is that neither country-of-origin labeling on meat products or mandatory price reporting would have kept hogs from dropping below $10/cwt.

In the case of country-of-origin labeling, it does nothing but add costs and decreases competitiveness, especially in the ground beef segment, which heavily relies on imported material. Ground product can't be labeled as U.S. in origin if it contains any foreign material. Also, if there was a contamination event, and the product was described as U.S. origin, demand for U.S. meat would be severely affected.

As for price discovery, if this is so important, why don't producers call in the prices they are being paid to the U.S. Department of Agriculture or some clearinghouse to preserve confidentiality? Besides, tools already exist to manage price risk — from contracts to futures. Agricultural economists say "discovery" can be based on 5% of trading, indicating it doesn't take mandatory reporting for price discovery to occur. Mandatory reporting also adds costs and decreases competitiveness of the U.S. meat sector.

Neither country-of-origin labeling on meats nor mandatory reporting of livestock prices can alter the economics of supply and demand. Likewise, neither approach can negate the price dips of the traditional livestock cycles. What the two approaches can, and will, do is limit opportunities for agriculture and add cost for processors, retailers and consumers.

When it comes right down to it, these added costs could actually hasten the meat sector's consolidation. The more costs that are added, the less competitive the industry becomes, and the more the sector has to consolidate to capture economic efficiencies.

There is no question that the changes taking place in U.S. agriculture are painful. At the same time, though, they are necessary if U.S. agriculture is to remain competitive and if U.S. consumers are to continue to have an abundant, high-quality and safe supply of food in the years to come.

If U.S. agriculture is not allowed to remain competitive, other parts of the world will undoubtedly take the lead. There is no question they are capable of doing so.

If U.S. agriculture does lose its competitive advantage, with it would go its opportunity to grow. The result would be that U.S. agriculture would find itself contracting as more efficiently produced, higher quality food from other countries makes its way into U.S. consumers' hearts. Like with cars, electronics and other consumer products, most U.S. consumers have no loyalty to U.S.-produced products. The same is true with U.S. agricultural products.

As decisions on how to "fix" U.S. agriculture are made, lawmakers must take care not to jeopardize all that has already been gained and all that U.S. agriculture already has going for it. Lawmakers must give full consideration to the long-term implications of any and all agricultural policy initiatives they consider and take the time to fully educate themselves on the issues. They need to be committed to seeing the whole picture and not just the position of a few who are opposed to change and growth.

By doing so, lawmakers will recognize that the ultimate goal of U.S. agriculture has to be to remain competitive in world markets and that the only way for this to be accomplished is through the continued production of high-quality, safe food at a low cost.

U.S. agriculture, U.S. consumers and U.S. lawmakers simply cannot afford the unnecessary implementation of new and costly mandates.

1-50

1-51

Consolidation to build branded, global house

■ By ROD SMITH
Feedstuffs Staff Editor

"Life on this Earth is not designed for the past" — David Kjome, University of Minnesota.

Agriculture, in the U.S. and worldwide, is both consolidating and integrating for one reason: It must.

In the future, agriculture and food production — from corn and soybean fields to dairy farms and dairies, to cattle ranches and feedlots, to hog operations, to poultry complexes, to packers and processors — will be consolidated into huge, integrated production systems. It will consolidate and integrate so that agriculture itself and independent, individual producers themselves can compete, expand and prosper.

Consolidation is already an established event. In the U.S., essentially five companies control most of the field seed business, 4-5 companies control most of the meat packing business, 20-25 companies control most of the chicken business and 10 companies control half of the food retailing business. Within 10 years, 30 beef cattle feeding and 50 hog-producing businesses will finish 50% or more of all beef cattle and hogs.

Consolidation is documented and reported, consolidation is occurring in every industry in every country in the world, and consolidation is indisputable and irreversible.

Those who have sought to explain the phenomenon — at levels above clashing ideologies — have said there are certain critical points ushering agriculture consolidation, each leading to or supporting another. If one understands them, he or she will make the future.

Consumer demand: Building a branded house

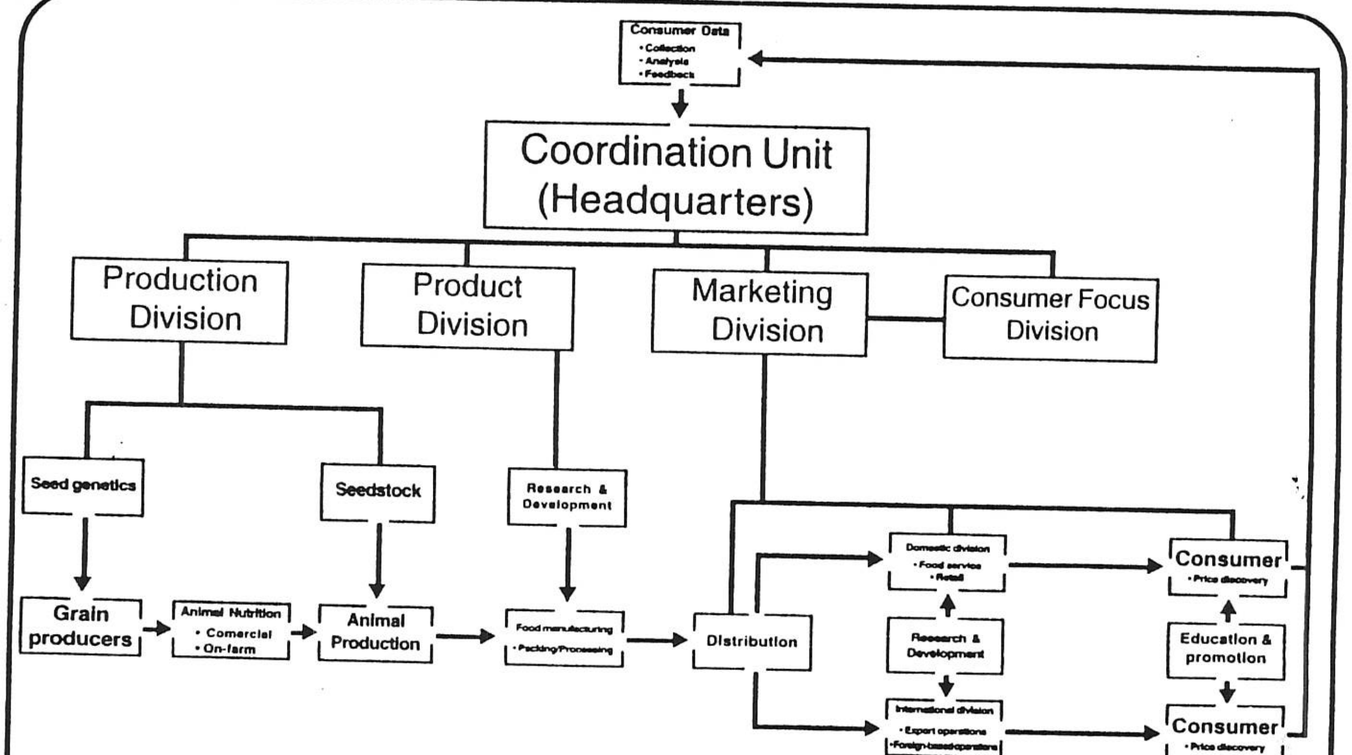
As with all food issues, consolidation starts at the end — with consumers and their requirements for their food. Consumers demand food that's healthful, nutritious and safe, high in quality, tasty, convenient and a price value. Consumers demand food produced in an environmentally sustainable way, and if animal-derived, from animals

Consolidation/ p. 17

(EDITOR'S NOTE: *Over the last 15 years,* Feedstuffs *Staff Editor Rod Smith has interviewed nearly 1,000 board chairpeople, chief executive and chief operating officers, strategic planners, analysts and consultants, economists, extension specialists, packers and processors, foodservice operators and retailers and producers themselves at their farms and ranches across the U.S.*

(He has reported their views about how agriculture and the business of food production — from corn seed to meat, milk and eggs — will eventually and of necessity consolidate into large production systems so that American agriculture and individual producers can expand and succeed in a competitive, global marketplace.

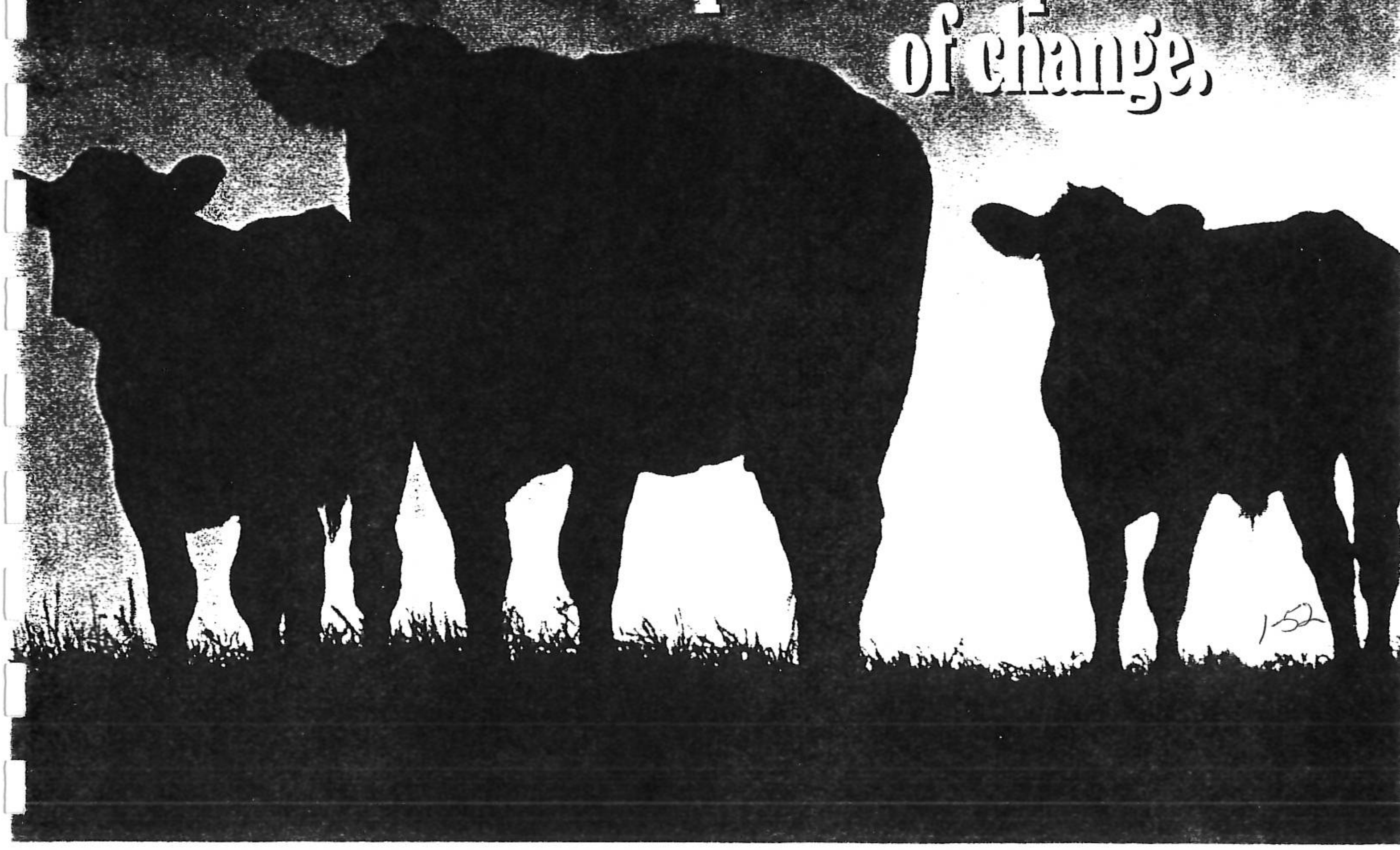
(This article represents a kind of "consensus" of all those interviews and an analysis and interpretation. It is published this week as events in much of agriculture in the past year appear to have pushed the industry to a critical stage in the evolution and understanding of consolidation.)



