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Background on Proposed Livestock Marketing Arrangements Legislation

Overview

The livestock industry has been the subject of various types of proposed legislation throughout history. However, the debate over specific types of marketing regulations has increased since the 2002 Farm Bill. During discussion of the 2002 Farm Bill, several bills aimed at restricting packers' purchasing practices were introduced, including a bill that would have restricted packer ownership and control of livestock. Instead of enacting the proposed legislation, Congress appropriated funding for a study of the marketing arrangements used in the livestock industry. However, many previously proposed bills have continued to be discussed and periodically reintroduced and have evolved since 2002. In addition, all of these proposed bills have been offered as amendments to the 2007 Farm Bill. This fact sheet divides the previously proposed legislation on marketing arrangements into three categories to provide an understanding of how the legislation has evolved and possible implementation issues.

Three Types of Proposed Legislation

Proposed legislation on marketing arrangements in the livestock industry generally fall into one of three categories:

- make it unlawful for a packer to own, feed, or control livestock prior to slaughter;
- prohibit anticompetitive forward contracts; or
- require packers to use spot market arrangements.

The history of the legislation in each of the categories is described below.

Ban on Packer Ownership

The most often cited proposed bill banning packer ownership of livestock is commonly known as the Johnson Amendment (Senate Bill 142) and was introduced by Senator Johnson (D-SD) on January 22, 2001, and co-sponsored by Senators Grassley (R-IA), Thomas (R-WY), and Daschle (D-SD). Senate Bill 142 would have amended the Packers and Stockyards Act to make it unlawful for a packer to own, feed, or control livestock for more than 14 days prior to slaughter. The bill provided exemptions for producer cooperatives that owned packing facilities and small producer-owned packing facilities.

Other versions of this bill have been introduced in both the House and the Senate seven times between 2001 and 2007. In that time, some versions of the legislation have included exemptions for forward contracts and provisions aimed at corporate mergers in the packing sector, while other versions remained unchanged.

The last change to the proposed ban on packer ownership came in 2003 when Senators Grassley (R-IA), Johnson (D-SD), Enzi (R-WY), and Harkin (D-IA) introduced Senate Bill 27. This bill was very similar to Senate Bill 142, but the extent of affected packers was more limited. Only multiplant packers (excluding producer-owned cooperatives) that met the criteria for participation in Mandatory Price Reporting (MPR) would have been banned from owning livestock. In addition, Senate Bill 27 narrowed the marketing window for the affected packers from 14 days prior to slaughter to 7 days. This version of the ban on packer ownership has been introduced twice in both the House and the Senate. Prior to discussion of the 2007 Farm Bill, the most recent legislation was introduced in January 2007 by Senators Grassley (R-IA), Dorgan (D-ND), Enzi (R-WY), and Harkin (D-IA).

Prohibition on Anticompetitive Forward Contracts

The second type of proposed legislation would eliminate certain forward contracts. This type of legislation has been introduced twice in the House and four times in the Senate between 2002 and 2007. The limits on forward contracts were laid out in March 2002 when Senator Enzi (R-WY) introduced Senate Bill 2021. This bill would have amended the Packers and Stockyards Act to prohibit the use of "anticompetitive forward contracts." Anticompetitive forward contracts were defined as contracts that

- do not contain a firm base price that may be equated to a fixed dollar amount on the day on which the forward contract is entered into;
- are not offered for bid in an open, public manner;
- are based on a formula price; or
- provide for the sale of livestock in a quantity in excess of 40 cattle or 30 swine.

Senate Bill 2021 further specified forward contracts as an oral or written contract for the purchase of livestock that provides for the delivery of the livestock to a packer at a date that is more than 7 days after the date on which the contract is entered into, without regard to whether the contract is for a specified lot of livestock or a specified number of livestock over a certain period of time. The provision regarding formula pricing included specific exemptions for formula pricing that used futures prices or carcass merit-based valuation.

The versions of this legislation that were proposed after Senate Bill 2021 have remained largely unchanged. Prior to discussion of the 2007 Farm Bill, the most recent legislation prohibiting the use of anticompetitive forward contracts was Senate Bill 1017. This bill was introduced in March 2007 by Senator Enzi (R-WY) and cosponsored by Senators Dorgan (D-ND), Grassley (R-IA), Thomas (R-WY), and Conrad (D-ND).

Requirement that Packers Use Spot Market Arrangements

The third type of proposed legislation is aimed at the use of certain types of marketing arrangements in the livestock industry and would require packers to use the spot market to purchase a specified percentage of their livestock. This legislation would not limit the specific types of marketing arrangements that packers can use; however, it would limit the use of alternative marketing arrangements (AMAs) to a certain percentage of overall livestock purchases. Legislation requiring packers to use the spot market for some percentage of their sales was first introduced in the House; however, the three subsequent bills were introduced in the Senate. The original proposed legislation, House Resolution (HR) 5247, was introduced in July 2002 by Representatives Latham (R-IA), Ganske (R-IA), Nussle (R-IA), and Thune (R-SD).

HR 5247 would have amended the Agricultural Marketing Act of 1946 to require packers to use spot market arrangements for procuring a minimum of 25% of their animals. Spot market transactions were defined as purchase agreements that specified a firm base price on the day of the agreement and under which the livestock are to be slaughtered within 7 days. HR 5247 would have only included multiplant packing companies that met the criteria for participation in MPR. Furthermore, any of the included plants that were producer cooperatives would only be required to procure 12.5% of their slaughter volumes from spot market purchases.

