Frequently Asked Questions regarding the
Livestock and Meat Marketing Study & Answers
Updated July 11, 2007

Question 1: Why did the Grain Inspection Packers and Stockyards Administration (GIPSA) conduct the recent Livestock and Meat Market Study (Study)?

Answer: Congress directed GIPSA to conduct the Study and appropriated the funds to GIPSA. GIPSA has authority under the Packers and Stockyards Act of 1921 as amended (P&S Act) to collect business information from packers and other regulated entities.

Question 2: How was the scope of the Livestock and Meat Market Study (Study) determined?

Answer: An interagency group of economists and attorneys from GIPSA, the Department of Justice (DOJ), Federal Trade Commission (FTC), Commodities Futures Trading Commission (CFTC), United States Department of Agriculture (USDA) Economic Research Service ERS, USDA Agricultural Marketing Service (AMS), USDA Office of Chief Economist (OCE), and the Office of General Counsel (OGC) took the issues that Congress wanted examined and designed the Study requirements. The Study requirements were published in the Federal Register for public comments and a final Performance Work Statement was released for competitive bids. After all the submitted proposals were reviewed by a technical team of members from the interagency workgroup, the Study was awarded to RTI, International (RTI). RTI used 13 researchers and subcontractors from Colorado State University (1), Iowa State University (2), Montana State University (3), North Carolina State University (5), and the Wharton School of Business (5). All RTI reports have been independently peer reviewed by economists with affiliations such as the University of Minnesota, Idaho State University, and Michigan State University

Question 3: Was the recent Study biased by more responses and data from larger firms to the exclusion of smaller firms?

Answer: The Study actually received a greater absolute number of responses from smaller sized entities than larger ones. This is not surprising since there are a greater number of small firms compared to large firms; however, the larger firms do handle larger volumes of livestock.

Question 4: Some observers have pointed out that the supply of Alternative Market Arrangement (AMA) cattle is actually more variable than spot market cattle, and claim this contradicts findings in the Study that AMAs are more reliable than the cash market. How do you reconcile these apparent contradictions?

Answer: The report concludes that AMAs *facilitate procurement of a reliable supply* of consistent, high quality cattle, whether fed or feeder. This conclusion is based on findings (Beef Volume, pages 5-5 and 5-6) that, among both packers *and producers*, three of the top five reasons for using AMAs to procure fed cattle and feeder cattle, respectively, are securing higher quality calves and cattle, improving week to week supply management, and improving efficiency of operations. The report's conclusion, which relates to maintaining a reliable total supply of desired livestock, does not contradict the claim that the number of cattle traded through AMAs is more variable statistically than the number traded through the spot market. The variation in number of AMA cattle may simply reflect the use of that source to maintain a more uniform overall total supply.

Question 5: Given that currently, and during the time frame of the Study, only about 10 percent of hogs are purchased on the spot market, is this an adequate volume to ensure accurate price determination and fair price discovery in the spot market?

Answer: Price determination is the broad interaction of supply and demand forces to equalize what consumers are willing to pay for a given product with what producers are willing to accept in exchange to cover commodity costs. The Study indicates market driven price determination is occurring in the hog spot market. Price discovery is how producers and consumers learn what *most* consumers and producers are paying and accepting for a commodity. Multiple factors facilitate price discovery, evidence that uniform price discovery is taking place in the hog-pork market is reflected two ways. First, while Mandatory Price Reporting is voluntary, packers continue to report. This indicates there is value in prices reported as a source of market price conditions to packers. Second, the rate of decline in the spot market has stabilized in recent years indicating that packers see benefits from maintaining some minimum presence in the spot market to gain market information.

Question 6: The results of this Study once again demonstrate that use of AMAs is associated with lower prices. How many studies of this sort are necessary before we take action to end this use of AMAs to manipulate prices?

Answer: The Study did not find that AMAs lowered overall average prices for livestock. The Study found that prices in spot markets tended to fall as use of AMAs increases. This is consistent with substitution effects for the demand for all normal goods. The Study additionally analyzed these effects in the context of the interaction of demand and supply, and that analysis does not imply that packers are manipulating prices.

This isn't to suggest that individual packers, in individual instances, could not use a combination of different types of purchases, including spot purchases, to manipulate prices. GIPSA monitors and investigates behavior of individual purchasers, and will continue to do so.

In the aggregate, the key measure for judging the inherent attributes of AMAs is the overall affect of the mix of purchase methods. The analysis showed that there would be a net loss to producers, especially feeder cattle producers, as well as to consumers if there were restrictions placed on the use of AMAs. The analysis did not show that AMAs depress the overall price to producers. To the contrary, the analysis showed that restrictions on the use of AMAs would cause an overall net loss as a result of declines in both quantities purchased and consumed and in overall average prices received by producers. Prices paid by consumers and prices received by processors would, in general, increase if use of AMAs was restricted.

Question 7: Do you believe that hog production and slaughter will become totally integrated, as has poultry?

Answer: The Study researchers concluded that they don't expect hog production and slaughter to become totally integrated. A variety of distinguishing characteristics act to prevent this industry from being completely vertically integrated like poultry, e.g., the high capital investments required in hog production compared to its output level. Additionally, poultry integration was facilitated by lack of alternatives for poultry growers. The volume of contracting that exists between livestock sellers and purchasers reflects the desire to achieve the cost efficiencies of vertical integration without the costs of actual vertical integration.