Consumer is point of price discovery (worth discovery)
Feedstuffs graphic by Nathan Olmscheid and Rod Smith

Changing industry structure

Revitalizing the beef industry requires acceptance of change.



1-52

The whole food and fiber system is being Wal-Marted.
—Wayne Purcell

From the time homesteaders stretched the first strand of barbed wire America's beef industry was destined to change. And at every critical junction in the storied past of America's cattle industry, change was vehemently resisted.

Today, beef producers are faced with an industry that is struggling to find its place in a modern society. Consumers are demanding, yet impatient. They want quality food products with the convenience of easy preparation. If one product line, such as beef, can't deliver on those demands consumers quickly move to a product that can—poultry or pork, for instance. That, in a nutshell, is driving the upheaval of rapid change in today's beef industry.

Wal-Mart effect

Twenty-two years ago Americans consumed 95 pounds of beef per person. During 1999, consumption will be approximately 63 pounds, a decline of nearly 34 percent. Such rapid decline in consumption affects much more than just cow-calf producers. Every segment of the beef industry faces the same problem—trying to push product through a marketing channel which has weakened demand pulling it from the other end. Any industry with such a problem will experience consolidation as businesses close. Unfortunately, many beef businesses forced to close during the current economic squeeze are family operated cow-calf, stocker and feedyard operations. Many family owned packing and processing companies have also closed during the past 20 years, leaving jus [illegible] r firms controlling more than 80 percent of the industry's slaughter capacity.

"The whole food and fiber system is being Wal-Marted," says Wayne Purcell, professor of agricultural economics at Virginia Tech and director of the Research Institute on Livestock Pricing. "The Wal-Mart effect is: If you can do it bigger, you can do it cheaper. We may not like it, but the consumer likes cheap foods. At least some of the benefits of the larger, lower-cost processing operations are being passed on to consumers."

But consolidation of the packing industry and the resulting lower costs have not been enough to stop beef's erosion of market share. That's because despite their size and their ability to swing a big stick in the market, packers have had little control over product quality. Dr. Purcell suggests that today's pork industry is an example of how an industry took control of product quality.

"I think pork people would argue that they needed to coordinate vertically, including vertical integration, to gain any quality control. The pork pricing mechanism really wasn't distinguishing between low value and high value hogs in any effective way," says Dr. Purcell.

Quality control

Economic turmoil, such as seen in the beef industry the past few years, also presents opportunities for survivors and those willing to innovate. Beef's problems are nearly identical to those of the pork industry 10 years ago. And like pork producers, many beef producers are working to create new production and marketing systems that reward quality.

"There is more opportunity in beef agri-business right now than at any time in history," says Tom Hogan, president of AGRI-PLAN Corp., a Marietta, Ga., agricultural business consulting firm. "We have technology just waiting for us to use that is worth literally hundreds of dollars per finished animal."

Many producers seem to agree, and are building production and marketing systems to capitalize on the opportunities ahead. For instance, at least 30 beef cattle alliances are operating that marketed between 2 percent and 4 percent of the total cattle slaughtered in America last year. Some of these programs are operated by packing companies, some by breed associations and others by independent ranchers and feeders. But all are functioning with similar goals—identify higher-value animals and reward those who are willing to produce higher value animals.

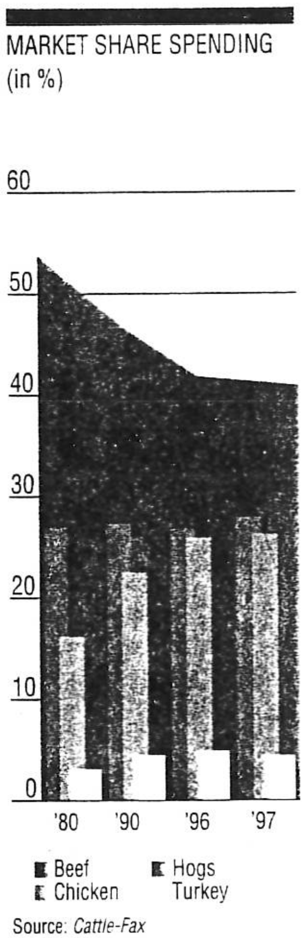
"Alliances are a way to create vertical coordination without one individual or one company having to own the animal at every stage of production," says Dr. Purcell. "We need alliances or some form of vertical coordination so we can develop some quality control in order to offer a product that the modern consumer wants. There will be an economic benefit and payoff to any group of people who identify a consumer sector and serve its needs."

Many alliances, and a growing number of independent producers and feeders, are utilizing new technologies to enhance performance and improve quality.

1-53

"We have very accurate available through our breed associations," says Mr. Hogan. "And we have ultrasound technology that, when used on an 800-pound animal, can predict with 90 percent accuracy when an animal should be harvested and what the animal should grade. Those are just two of the technologies all producers should be using to improve their product."

Most alliances or vertical coordination systems



already are providing advanced services to participants, including collecting carcass data to improve future genetic selections.

Lifestyle or business?

For many beef producers, phrases such as vertical coordination, vertical integration, contract production and alliances carry a negative image. They suggest a loss of control and a lack of independence. Many ranchers bel current trends suggest the industry's future structure will look too much like the poultry industry—a handful of corporate players dominating the market. Can that happen to beef?

"It's unlikely," says an executive with one of beef's major corporate players. Speaking on the condition of anonymity, he says because the cattle industry is land- or forage-based, it would be impractical for a corporation to own the assets necessary to totally integrate. He also disputes the idea that the feeding industry is as concentrated as perceived.

"Concentration in the feeding industry is hard to identify, because the people who own the feedyards don't own all the cattle. If they did, this past year would have taken a lot of them out."

He says that value-based marketing systems, such as those found in alliances, may actually help control feedyard concentration. "There's always an incentive for people to retain ownership if they have cattle that they can increase in value. As cattle start selling in value-based ways, those that have better cattle will have the incentive to try to capture part of that value."

Alliances, however, will take some of a rancher's independence, says Dr. Purcell. "Alliance members are going to lose some of their decision-making authority because they must be subservient to the needs of the whole. But alliances are a way to get the coordination and quality control we need while compensating the original producer in accordance with value."

The reality of the evolving beef production and marketing system is th many successful producers will give up a little of their independence to participate in the more profitable alliances.

Mr. Hogan agrees, and AGRI-PLAN's business philosophy speaks volumes about the tough choices facing many producers: "Agriculture as a lifestyle is a terrible business; but agriculture as a business is a wonderful lifestyle."

"I've had a lot of producers tell me they don't want to end up as a serf on their own land," Mr. Hogan says. "I ask them, 'Do you want to maintain your lifestyle and give up a little of your independence, or do you want to just hang on to your independence? When the banker shuts you off you have zero independence.'"

The road back

Changes for beef producers over the next few years are likely to be dramatic. Whether you prosper during this time may depend on your willingness to make hard business decisions and embrace non-traditional ideas.

"It's going to be difficult to revitalize this industry unless we move toward alliances or some form of vertical coordination so we can control quality and offer a product consumers want," Dr. Purcell says. "There's a road back to growth and success and growing market share—if we'll just understand that the only dollars out there to compensate every participant in this industry are what the consumer is willing to pay. And we've got to offer consumers something they're willing to pay for."

By Greg Henderson

There is more opportunity in beef agribusiness right now than at any time in history.

—Tom Hogan

1-54

Consolidation: Tre d will build branded, globa house/ From p. 1

that were humanely raised.

Consumers have little patience or time — or the knowledge — to sort through grocery stores and meat cases to find dairy, meat and poultry products that will meet their expectations. Accordingly, they are buying and will increasingly purchase brands because brands represent an assurance of the integrity of the products selected. Brands will be their guarantees.

Foodservice operations, then, will buy and serve brands that will be promoted in menus and other ways, and retailers will buy and merchandise brands. Brands will be their guarantees to their customers.

Foodservice operators and retailers will demand brands, including beef and pork brands, from suppliers — labels that carry processors' names or even a restaurant's or store's name.

Processors, therefore, will develop, produce and promote brands, and that is where the stakes get high. Brands have a name on them. Brands say to the customer — the operator, the retailer, ultimately the consumer — that a product will deliver expectations every single time. If it doesn't, even just once, it risks the distrust of the marketplace and the loss of the market.

Processors must deliver absolute consistency in every box, in every truck, every day. Processors, therefore, will need consistency in manufacturing processes and raw materials, and in the dairy, meat and poultry sectors, they will procure raw materials from suppliers who can provide beef, pork, poultry and milk that, when further processed, become guaranteed products on which a brand, a name, can be put.

Packers and other suppliers, therefore, must deliver those raw materials every time. Accordingly, they will demand cattle off the feedlots, hogs and milk off the farms and eggs and poultry off the complexes that have the carcass qualities that deliver the raw materials that can be processed into the products that make the house that the brand builds.

Producers, therefore, must husband animals from genetics, animal health and nutrition programs and other production regimens — animals managed to precise standards — for that brand, for that house.