The Senate Bills proposed by Senators Grassley (R-IA) and Feingold (D-WI) requiring packers to use the spot market have been virtually identical to HR 5247. Prior to discussion of the 2007 Farm Bill, the most recent legislation proposed by these Senators was Senate Bill 325, introduced in March 2007. However, this bill did not include the lesser spot market requirements for producer-owned cooperatives. Therefore, cooperatives would presumably be required to meet the same 25% spot market criterion as other packers.

Implementation of Proposed Legislation

To estimate the number of packers that could be affected by these proposed restrictions, we examined the breakdown of packing plants by species that report to the Grain Inspection, Packers and Stockyards Administration (GIPSA). Several proposals to limit marketing arrangements have developed a common size baseline for affected packers. The packers included in these bills would be those that are currently required to report prices and quantities under MPR and that operate more than one livestock packing plant. Packers required to report under MPR (annual slaughter of 125,000 cattle or 100,000 hogs) are fewer than the number of packers required to report annually to GIPSA ($500,000 in annual livestock purchases). Thus, data reported by GIPSA provide an upper bound on the number of packers affected by the proposed legislation. In 2005, 657 federally inspected plants slaughtered cattle in the United States, but only 172 plants (26%) reported to GIPSA. During the same year, 630 federally inspected plants slaughtered hogs, and 163 plants (26%) reported to GIPSA.

The 2005 GIPSA Statistical Report shows that 20 multiplant firms operated 64 cattle plants in 2005 (USDA, GIPSA, 2007). Assuming that all of these plants meet the size requirements of MPR, approximately 10% of the federally inspected cattle slaughter plants would be subject to legislation that uses the multiplant/MPR baseline. Following the same assumptions, the percentage of federally inspected hog slaughter plants subject to these proposed bills would be 8%. In 2005, 20 multiplant hog firms operated 52 plants. Additionally, exemptions for producer-owned cooperatives could decrease the number of affected packers depending on how the legislation is worded.

Ban on Packer Ownership

The ban on packer ownership could effectively eliminate direct packer ownership of livestock, including packers feeding cattle or producing hogs under production contracts. However, the legislative definitions of the terms “ownership” and “control” do not clearly specify what impact this legislation would have on market participants who use forward contracts and marketing agreements. The legislation stated that packers may not do the following:

“Own or feed livestock directly, through a subsidiary, or through an arrangement that gives the packer operational, managerial, or supervisory control over the livestock, or over the farming operation that produces the livestock, to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of the livestock.”

However, many questions remain about the specific implementation of this prohibition. For example, within most cattle marketing agreements the feedlot determines the week that the cattle are delivered and the packer determines the day within the week. Whether this behavior falls within the control requirements of the proposed legislation would need to be determined. Despite these questions, a ban on packer ownership would be more straightforward to implement because it is easier to define and observe than other market restrictions.

Minimum Spot Market Purchase Requirement

Traditionally spot market purchases have been defined as any purchase of livestock by packers from producers within 14 days of slaughter. The level of cattle industry spot market purchases ranged from 56% to 68% of steer and heifer slaughter between 1999 and 2005 (USDA, GIPSA, 2007). The Livestock and Meat Marketing Study (Muth et al., 2007; Vukina et al., 2007) showed spot market purchases accounted for 62% of cattle purchases and 11% of hog purchases from October 2002 to March 2005. These industry-wide levels of spot market purchases indicate that the proposed minimum level of spot market purchases (25%) would not affect many, if any, cattle slaughter plants, but it would affect a large number of pork slaughter plants. However, the proposed legislation narrows the definition of a spot market purchase from within 14 days of slaughter to within 7 days and requires that a firm base price be set at the time of the agreement. Therefore, it is difficult to precisely determine the total number of packers that this proposed legislation would actually affect. The minimum spot market purchase requirement focuses on market institution or structure components that are relatively easy to observe, and it does not require details on market participants' conduct.

Prohibition on Anticompetitive Forward Contracts

Proposed legislation that would eliminate the use of certain forward contracts has been much broader in focus than the other types of legislation reviewed here. It does not have any limitations on the size of packers that could be affected and could conceivably affect any packer that purchases cattle more than 7 days prior to slaughter. This legislation could eliminate the use of virtually all forward contracts (as typically defined in the industry), all marketing agreements, and many direct trade transactions that are negotiated more than 7 days prior to slaughter or that use formula pricing.

The stipulations of this legislation raise several interesting questions. Would producers be required to solicit bids from more than one packer? What constitutes an open and public offering? How would prices be revealed to other cattle producers? Regardless of the answers to these questions, the elimination of anticompetitive forward contracts would likely be the most difficult of the three types of proposed legislation to implement. Enforcement of this legislation would require monitoring market participant conduct that is typically difficult to observe.

Summary

The number of packers actually affected by legislation proposed to limit the use of marketing arrangements in the livestock industry will vary depending on the specific language of the bills. However, the large capacity of individual plants in the industry relative to the size of livestock production facilities means that even the most narrowly defined legislation could affect a large number of producers that sell livestock to these plants. Therefore, it is important to understand the different economic incentives for packers and producers to use different marketing arrangements and the costs that may be imposed by limiting the types of marketing arrangements that can be used. The incentives for packers and producers to use different marketing arrangements are described in the remainder of the fact sheets in this series.

Specifically, the other fact sheets in this series summarize research from the Livestock and Meat Marketing Study and provide definitions of AMAs used in the livestock industry at the time of the study, the extent of their use, the reasons why buyers and sellers use the cash market or AMAs, and results of analyses examining the effects of restricting AMAs.

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