All of this — from farm gates to further processing plants to consumers — requires a production system that can identify and "integrate" management strategies so that the finished product wins as a brand, in the marketplace, through to the consumer.

Global demand:
Building a worldwide house

The production system must also deliver the quantity required because a brand that's not available every time a consumer goes into a restaurant or retail store will be as fragile in the marketplace as one that fails to meet quality expectations. Consistency applies to both quality and quantity.

This is especially true considering globalization, in which democratization and freer trade have not only opened markets around the world, but have strengthened economies and increased demand for branded, western protein.

Here's another point where the stakes get high.

By 2050, the global population will have expanded from 5 billion people today to 10 billion people with more affluence and demand for beef, pork, poultry and dairy foods than ever before. However, populations in the traditional global markets will have hardly budged, while the Asian population will have expanded 52%, the African and Near East population 33% and the Latin American population 9%.

Clearly, for agriculture to expand, it must expand globally. Clearly, for beef cattle producers in Montana, dairy producers in Wisconsin, pork producers in Iowa and poultry producers in the Southeast to expand, they must access markets worldwide.

Certainly, 85% or more of all beef, pork and poultry production is consumed domestically and producers should be careful not to disregard that market, but expansion in that market will become increasingly inconsequential next to market opportunities worldwide. Production must have the brand and the scale to be worldwide.

However, from Montana to the Southeast, American producers are not alone. Globalization has not occurred only to benefit American agriculture (and other American industries), and agriculture elsewhere realizes, too, that the future requires brands and scale.

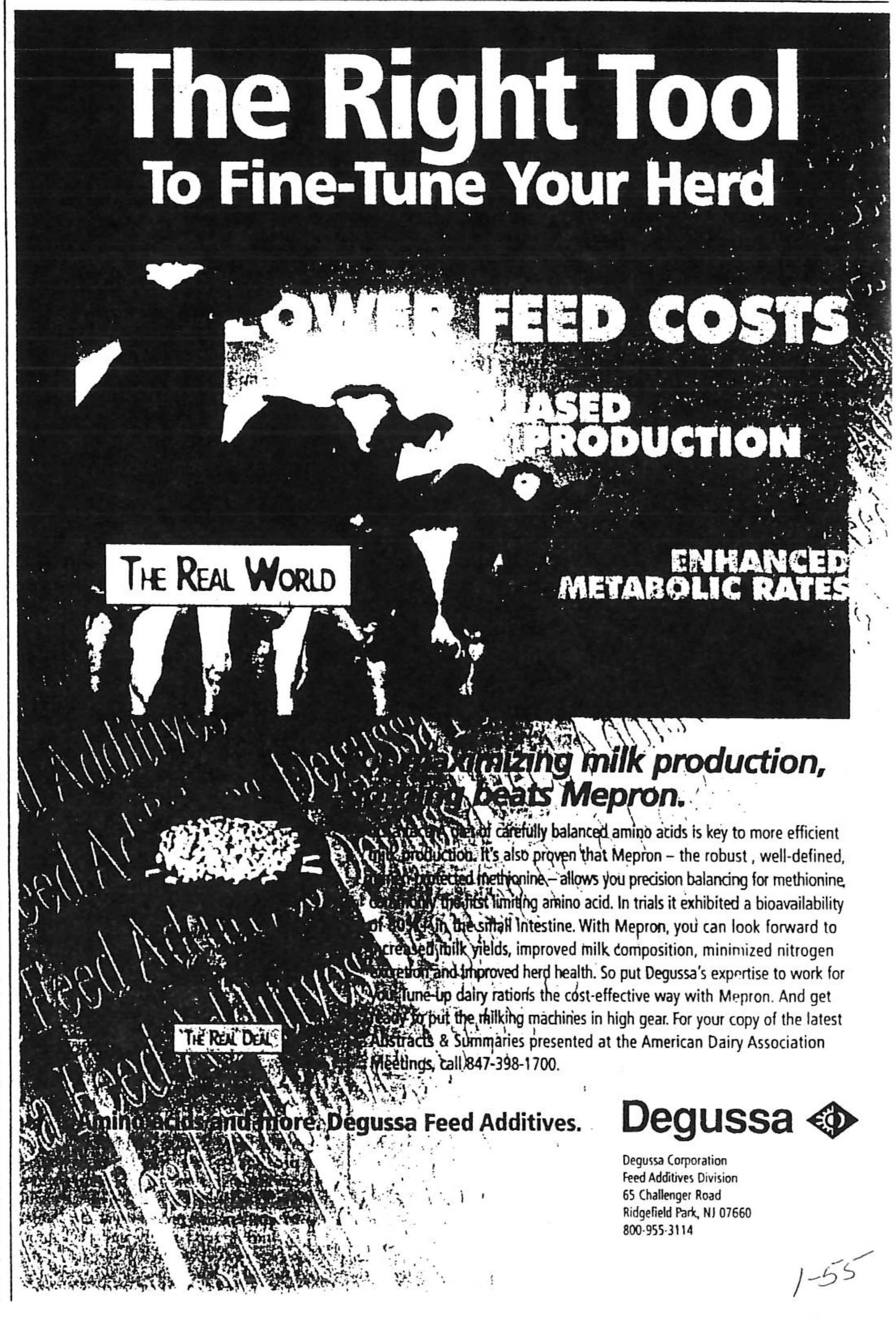
This is not a side statement. Agriculture elsewhere is competitive, with benchmarking data showing that Brazil, as one example, already can produce chicken, hogs, soybeans and other commodities as or more efficiently than the U.S. Agriculture from the Prairie provinces of Canada to the steppes of Eastern Europe can potentially compete with the U.S.

Furthermore, it's the brand consumers buy, not the country of origin, which means in the U.S. and worldwide, beef brands from the Argenti[illegible] or pork brands from the Brazil[illegible] interior may become the brands of choice if they deliver the guarantees consumers demand.

Accordingly, agriculture, from farm gates to plants to consumers, requires production systems that are coordinated enough to develop brands and large enough to be global players.

Biotechnology, equity:
Building a strong house

To be branded and global, agriculture is consolidating into food production systems that will be few in number and very large, each consisting of thousands of producers, including corn and soybean growers and feed manufacturers, and packers and processors (Figure, p. 1). Each system will be focused on producing one or more brands fol-



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Statement of Steven D. Hunt
Chief executive Officer
U.S. Premium Beef Ltd.
Before Kansas Senate Committee on Agriculture
Testimony Opposing SB 258
March 8, 1999

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you today to discuss concerns relative to SB 258 and entertain solutions to the challenges facing the beef industry. My name is Steve Hunt. I am a fourth generation cattle producer and the CEO of U.S. Premium Beef, the first large-scale producer-owned beef marketing cooperative in the United States. I am proud of the history of independence that is a stalwart of the beef industry. Historically, this has enabled us to survive and prosper. Though, today and in the future it will be our ability to build on our independent legacy through cooperative efforts that may ensure our survival and prosperity for years to come. By cooperatively and strategically aligning ourselves among the many segments of the beef industry today, we will be better positioned to compete in tomorrow's market. This action will allow producers the opportunity to move up the value-added ladder enabling us to sell meat and meals instead of cattle. And, when referencing segments, I am referring to all participants up and down the food chain, from the ranch to the consumer.

We will look back on this time as a watershed moment for both cattle producers and other segments of the beef industry. The issues and factors affecting our industry are complex and sometimes emotional. However, it is my intent to present before you a unique perspective as both a producer and as a packer.

Changes in the Market

As one reviews the facts, today there certainly exist efforts by both producers and packers to enter marketing agreements that remove cattle from the weekly spot market. Some estimates suggest that at times this could be as much as 50 percent of the cattle on a weekly basis. This change within our industry is likely to continue as producers decline in numbers and grow in size. Does this provide for an unfair advantage to the participants and remove the competitive forces of the live cattle markets? Looking at a year as a whole or even historically, there is little evidence that so called captive supplies have played a role in depressed live cattle prices.

Looking at the shear economic factors of supply and demand, as producers, the thoughts of limiting production is not one easily embraced. The key for producers of any size to remaining competitive is to increase demand by responding to consumer's preferences, increase productivity, and lower costs. Therefore, market development is key for the success of the cattle and beef industry as the trend of eroding market share to competing

Senate Agriculture
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Attachment 2

proteins continue. Reliance on antiquated marketing practices that inhibit value based marketing, stifle communication and breed mistrust between sectors will only lead to further erosion of market share for beef products. It was and is our conclusion that these disturbing trends can only be reversed through creative marketing systems that provide:

1. True value based carcass merit pricing (price based on meat quality).
2. Transfer of carcass data back to producer.
3. Producer ownership in value-added processing through market alignment.

Background of U.S. Premium Beef, Ltd.

As early as the fall 1995, Midwestern producers from all segments of the cattle industry, seed-stock, cow-calf, farmer feeder, and feedlots, began meeting to discuss the problems plaguing the current cattle marketing system and also to examine some solutions. The problems that we discovered with the current market included:

1. A system that promotes mediocrity by the gathering of cattle in large numbers, primarily entire feedlot showlists, and establishing one average price without regard for quality or value differences.

2. A system which provides incentives only for production efficiencies (i.e. faster weight gain and lower feed cost) and little or no incentives for carcass or meat quality thus lowering the overall quality of beef and neglecting consumer preferences.

3. A system which provides large producers the advantages of the efficiencies of economies of scale and the leverage to negotiate private marketing agreements with little opportunity for the independent family rancher or feeder to enter agreements that reward for producing a more valuable animal.

After much research by a group of cattleman, tired of the rhetoric of problems and finger pointing, and committed to taking control of their own destiny, U.S. Premium Beef, Ltd. was formed. Founded on July 1, 1996, U.S. Premium Beef was structured as a new generation marketing cooperative, the first and only in the United States. Shortly thereafter a business plan was established and a mission statement was adopted. This mission reads:

"To increase the quality of beef and the long-term profitability of cattle producers by creating a fully integrated producer-owned beef processing system that is a global supplier of high quality value-added beef products responsive to consumers desires."

From there, more than 675 producers from 24 states committed both cattle production and capital to seek out the most economically feasible inroad into further processing and value added products. After extensive research into the different alternatives of acquisition, building or joint venture, it became evident that the only viable avenue for producers to gain a greater share of their marketing dollar was through a joint venture.

As producers, what we bring to the table is the ability, through known genetics and cattle management, to design supply cattle tailored to consumer preferences and delivered in a systematic way that will provide year around supply of cattle to plants. As producers, we provide little expertise in processing and consumer marketing and are ill equipped to compete in a mature beef packing industry that is highly competitive.

In July of 1997, we announced that U.S. Prěmium Beef (USPB) had signed an agreement to enter a partnership with Farmland Industries, the nation's largest farmer-owned cooperative, to purchase up to 50 percent of Farmland's National Beef Packing Company. Farmland National Beef is the only producer-owned beef processing company and an international leader in value-added branded products.

During the fall of 1997 USPB mounted a stock offering drive through the United States. By December 1, 1997 our efforts were successful. We had commitments for nearly 700,000 cattle annually and over $72 million in capital raised. The following week, USPB began operations, buying more than 10,000 member cattle on an individual animal basis over a progressive carcass value based grid.

At USPB, we designed a progressive grid system to increase the quality of cattle and the returns to our producer owners by providing monetary incentives based solely on quality. Since we began delivering cattle in December of 1997, USPB cattle have exceeded industry quality levels and our producers have earned significant premiums over cash price. Contrary to previous false testimony, the USPB pricing mechanism has been upgraded three times our first year. Each time, our premiums on carcasses that our customers prefer have been increased. Today USPB is proud to have an industry high $4.50 / cwt. Premium on every CAB carcass and $9 / cwt. Premium on every Prime carcass.

As a producer owned cooperative, we provide services that help our owners consistently produce and market better cattle and in return earn better premiums. For example, our strong economic incentives for delivering cattle on time have reduced the number of yield grade fours, fives, and heavies that are delivered to market and have increased the number of choice or better cattle that have been delivered.

An important component to helping ranchers grow better cattle is having access to the carcass data. The carcass data informs packers and producers how specific cattle perform on a cut out basis. As producers, we felt that this information would be very helpful when coordinating our genetics, nutrition, and other elements involved in production. Therefore, we offer this information free of charge to our producer-owners. We believe that it is beneficial to not only our producers who may use it to earn a better premium, but also to our consumers who demand a higher quality product. By working together to produce a better product, it's our intention to improve the overall image of beef and hopefully earn more of the consumers trust and business with our efforts.

Current USPB Operations

To date, USPB and its members have marketed over 550,000 cattle through its plants and beef company. Membership totals over 675 producers from all segments in 24 states. While still in its infancy, USPB has paid out over $5.5 million in premiums over the cash live cattle market. This represents a $10 per head premium. The top 25 percent of performers earned an average of $30 per head. In addition, our stock holders/ members will realize earnings of over $10 per head through the profits of the Beef Company they own. This represents an average return on investment of over 34 percent on the initial $55 investment (this was the price of a share of stock in the beginning). For those producers in the upper 25 percent, the return on investment is over 70 percent.

Additionally, ever producer member is ensured a competitive carcass merit grid pricing with equal governance, carcass data on individual animals, transportation credit up to 110 miles or $6 per head, and livestock and meat consulting, all at no charge.

The results of our first year of operations have far exceeded expectations. As is apparent in exhibit I, the level of premiums has steadily increased over the past year. This has occurred in great part due to the utilization of carcass data and the financial incentives in place through grid pricing. Any producer armed with the correct system and information can achieve these results.

Conclusion

For years the cattle industry has talked about the problems of the marketplace. For years we have witnessed devastating erosion of market share and loss of independent cattlemen and women. U.S. Premium Beef is a solution, created as a producer effort to respond in a proactive way to the challenges of our industry. Some have suggested actions be taken that would limit our cattle marketing options. While we have great empathy for those positions, we feel that our success reinforces the need for producers to move forward. Three years ago, the founding members of USPB shared many of the same concerns surrounding price discovery and captive supply issues. It wasn't until we took a step back and began looking at the facts objectively that we as producers realized the solutions lied in cooperation between segments vs. isolation.

Summary of Facts

- Gross Beef Packer Margins are the lowest in five years.
- Beef processor margins average 1-1.5%.
- Livestock producers produced record levels of beef and pork.
- Per capita consumption of beef is down and deflated retail price is down.
- Per capita consumption of Pork and Poultry is up and deflated retail price is up.
- Demand for beef is number one problem. (USDA, Fed. Reserve, Universities, P & S, NCBA, KLA, USPB, ..)
- Value Based Pricing reduces overall meat supplies.

- Value Based Pricing provides economic signals to produce better beef.
- USPB is designed to reward small producers from all segments

Price Discovery

- Will reveal little valuable information.
- Will encourage collusion among meat processors.
- Producers will bear all costs.
- Add to the leverage large participants already have.
- There are efforts at Federal level to draft a compromise.

Value Based Marketing Limitations

- Limits development of value added pricing.
- Will not reward commitment.
- Encourage average pricing.

Results of SB 258

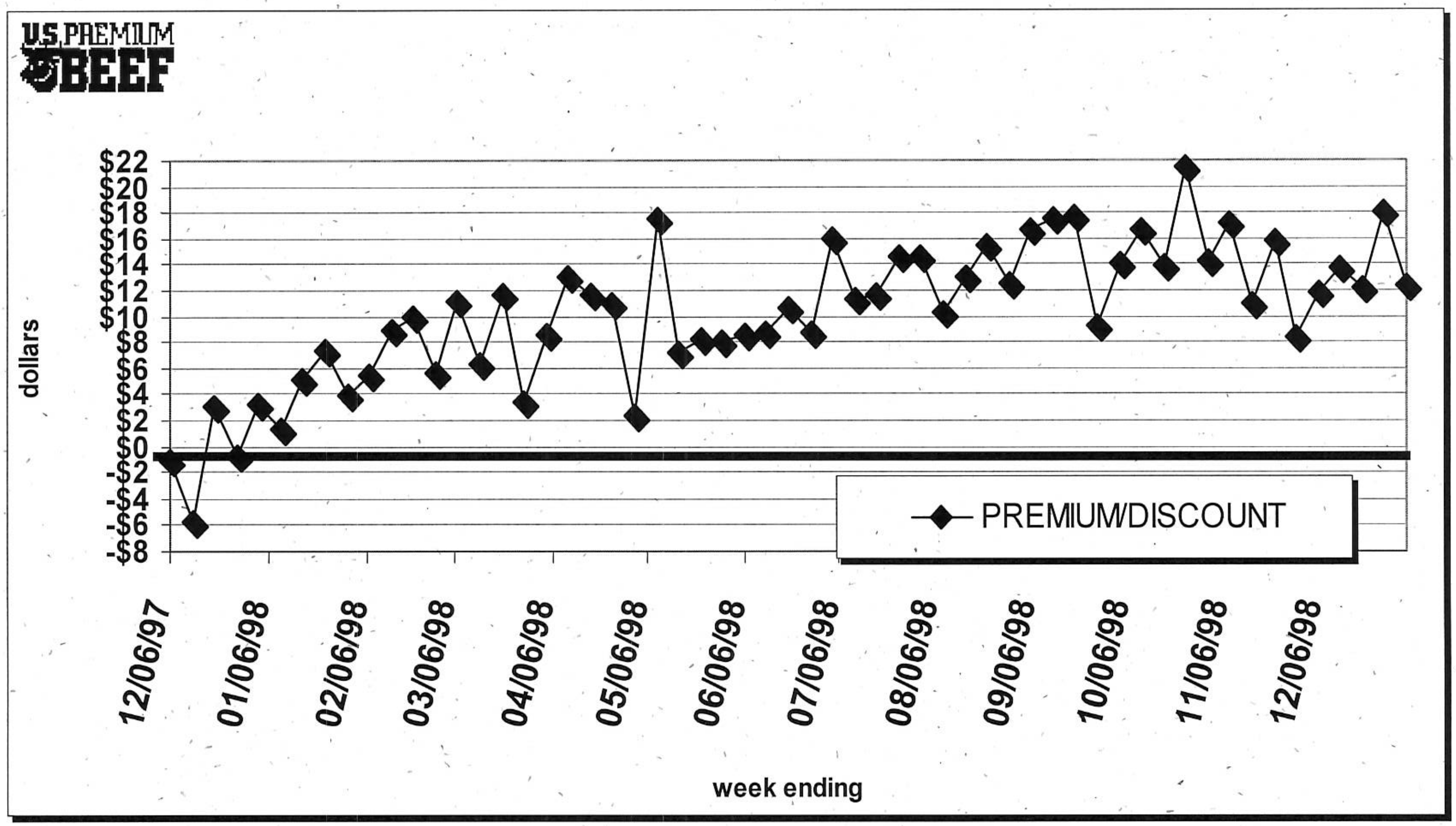
- Will force producers and processors to move business outside Kansas.
- Destroy the development of solutions to industry problems.

As producers we now have an opportunity to gain a greater share of our marketing dollars by aligning ourselves closer to the consumer and doing this from the bottom up. I would ask for your support through voting against SB 258 thereby allowing more producers the freedom to develop creative new marketing strategies, such as U.S. Premium Beef, that will truly add value for producers.

Thank you for the opportunity to testify before you today. I will be happy to respond to questions.

2-6

USPB Average Weekly Premiums



Testimony

Presented by

Warren Weibert
Owner/General Manager
Decatur County Feed Yard, Inc.

Regarding

Senate Bill 258

before the

SENATE COMMITTEE ON AGRICULTURE

March 8, 1999

Senate Agriculture
3-8-99
attachment 3

Decatur County Feed Yard is a 30,000 head commercial cattle-feeding operation located at Oberlin, Kansas. It is owned by Warren and Carol Weibert. We have been specializing in retained ownership of ranch cattle since 1980.

We have been concerned about efficiency of production in beef production, as well as quality and consistency of the beef product (especially size of portion) and value discovery. Many backgrounders and feeders buy "upgrading" (lower quality) kind of cattle, bought one at a time, blend them into higher quality cattle and expect to get the Kansas top price in the feedlot (one price for all cattle).

The history of our feedlot is that we feed cattle for ranchers from Kansas, as well as ranchers in Hawaii and Virginia and many other states. We offer to buy up to a 50% share of many of these cattle. Through various types of alliance arrangements, we have fed as few as five head for one individual, with 30 to 60 head being common the past four years. These cattle are co-mingled and fed in pens of 150 head.

We as a beef industry seem to be producing a beef product which lacks predictability to our consumers. It is reported that our consumers are disappointed in one in four steaks that they eat. Because of this and other reasons, the demand for beef has been dropping steadily since 1980. Recently, the National Cattlemen's Beef Association, with the help of several industry economists, published the beef demand index. If the beef demand index was 100 in 1980, it measured 51 in 1997. Obviously, we have a demand problem, and the solutions recommended in SB 258 do nothing to improve demand for beef.

Because of frustration of dealing with the old marketing system and wanting to improve the consistency of what we were selling and improved information transfer from packer to rancher, we installed phase three of the Accu-Trac electronic management system developed by Micro Chemical Inc. of Amarillo, Texas, in the fall of 1994. Today, we call this program the Decatur Beef Alliance. This system allows us to use Allflex (brand) electronic ear tags and track the finishing process of cattle through our feedlot, sort the cattle, co-mingle cattle, and harvest the cattle as individuals when they hit the marketing grid target. The individual animal identification is maintained at all times, including at the packinghouse, and the carcass is valued individually. We literally might ship one animal from an owner or 80, depending on when the animal's reach the peak marketing window to maximize profit. We usually sort and ship an owner's cattle in six or eight different marketing groups. When all his cattle are shipped and the value determined, the owner receives a detailed individual animal close-out, ranked in order from worst net return to best net return, so the breeder of the cattle can make genetic changes for the future. Also, once per year, the rancher receives a printout comparing how his cattle performed with all other cattle in the Decatur Beef Alliance during a twelve-month period. We negotiate a grid formula approximately twice per year with Excel Corporation and deliver our cattle each week to their plant at Dodge City, Kansas. We personally visit our customers at least once per year and interpret the performance data with them so they can improve their net return per cow.

We are now in the fifth year of the Decatur Beef Alliance. We currently have 22,000 head of cattle on feed—20,500 of them are currently managed electronically. The cattle in our program come from extremely small herds to very large herds, and we co-mingle the cattle and manage them as individuals because of electronic ear tags. One of our rancher customers in Wyoming sold 25% of his cows and culled all his bulls two years ago because of data he received from our program.

In summary, I am opposed to SB 258 because it does nothing to improve the quality or demand for our beef product. We need to sell our cattle and beef based upon quality and consistency—on a beef value based system. Most ranchers and cattle feeders don't know the quality of the beef they are producing. Posting a standard price each day for "cattle" will only slow down the progress independent feeders are making toward value based marketing. Because we get paid for each carcass, we routinely see $200 value spread from best to worst carcass in each rancher's set of cattle.

It is human nature to brag about the high price you received for selling cattle as opposed to the less than average price you received, so mandatory price reporting will by nature lower the average price posted. The USDA and Cattle-Fax do a very good job of reporting beef prices and cattle prices. It is interesting to me that most of the people who are asking for mandatory price reporting and a posted price are not cattle feeders nor feedlots, but cow-calf producers.

There are at least twenty marketing alliances already formed and surely more will form in the future. New pre-cooked and portion control beef products are being introduced to supermarkets monthly. SB 258, in my opinion, will stifle innovation and ingenuity in the beef business and take away the best chance we have of fixing our problem in the beef business—demand for our product.

Thank you for your concern for our problems, but please let us fix our own problems by new, innovative marketing programs that help us improve our product. Please vote against SB 258.

Testimony

presented by

Bill Hogan
Hitch Feeders II
Garden City, Kansas

regarding

Senate Bill 258

before the

Senate Committee on Agriculture

March 8, 1999

Senate Agriculture
3-8-99
Attachment 4

Good morning. My name is Bill Hogan from Garden City, Kansas. I am a cattle feeder and manager of Hitch Feeders II. Our feedyard is a 50,000 head cattle feedlot located south of Garden City.

I am here today to speak in opposition to Senate Bill 258. In my view, calls for mandatory price reporting are merely an attempt to impede alternative marketing arrangements under the justification of more accurate price discovery. Some believe this would lead to higher prices. Frankly, I disagree. A 1996 P&S investigation confirmed that nearly 8 times more unreported cattle sales were actually below (approximately 400,000 vs. 52,000 head), not above the USDA reported daily price. Regardless of the reason for these unreported sales, mandatory reporting would more likely create a downward bias in price. This would not be in the best interest of cattlemen.

Mandatory price reporting and compelled disclosures of confidential agreements threaten the very core of competitive markets. The denial of basic rights to negotiate and protect the terms and conditions of a sale is a strike at the heart of free enterprise. Allowing government to review and intercede to assure every producer receives the same price for livestock is shortsighted. Quite simply, mandatory reporting would assure a lack of competition in the beef industry.

Furthermore, mandatory price reporting for formula cattle would be rather useless in analyzing daily markets. There is typically a week or more delay before price is actually determined. Similarly, contracted cattle are often committed, but not priced, for weeks or months. USDA has stated this would be next to impossible to monitor or enforce, not to mention extremely costly. I suspect the same would be true for state government. Simply put, this would be further government intervention in private enterprise which Kansas cattle feeders oppose.

Nonetheless, if mandatory price reporting is forced on the industry, it would be best left to the federal government. "Here and there" state laws would create islands leaving some producers at an unfair, competitive disadvantage. In contrast, producers in states without price reporting requirements would be able to strive for economic rewards and competitive premiums.

Moreover, I am deeply concerned this unprecedented attack on free enterprise would compromise the ability of creative producers to participate in non-traditional marketing arrangements. I believe strict enforcement of existing laws and regulations to ensure accurate price discovery and fair competition at all points in the marketing chain is absolutely necessary. However, I continue to believe, absent empirical evidence, the free market system should be allowed to resolve how best to market our product. Further government intervention may actually stifle new innovations in cattle marketing that could solve the price discovery concerns held in the industry.

It is no secret times have been tough for agriculture, especially the beef industry. Make no mistake - I appreciate all your efforts to address low prices and fairness. However, while this bill is well intentioned, it could have a devastating impact on Kansas producers struggling through industry transition and change. In conclusion, let me emphasize, there is no mandate for this action by the industry. Supporters of this proposal in no way represent any type of consensus. The majority of livestock producers would rather focus their efforts on improving quality and demand for beef through efficiency, technology and competition. I respectfully urge you to let them do just that.

Pioneer, Inc.
1021 County Road CC
Oakley, Kansas 67748
785/672-3257

An Agribusiness Company – Since 1960

3-8-99

To: All Members of the Kansas Senate Committee on Agriculture
Fr: Jim Keller

Re: Opposition to Senate Bill 258

Members of the Senate Committee on Agriculture:

Thank you for your time given us here today.

There must be a lot of people that think "only the government can save us from ourselves"- a tremendously flawed ideology that in itself should preclude any more discussion on this livestock pricing issue.

I am disappointed that this thinking got as far as this committee. I do not think this would be an issue at all if the cattle business was profitable these past few years.

Pioneer is an independent cattle producer based in Oakley with a 30,000 head capacity cattle feedyard and with several ranches scattered around. At our feedyard, we feed cattle for customers of all sizes and ourselves. We started selling our fed cattle on a formula basis in 1987 and you could call us one of the originators of the concept. We have shipped over 700,000 head since that time and have been paid what they were worth at shipment time. I can tell you that in that 700,000 head that there has not been one instance of two pens having the exact same quality and yield specifications- not one instance and I have the data to prove it. I might add that we are not Kansas Livestock Association members.

So, here we are trying to fend off more socialistic government intrusion & more bureaucracy. How many things do you think you could apply this livestock pricing issue ***THINKING*** to?

Now, to point out a few details that I find unworkable:

Senate Agriculture
3-8-99
Attachment 5

*Packer A on Monday morning buys Feedyard X's cattle for $65 per hundred delivered to his plant- now Packer A has to bid every feedyard or cattle owner $65 in the state of Kansas for the same quality. Now we can argue about quality- you know that ancient Chinese proverb of "no two chops alike"? Well, it applies to cattle too- I personally have never seen two groups of cattle with the same specifications.

Let's set the "same quality" argument aside and assume that in the above scenario that nobody raises the issue. Go back to Packer A buying @ $65 Monday morning- now the $65 figure is known and Packer B of course knows it too so he makes his first purchase @ $66 at Feedyard Y. Packer A is stuck with his $65 money because if he offers $66 to compete, he is violating the law so he has to sit on $65 for the rest of the day. Now comes Packer F and offers and buys cattle at Feedyard Z for $68 because he was in a panic that they'd have to shut down their plants because there would be no cattle left to buy. Meanwhile, Packer A and Packer B have to sit with their prices for the rest of the day. So, the Kansas cowboys know that $68 is the best money for the day and that sounds pretty good because they only realistically expected $64 for the week so they all sell @ $68. News headlines "Packer F buys 70,000 cattle @ $68 in Kansas as a direct result of SB 258". Meanwhile, Packer F goes to bed with a stomach ache wondering why he's in this business- now he has 3 weeks supply of cattle for his Kansas plants and only has 7 days to pick them up or pay for them and put them back on feed- not to mention trying to make money on them. So Packer F is the dumbest packer.

Now we go on to find the next dumbest packer the next week- Packer A comes out and bids $65 again and Feedyard X goes ahead and sells again because they feel like the market is out of whack. Of course, Packer B finds out and he bids $66 again and buys 60,000 cattle in one day- the cowboys go ahead and sell because last week was "a gift anyway". Meanwhile, Packer F is processing his $68 cattle and needs no more for 2 weeks anyway so he just throws out a bid for looks. Packer B is in great shape now for 3 weeks because he just bought out Kansas. Packer A ran out of cattle last week and will certainly not have any for this week so he shuts his plants down and puts the boys on unemployment and tells them that the fat lady hasn't sung yet and he'll get back to them at the first sign of cattle buying.

Week 3 rolls around and Packer F and Packer B are still supplied and Packer F is trying to gouge his beef customers to cover the cost of the $68 cattle but Packer B is underselling him because he has $66 cattle. Packer B this time puts out a $60 bid for giggles and Packer F sees that he'll need cattle for next week so he's a little more serious and bids $62 and Feedyard Z sells him some cattle because he paid so much a couple of weeks ago. Now Packer F has to hold at $62 and Packer A comes in and sets the market @ $63 one day and he too buys 60,000 cattle and is supplied for three weeks.

Now Packer A can be just a little easier on his beef customers and he forward sells everything based on what Packer B was selling his beef at last week which Packer B barely broke even on his $66 cattle. Packer F is now out of the market with shut down plants and he paid $68; Packer B paid $66 and he'll probably have to shut his plants again; Packer A struggled but had the same operational hours as Packers B & F but he paid $63 for his cattle.

Packer F was the dumbest so he is the first one to go out of business and Packer B is gun shy and wondering if they are going to get set up to pay too much so sure enough they keep falling into the trap and pretty soon only Packer A is left standing. Now this is really great- just one packer.

How would you like to run your business this way?

*Mandatory price reporting? How would that help prices? I can't think of a scenario of where it would but I do know what it would do- it would limit my rights as an American. It's just the start to limit my ability to get the best possible price for my product that I invested the time, energy, and resources to accomplish. It's simply just a step backwards in time with government auditing everyones books to make sure "the playing field is level"- why not give them your financial statement too when they come do their pricing audits?

Furthermore, let's do this mandatory reporting with all commodities not just fed cattle. The people in our industry that are behind SB 258 buy feeder cattle and calves- why not have all of us report (under the penalty of law) all of our feeder cattle and calf purchases within 24 hours. Why not take that to corn, wheat, beans, sunflowers, chickens, hogs, sheep, elk, ostrich, & etc. Make all of us report all of our feed purchases whether it is corn, hay, or straw while you're at it. You know where I'm going with this.

That is all for now.

I appreciate your time and attention- thank you.

Regards,
Jim Keller

JKeller

5-3

PUBLIC POLICY STATEMENT

SENATE COMMITTEE ON AGRICULTURE

RE: SB 258 – Regulates certain livestock transactions between the producer and the packer.

March 8, 1999
Topeka, Kansas

Prepared by:
Bill R. Fuller, Associate Director
Public Affairs Division

Chairman Morris and members of the Senate Committee on Agriculture, we certainly appreciate this opportunity to express the views and outline several concerns of Kansas Farm Bureau in regard to SB 258.

The farm and ranch members of Kansas Farm Bureau were actively involved in recommending, developing and approving American Farm Bureau Federation policy concern livestock marketing. That member-adopted policy includes these following important statements:

- ***"USDA, in conjunction with the Department of Justice, should closely investigate all mergers, ownership changes or other trends in the meat packing industry for actions that limit the availability of a competitive market for livestock producers."***
- ***"Action should be taken to oppose further concentration of the meat packers. The Departments of Agriculture and Justice should more aggressively enforce current antitrust laws pertaining to packer concentration."***

Senate Agriculture
3-8-99
Attachment 6

- ***"Beef packers who process more than 1,000 head per day should be monitored so they cannot manipulate the market through forward contracting. The current threshold for reporting such purchases should be lowered from two weeks to five market days."***
- ***"Improvements for livestock information reporting should include expanded daily and weekly report of sale terms for cattle traded under contract or formula sales, including premiums and discounts earned for carcass grade, yield and weight factors."***

One provision of SB 258 calls for mandatory price reporting. We support a national system of mandatory price reporting. Our support is based upon AFBF policy. We insist the confidentiality of individual information should be maintained. The reporting requirement should not burden small processors. We believe only packers who process more than 5 percent of national daily slaughter should be required to report all cash and contract prices and terms of sale.

We believe the price reporting should be implemented at the national level with all states being required to comply. If a packer is willing to purchase cattle at a higher price, would that packer be more likely to buy cattle in a state that requires mandatory pricing, or in a state that did not require mandatory pricing? As an unintended consequence, a state requiring mandatory pricing may cause a negative impact on livestock prices in that state.

SB 258 requires packers to report each day to the USDA the prices paid for livestock. What is the USDA to do with this information? Is there a system currently in place to utilize this information? If a system must be created, who is responsible for this new expense?

Another provision of SB 258 attempts to prohibit discriminatory pricing. This would require meat processors to offer the same bid to all potential sellers of livestock with similar carcass characteristics. This fails to recognize there are a number of factors that establishes the full value of livestock. We suggest this is not practical, workable or enforceable.

The third provision of SB 258 proposes to prevent retaliation by any packer against any livestock producer on account of any statement made by the producer. While this provision is well intended, we suggest it is not enforceable.

Some of the proponents of SB 258 have suggested the bill is needed to send a message to Washington, D.C. We suggest an acceptable alternative to SB 258 would be a resolution from the Kansas Legislature to the U.S. Congress and the Secretary of USDA insisting on action to create a mandatory price reporting on the national level. Chairman Morris, your leadership in contacting and encouraging other state legislatures to develop and submit resolutions as you did earlier this session in regard to another resolution would send a strong message to our nation's capitol.

There is growing interest in livestock price reporting in the U.S. Congress. The leadership of the House Agriculture Committee is calling for action. Chairman Larry Combest (R-Texas) after a hearing last month said, "It became clear that there was common ground between the two sides. The witnesses expressed a willingness to work together to craft a solution." Ranking Minority Member Charles Stenholm (D-Texas) agrees it is time for packers and producers to sit and talk, "I gladly join the chairman in urging both producers and packers to roll up their sleeves and hammer out a workable solution. Given the serious challenges facing all segments of the livestock industry, we cannot afford to have continued disagreement."

We thank you for this opportunity to testify on SB 258. Establishing mandatory price reporting on the national level is a high priority for AFBF as we work with the U.S. Congress in Washington, D.C. this year. Some work is already underway. We invite others to assist us in this important task.

Kansas Grain Sorghum Producers Association

Kansas Corn Growers Association

TESTIMONY

TO: Kansas Senate Committee on Agriculture
FROM: Jere White, Executive Director
DATE: 8 March 1999
SUBJECT: SB- 258

My name is Jere White and I am the Executive Director of the Kansas Corn Growers Association and the Kansas Grain Sorghum Producers Association. I am actually here to testify today on behalf of those two entities as well as a third, my family.

The KCGA and KGSPA support efforts of Kansas producers to become price makers and not merely price takers in the marketplace. It is a never-ending effort. We work with the Kansas Corn and Grain Sorghum Commissions to develop new markets here in this country and abroad. The use of sorghum and corn to make ethanol or sweeteners or plastics would not be a reality if not for the work of our people. Yet we grind over a billion bushels each year to make these products. And the livestock industry is the best customer we have ever had. The KCGA was one of two state commodity associations that founded the 21st Century Alliance, an organization dedicated to link producers with processing and have Kansas farmers growing food, not just corn and wheat. The point is we do all of this and more because, like those that testified in support of this bill, we are not satisfied in what the marketplace offers our farmers…when we merely produce, deliver, and take whatever compensation might be tossed our way.

If SB-258 somehow could solve the inequities of production agriculture it could be embraced by all. Unfortunately, this bill does not achieve that lofty goal. In fact, we believe the opposite to be true. If any processor of a commodity, whether livestock, grain or whatever, is forced to lock in the daily price, regardless of circumstances that may transpire during that day, there is no doubt in our minds that they will always error on the conservative side. They will have no choice as the stockholders or owners will demand it. The outcome will be a lower overall average price. And with this proposed

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Senate Agriculture
3-8-99
Attachment 7

Kansas law having no bearing on operations outside our borders, we actually believe our livestock producers could find themselves at a relative disadvantage. If I am a packer looking at potential legal exposure over alleged price differential or retaliation charges from Kansas producers, that would have to be factored in to the overhead of doing business in Kansas. The potential for alleged violations is great and the fiscal note could very well be grossly under-estimated. Just the concept of differential pricing, what is allowed, what is not, is a concept that begs for dispute. It is not merely one of two animals that grade and yield in like manner. Think about other differentials that are less definable as to dollar value. What about Certified Angus Beef, or Hereford, or organic, or beefalo? The possibilities for disagreement are endless. After all, the disagreements about differentials are why we are here today. SB-258 doesn't solve anything. It provides more questions at a time when producers are looking for answers.

The concept of expanded price reporting that could allow for more accurate price discovery by Kansas producers has merit. However, we believe that a voluntary, perhaps incentive based, national system is the only type of price reporting that makes sense. Agricultural production and processing is hardly local or even state oriented. Their issues are national and in fact many times global. Policy solutions to marketing issues will need to be more encompassing than those we might attempt to implement only in Kansas. Unilateral trade regulations in Kansas are likely to be no more effective than unilateral trade sanctions from the United States are overseas. However, individual voluntary marketing solutions can and should be promoted from the local and state level. US Premium Beef is a group born out of frustration with the current system. It might not now, or for that matter, ever be the perfect answer to producers that find themselves on the outside of what looks like a better deal. It is a voluntary, educated response that seeks to allow beef producers the opportunity to get closer to the consumers. US Premium Beef can provide a high quality identity preserved product through the delivery system from mother cow to dining room table. We need more producers willing to step up and look for new ways to market in a new world. We do not need yet more laws to try to turn the clocks back and hope our neighboring states do likewise.

On a personal note, although I work for our states' grain industry, my family background is very much livestock oriented. My family has run cattle on some of the same Anderson County pastures for four generations. We are not large operators, nor would I consider us small. Our family commitment to the beef industry and agriculture is one that few who know us would question. My grandfather, who served as President of the Kansas Livestock Association in the early fifties, left his home and lobbied tirelessly in Washington and elsewhere on behalf of less government involvement in livestock production. Post war price controls were an issue at that time. My father has no equal as a promoter of beef in our local area. Also a past board member of the KLA and Kansas Beef Council, and past president of the Kansas Livestock Marketing Association, he carries on my grandfather's strong belief that bigger government is not the friend of the livestock industry. I share these beliefs of my father and grandfather, although while their legacy in the beef industry is certain, mine is far from it. My grandfather has long passed on, but my father and I are members of the 21st Century Alliance and US Premium Beef…meaning only we are looking for our own ways to continue in this tough business. We haven't determined exactly how we can utilize these two business structures or others that will come along to help sustain our family operation for future generations, but we believe it is our job, not the states' to try. It is always a temptation to ask government to intervene in the name of saving agriculture. However once you make that leap it is hard to come back. The grain sector knows this all too well. Freedom to Farm is a response to decades of good intentioned farm policy. And we are experiencing the pain today of making our own decisions. Eventually, we will get it right. Eventually, the government never will.

On behalf of the KCGA, KGSPA and my family, we respectfully ask this committee to not support SB-258 and the bigger government it promises and instead look for positive ways to support efforts of producers to help themselves.

KANSAS AGRICULTURAL ALLIANCE

STATEMENT
OF THE
KANSAS AGRICULTURAL ALLIANCE
ON
SB 258
BEFORE THE
SENATE AGRICULTURE COMMITTEE
STEVE MORRIS, CHAIRMAN
MARCH 8, 1999

The Kansas Agricultural Alliance is a coalition of statewide agricultural organizations that represents a broad spectrum of Kansas agriculture, including grain and livestock producers, input suppliers, agribusinesses and professions.

The Alliance opposes SB 258.

The members of the Alliance recognize the difficult, if not desparate, situation that exists in the agriculture community in Kansas. Near-record low prices are being paid for nearly all commodities and individual farmers and ranchers are struggling. Some producers, however, will survive this crisis because they use innovative methods to market their product. Most of these methods either help to minimize downside risk or reward production of a superior quality product. Clearly minimizing downside risk is to the producer's advantage since it helps to level out fluctuations in price over time. Rewarding superior quality has always been a basic principle of free market economies. After all, most people would not pay the same price for a Cadillac as for a Yugo. All producers have an equal opportunity to employ the innovative marketing and pricing techniques that would provide the greatest benefit for their individual situations.

The members of the Kansas Agricultural Alliance agree with the other opponents of this bill who feel that the remedies created in SB 258 will have no positive effect on prices received by cattle producers and may, in fact, have just the opposite effect. **We ask that you defeat SB 258.**

Senate Agriculture
3-8-99
Attachment 8

Marty Vanier, DVM ◆ Executive Director
1728 Thomas Circle ◆ Manhattan, Kansas 66502 ◆ (913) 539-9506

Farmland.

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Written Statement Submitted by
Farmland Industries, Inc.
Before the
Senate Committee on Agriculture

Monday, March 8, 1999

On behalf of the farmer-owned Farmland System, we recognize the meat and livestock industry continues to go through tremendous changes. The challenge for the Farmland System is to ensure that its livestock producer-owners are provided opportunities to position themselves to be competitive in this quickly changing industry. These efforts are to ensure their survival and prosperity throughout the future.

During the past two decades, concern over price discovery, captive supplies, and the potential effects of marketing agreements has raised significant interest among many in the livestock industry to call for increased regulation. Several states have responded by introducing resolutions and legislation to restrict marketing opportunities, capital movement, and the size of operations. On the federal level the scene is no different. Several organizations are urging Congress to mandate greater packer regulation.

As for price reporting, Farmland and the National Pork Producers Council (NPPC) coordinated a price reporting service which reports cash prices, discounts, premiums, and related information on a daily basis. This Internet-based service, which began in September, utilizes information from our four pork-slaughtering facilities and displays the actual prices paid to producers.

During testimony on February 10, 1999 before the Committee on Agriculture of the US House of Representatives, Farmland pledged to meet again with NPPC and to include the National Cattlemen's Beef Association, to develop a voluntary price-reporting system for both species. The attached press release from the House Agriculture Chairman (Larry Combest) and Ranking Minority Member Charlie Stenholm, encourages such action.

Senate Agriculture
3-8-99
Attachment 9

Farmland Industries, Inc. World Headquarters P.O. Box 7305 Kansas City, MO 64116-0005
Phone: 816 459-6000 Fax: 816 459-6979 http://www.farmland.com

Farmland has the greatest concern with the regulation of ownership. As a cooperative, Farmland's producers own the packing company. By adding regulations concerning ownership, they may be limiting opportunities for producers to participate in marketing arrangements like Farmland and U.S. Premium Beef, a closed cooperative of independent cattle producers. Producers have been limited for years from earning profits realized at the wholesale and consumer levels. By allowing producers to participate in these agreements, they will have a greater opportunity to earn more return for their marketing dollars.

In Conclusion

We encourage the Kansas legislature to consider cooperative approaches to livestock marketing challenges and policies that increases producers' profits through new marketing strategies, coordination, risk management, and retained ownership. Farmland is committed to working with our livestock producer-owners and their producer organizations to develop a responsible voluntary price reporting system. We will also continue to work with producers, consumers, policymakers and others to identify areas where we may assist in the long-term viability of our producer-owners.

Therefore we encourage the Senate Committee on Agriculture, in its deliberation of SB 258, to table this legislation and to encourage others in the industry to join the Farmland System in working out resolutions.

For further information, please contact Gina Bowman-Morrill, Director of Government Relations, 800/822-8263, ext. 6745.

Enclosures include:

- Farmland System Background Overview
- Combest/Stenholm Press Release, 3/5/99
- Farmland Press Release-Price Reporting, Sept. 1998
- KC Star Article 3/5/99

COMBEST AND STENHOLM CHALLENGE PRODUCERS AND PACKERS TO DRAFT A WORKABLE COMPROMISE ON PRICE REPORTING

(March 5, 1999)
The Chairman and Ranking Minority Member of the House Committee on Agriculture today issued the following statement urging producers and packers to draft a workable compromise on livestock price reporting:

"We're calling on producers and big packers to sit down together and work this out. Those of us who care about the future of our nation's livestock sector want to see a constructive dialogue. Nobody is better qualified for that task than the interested parties themselves," said U.S. Representative Larry Combest (R-Texas), Chairman of the House Committee on Agriculture. "During the House Agriculture Committee's February 10th hearing on livestock prices, it became clear that there was common ground between the two sides about what might helpful. More importantly, the witnesses expressed a willingness to work together to craft a solution."

"Moreover, we recognize that a real dialogue, building on common ground, has the best chance of producing an outcome acceptable to both sides," said Ranking Minority Member Charlie Stenholm (D-Texas). "I gladly join the Chairman in urging both producers and packers to roll up their sleeves and hammer out a workable solution. Given the serious challenges facing all segments of the livestock industry, we can not afford to have continued disagreement."

BACK to news releases

9-3

News & Information

Farmland
Proud to be farmer owned

National Pork Producers Council/Pork Board to launch voluntary market hog price reporting system; Farmland Industries to be initial participant – 9/8/98

KANSAS CITY, MO., (September 8, 1998) – In response to the growing need of pork producers for accurate and reliable market information, the National Pork Producers Council (NPPC) and the National Pork Board have announced plans to launch an unprecedented voluntary market hog price reporting service which can be accessed through the producer organizations' Web site on the Internet. Initially, the system will offer market information from Farmland Industries Meat Group, one of the nation's largest pork packer/processors. Other pork packers will be invited to become participants in the voluntary reporting service that is expected to be operational on or about Oct. 1.

"Until now, we have not had the means to deliver a meaningful price marketing vehicle," said NPPC president Donna Reifschneider, a pork producer from Smithton, Ill.

"With the Internet, we now have that vehicle, and with Farmland we have a packer/processor willing to join us in taking a leadership role in providing the kind of information that pork producers need to enhance the marketability of their hogs," she said.

The voluntary pork industry price reporting service will report the plant price received in cash sales on the previous marketing day. Other quality factors will also be included in the report, among them percent lean and carcass weight. The information available on the web site will be available to all members of the news media for duplication, with proper source attribution.

The U.S. pork industry has changed dramatically in recent years. One of the major changes has been an increasing need for the availability of timely and accurate marketing information for the pork producer. In order to make the right marketing decisions, pork producers need expanded information that is transparent.

"Pork producers asked NPPC to develop a system that would send a signal to the entire pork chain about the real value of hogs on any given day," Reifschneider said, "but we wanted it to be voluntary. NPPC producer delegates on two occasions in recent years have made it clear they prefer voluntary rather than mandatory price reporting," she said.

9-4

"Since Farmland is farmer-owned, we understand and are concerned about the challenges pork producers face with finding accurate, timely price information," said Gary Evans, Farmland's executive vice president and chief operating officer, Meats Group. "Farmland is pleased to provide voluntary price reporting because pork producers are most efficient at marketing when they have accurate, up-to-date price information."

"Accurate information is necessary in order for a competitive market to function effectively," said Al Tank, NPPC's CEO. "All parties that compete in such a marketplace need the information to ensure that resource allocations are correct and that consumers receive the product they want at the lowest possible cost, but with acceptable returns to market participants."

The pork industry's web site, funded in part with producer checkoff dollars, may be found at the following location on the World Wide Web: www.nppc.com

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News Release Archives

Home
Business Office | Operations
News & Information | Shopping Aisle| Employment | Site Map

9-5

News & Information

Farmland Proud to be farmer owned

Farmland Established First-Ever Hog Price Floor

Farmer-owned cooperative leads market relief for pork producers– 12/22/98

KANSAS CITY, Mo. (December 22, 1998) In an unprecedented move to support pork producers who are facing the lowest hog prices in four decades, Farmland Industries, Inc., announced today that it has established a first-ever price floor for market hogs it purchases.

The Kansas City-based farmer-owned cooperative, which runs the sixth-largest pork processing operation in the country, said effective today, it will pay a base price of no less than $15 per hundredweight for market hogs that meet the weight and quality specifications of Farmland Foods. Producers eligible to receive this price, which becomes effective Tuesday, Dec. 22, 1998, are those who sold hogs to the farmer-owned cooperative between Sept. 1, 1997 and Dec. 19, 1998.

"We are deeply concerned about the farmers who supply us with market hogs," said Gary Evans, Executive Vice President and Chief Operating Officer, Farmland Meats Group. "Establishing a price floor is an essential step to help our farmer-owners through one of the toughest economic periods in the history of the pork industry. This price floor is proof positive that Farmland is "Proud to be farmer-owned®."

Evans said the concept of establishing a price floor was developed after the cooperative's leaders studied several ideas put forth during their annual meeting two weeks ago in Kansas City. Farmland typically buys hogs at competitive prices, markets pork products under the Farmland® brand, and then pays out its profits to livestock producers and local cooperatives in the form of patronage refunds.

"With some recent reports of producers receiving less than $10 per hundredweight for market hogs, we felt compelled to take this step to help producers contain their losses until the backlog of hogs can be moved through the country's pork processing facilities," Evans said. "Because we are the nation's only producer-owned pork processor, we felt a moral obligation to attempt to provide assistance to our producers," Evans added.

Farmland will continue to monitor the hog market situation and evaluate the need

9-6

for this floor on a weekly basis.

The pork industry is experiencing a highly unusual glut in the number of hogs that are ready for market. Despite strong consumer demand for pork, there simply are too many hogs in the production pipeline for processing plants to keep pace, said Harry Fehrenbacher, a pork producer from Effingham, Ill.

"We recognize that a price floor is not the total solution," said Fehrenbacher. "Nevertheless, for hundreds of producers it could mean the difference between staying or leaving the pork business."

Evans said Farmland's four packing plants and nine processing facilities are operating at complete capacity and are expected to process more than 8 million hogs this year, about 15 percent more pork than the previous fiscal year. The packing plants are located at Crete, Neb.; Denison, Iowa; Dubuque, Iowa; and Monmouth, Ill.

"We need a stable supply of high-quality hogs over the long-haul," said Evans. "If this helps producers weather the economic storm, then we're doing our job." Evans said Farmland already has instructed its hog buyers to incorporate the price floor. Meanwhile, Farmland will be notifying pork producers in a special letter that will be issued this week.

Farmland has already returned $82.6 million in cash to its members this year.

Farmland Industries, Inc., Kansas City, Mo., is the largest farmer-owned cooperative in North America with 1998 company sales of $8.8 billion and total sales of $11.9 billion in all 50 states and 90 countries when including sales from its affiliated businesses. Farmland is a highly diversified company with major business lines in crop production and crop protection products, livestock feeds, petroleum, grain processing and marketing, and the processing and marketing of pork and beef products.

News Release Archives

Home
Business Office | **Operations**
News & Information | **Shopping Aisle** | **Employment** | **Site Map**

9-7

TheStar. PREVIOUS STORY NEXT STORY

NATIONAL/WORLD

BACK TO...
Library
Search
Results

Tough times for pork producers Farmland provided critical support when hog prices were plummeting

By: *ERIC PALMER The Kansas City Star*
Date: 03/04/99

If hog farmers were as dramatic as stock market investors, Dec. 14 would be remembered as Bloody Monday - the day hog prices got slaughtered.
In fact, for folks like Jim Phillips, whose livelihood depends on hogs, December 1998 will live on as vividly as October 1987 does for stock investors, a time when a market fell so fast and so far that it nearly sucked the life out of an industry.
``We could see it coming, and there was nothing you could do about it," said Phillips, whose Cass County hog farm was losing $12,000 a week at the lowest prices. ``It was a financial disaster. "

The December market slide wiped out some hog farmers and left others teetering on the brink.
But the month might have been much worse had Farmland Industries, the mammoth farm cooperative, not put its own earnings at risk to help stanch the losses.
Today in Nashville, Tenn., the National Pork Producers Council will hold its annual Pork Forum and thank Farmland for helping change ``the market psychology nationally at a time that it was desperately negative," said Al Tank, chief executive of the council.
By setting a minimum price for what it would pay its hog customers, industry insiders said, Farmland interrupted the psychology of panic, sending a signal of hope to producers at a time when many thought they would lose their livelihoods.
Almost immediately, the market nationally bounced up from about $10 per hundredweight of live hog to Farmland's price of $15.
``It was a Kansas City company, Farmland, that took the bull by the horns," U.S. Agriculture Secretary Dan Glickman said. ``By setting a floor, it had a lot to do with prices turning. "
Farmland had to do something, according to Wayne Snyder, Farmland vice president of livestock production.
``We didn't want to interfere with the market's ability to correct itself," Snyder said. ``But we wanted to send a signal to the market that enough is enough. "
In Nashville, the hog-producing industry will contemplate its future in light of the 1998 meltdown, which cost hog producers an estimated $2.6 billion. Tank and other observers say that some

9-8

of the factors underlying the price slide remain and that similar troubles could spread to other farm sectors.

The meltdown

So what happened last December?

At its simplest, hog production was up 10 percent, and hog plant capacity was down 8 percent, thanks to a Canadian meat-packing strike and some plant closings in the United States.

Hog farmers, who need a price of about $41 per hundred pounds of live hog to break even, had been losing money for months.

Packing plants added shifts and still couldn't keep up.

Prices kept declining. In panic, some producers began selling off their entire herds, feeding the supply glut that was causing the price slide. It was like stuffing a whole pig down a python's throat.

By Dec. 14, some farmers were getting about $10 per hundred pounds of live weight, less for a 240-pound hog than diners would pay for a couple of pork rib dinners. With prices in single digits, hog farmers faced having their entire net value rendered worthless.

At Farmland's annual meeting, it became clear that the co-op had to do something dramatic to protect its producers. Farmland ranks among the largest pork-packing operators and is a big owner of hogs itself, though most of the hogs turned into Farmland ham and bacon come from small hog producers.

After some debate, Farmland announced Dec. 22 it was paying its customers a minimum of $15 per hundredweight for hogs delivered to its four meat-packing plants.

That gave producers hope, Tank said, and suddenly the panic selling eased.

If the market hadn't responded quickly to that signal, Farmland faced losing tens of millions of dollars in its pork division.

``Had the situation gone on for a year, we could have lost twice as much as our greatest annual earnings," Snyder said.

Underlying problems

By this week, hogs were bringing $26 to $28 per hundredweight, still a loss but manageable.

Though the market has rebounded, Snyder said he couldn't be sure that it wouldn't crash again, and soon.

The circumstances that created the mess continue to hover over the industry.

``I have a real pessimistic view," Snyder said.

Tank agrees that the industry is walking a tightrope. He also said the hog industry was a canary in a coal mine for the rest of agriculture.

``Other sectors are going to experience the exact economic crisis that we experienced," Tank predicted. ``With more efficiency, capacity and utilization become more important on everything you do. There will be more volatility, more specialization. Other industries should take very strong heed on what can happen. "

9-9

One problem underlying the hog industry's troubles is natural. Russell Lamb, senior economist with the Federal Reserve Bank in Kansas City, pointed out that hogs prefer to breed in cool weather. As a result, hog producing is seasonal, with more breeding occurring in the spring and pigs reaching their premium size of 240 to 260 pounds in November and December.

When all of those hogs mature, it can be hard finding enough slaughtering plants to handle them.

That's what happened in December for Phillips and his two sons, who raise about 20,000 hogs a year. They had 400 hogs a week ready for market and were having a hard time getting them sold.

``It doesn't do any good to keep them any longer," Phillips said. ``If you can't sell them one week, then you just have two weeks' worth. "

More specialization

Another problem is economic, stemming from the profitability and increasing concentration of the hog industry.

Though hog prices are cyclical, hogs in better years are by far the most profitable category of farm production.

``Hogs have been high margin over time," Lamb said. ``You can make more on hogs than your returns in the stock market. "

That is why companies such as Premium Standard Farms in Kansas City and Seaboard Corp. of Merriam have been able to attract money from Wall Street to build huge hog farms and new packing plants, Lamb said.

Many family farmers have come to specialize in hog production as well, industrializing the process to improve their margins. Good prices in 1996 and 1997 encouraged producers to bump up herd sizes. That helped set up the crisis of 1998.

Though some agriculture economists think the chaos of December will have forced enough marginal hog producers out of the business to bring supply and demand in line by midyear, Snyder is unconvinced.

He worries that more packing plants might close because they are inefficient money losers. He also said that with hog producers specializing, it was harder for them to cull their herds. They bet on everyone else doing that.

Tank agrees.

``This used to be an industry of inners and outers," Tank said. ``People got in when prices were good and got out when they declined. With more people specializing, the question is, Who is going to leave the business? We haven't seen anyone blink yet. "

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PREVIOUS STORY NEXT STORY

9-10

Background on the Farmland Cooperative System

Farmland Industries, headquartered in Kansas City, Missouri, is the largest North American farm supply and food marketing cooperative. We are owned by more than 600,000 farm families through their 1,700 local cooperatives in 25 Midwestern states, Mexico and Canada. More than 8,000 livestock producers directly own Farmland as well.

Farmland manufactures and distributes to local cooperatives those agricultural inputs necessary for both crop and livestock production. These products include petroleum and energy products, plant nutrients, crop protection materials, animal feed and health products, training, technical information, management and financial assistance.

Farmland provides marketing opportunities, both domestically and internationally, for our owners' agricultural outputs. Last year, Farmland sold these products in all 50 states and in over 80 other countries. Farmland adds value to these outputs through the production of ethanol, processed wheat products, meat processing, feed and pet food products. Farmland is the nation's only farmer-owned pork and beef packer/processor.

Farmland Cooperative System Presence Kansas

- As Farmland's state of incorporation, Kansas has more Farmland employees than any other state. Including joint ventures and subsidiaries, Farmland has over 6,000 employees in the state of Kansas and local cooperatives employ hundreds more.

- Over 50,000 farm families are served through more than 150 local cooperatives.

- As the country's largest wheat producer, Kansas is an integral part of Farmland's grain business. With elevators in **Hutchinson**, **Topeka**, **Wellington, Ogallah, Wichita** and **Kansas City**, Farmland has total storage capacity of over 60 million bushels with the Hutchinson elevators alone accounting for 25 million bushels of storage.

- Heartland Wheat Growers, located in **Russell**, is an example of value added products being produced to benefit the agricultural producer. Heartland Wheat Growers buys wheat from farmers and ranchers in Kansas and throughout the Midwest. This wheat is processed into various products from wheat gluten to wheat starch and marketed throughout the world.

- Farmland National Beef has beef processing facilities in **Liberal** and **Dodge City**. In partnership with U.S. Premium Beef, a new generation marketing cooperative of independent cattle producers, Farmland National Beef employs over 4,000 persons. As the nation's only farmer owned beef packing plant, National Beef processes 8,500 head of cattle per day. Recent renovations have more than doubled cold storage capacity to over 80,000 boxes. A $6 million "value-added" renovation project, due to be complete in the summer of 1999, will add an additional 250 jobs. Cattle are purchased from producers in Kansas, Colorado, Oklahoma, Texas, Iowa and Nebraska and sold as high quality beef products throughout the United States and several foreign countries. U.S. Premium Beef has marketed over 450,000 cattle through these facilities since December 1997.

- Farmland Foods facilities in **Topeka** and **Wichita** process a variety of products including Ohse brand meat products and of course the traditional Farmland brand. Over 300 brand labels are produced at these locations and products are shipped to customers throughout the world.

- The refinery in **Coffeyville** currently employs 340 persons. Recent improvements and modernization of the facility have increased output to 100,000 barrels per day. A $300 million project underway will utilize by-products of the facility previously considered waste. These former waste products will be converted through an elaborate process to create fertilizer products. The construction phase of the project, due to be complete in late 1999, has created 800-1000 construction jobs and the overall project will create over 100 permanent new jobs. The Coffeyville refinery has also taken several voluntary steps to reduce emissions below those required by the Clean Air Act including a new "sour water stripper" and upgrades to the sulfur processing unit.

- Farmland crop production facilities located in **Dodge City,** and **Lawrence** combine for a total output of over 4500 tons of fertilizer per day. Over 270 employees work at these two facilities that provide valuable crop production products to farmers and ranchers throughout the Midwest. Both locations have demonstrated an exceptional environmental record with several awards based on reduced emissions, safety and environmental records.

- The Farmland Feed division operates a feed mill in **Dodge City** and a feed mill and pet food plant in **Muncie**. These facilities employ over 100 persons who produce feed products for sale throughout the country and several export markets as well. Total annual production is over 230,000 tons.

- Farmland Feed Research and Development Farm located in **Bonner Springs** is a state of the art research facility. The farm, located on 380 acres, has been in existence since 1973. Ongoing studies regarding animal nutrition, crop production, feed efficiencies, reproductive technologies, etc. are continually being conducted.