Question 8: It seemed that the recent Study did not analyze the effects of concentration. Is that true?

Answer: No. There were three distinct models used: one for cattle-beef; another for hog-pork; and a third for sheep-lamb. A component of the modeling analysis included simulating the effects from a reduction in AMAs, which did include concentration considerations.

Question 9: Is market power directly associated with high levels of packer concentration resulting in price manipulation by the larger firms, and why didn't the Study address market power and resulting price manipulation?

Answer: The Study contract did not call for the researchers to engage in an investigation as to whether individual firms were manipulating prices. GIPSA believes that manipulation of price is an investigative and enforcement issue, not a research objective. Additionally, the intent of Congress when it mandated the Study was for GIPSA to conduct research to provide objective information for possible legislative action. GIPSA investigates incidents it believes are violations of the P&S Act including price manipulation, but that enforcement activity is distinct from the activity conducted in the Study.

It is important to note that whether a firm is large or not, it may have advantages that are not directly subject to competitive forces, such as managerial skill or knowledge (think of a corn farmer with especially fertile soil relative to all other farmers). If, a firm has these advantages the firm will receive extra-normal profits and that can be construed as market power. But possessing scarce resources is not illegal. Market power does not necessarily "result" in price manipulation. The low rate of return earned by packers in recent years suggests an absence of market power through price manipulation or otherwise. The final report does address relationships between market power and the use of AMAs.

Question 10: Didn't the researchers conclude that AMAs provide for a stable supply of quality cattle simply based on opinions versus actual data?

Answer: The researchers did use transaction and Mandatory Price Reporting data, in addition to survey data, to measure the quality effects of AMAs in their analyses. The results showed that cattle purchased through AMA's were generally of higher, more consistent quality than cattle purchased through direct spot markets. Interestingly, the exception was the relatively small volume of fed cattle purchased through auctions, which were of higher quality grade but lower yield grade. The data analysis also showed that use of AMAs resulted in an average savings due to reducing supply variability of $1.70 per head.

Question 11: Why didn't the Study prescribe alternative marketing methods for assuring quality and consistency?

Answer: The Study scope and requirements specifically excluded a "prescriptive" approach. Congress did not direct GIPSA to tell producers and others how they should organize their businesses and trading relationships. Congress asked us to identify the attributes, including quality effects, of various methods that industry members themselves have developed and adopted.

Question 12: How did GIPSA pick researchers for the Study?

Answer: GIPSA did not "pick" any of the researchers to perform the research. GIPSA widely advertised the objectives and requirements for the research, including special efforts to make sure that business schools were aware of the Study. The researchers were chosen through a competitive bidding process as required by government procurement regulations. The process requires the selected proposal to represent the best value to the government including technical as well as cost considerations. GIPSA received bids from teams that included a large number of researchers (including animal scientists, statisticians, management experts, and economists, amounting to well over 100 individuals) with expertise in the livestock industry and in industrial organization economics. There were no bids solely from "business schools" as such, although some members of the winning RTI team were associated with Wharton School of Business. Selection of the winning bidder was made by a selection team that included members from GIPSA, the Department of Justice, the Commodities Futures Trading Commission, USDA's Economic Research Service, and Agricultural Marketing Service, and the Federal Trade Commission.

Question 13: Does evidence from this Study and other sources, indicate that Alternative Marketing Agreements (AMAs) or captive supplies cause harm to competition?

Answer: Not at the aggregate market level. In this Study, the largest study of alternative marketing agreements ever conducted in this country, AMA's were found to be adding benefits to producers and consumers. The economic distinction between packer ownership and other contractual forms of arrangements was brought out in the Study. As noted in the answer to Question 6, contractual arrangements are trading methods that achieve the benefits of vertical integration without an ownership investment, whereas packer ownership is a step in the direction of vertical integration. The Study, in part, identified the economic distinction between contractual arrangements versus packer ownership as to whether the seller or buyer will bear different costs related to price risk.

While overall the AMAs add benefits to the economy, AMAs can be used by individual entities in ways that harm competition. GIPSA has dramatically increased its enforcement activity and has taken many steps to more effectively monitor procurement practices.

Question 14: How will the enforcement activities of GIPSA change given the Study findings?

Answer: The Study results are helping GIPSA set priorities in its regulatory and investigative activities. For example, while the Study did not reveal inherent anticompetitive effects associated with AMAs, the Study confirms the importance of pricing in spot markets for establishing base prices of AMAs. As a consequence of the Study, GIPSA is expanding its auditing of the procurement practices of the top 4 fed cattle slaughter firms to the top 5, and examining the feasibility and benefit from initiating similar audits of hog slaughterers.

The Study also confirms the importance of pricing in spot markets in establishing base prices of AMAs. GIPSA's regional specialists are constantly in touch with industry contacts to monitor market conditions and firms' marketing behavior. The Study has helped to establish a better base of common understanding about AMAs and to improve communications both within the industry and between the industry and PSP. GIPSA monitors weekly fed cattle and hog market prices using statistical models that utilize data made available publicly by the Agricultural Marketing Service (AMS) under the Livestock Mandatory Price Reporting Act. The findings from the Study contribute to GIPSA's analysis of anomalies in spot market prices, especially in circumstances where major market participants are known to be procuring livestock jointly through AMAs and in the spot market.

Question 15: One part of the Study suggests that prices paid by meat packers for cattle sold on a live weight basis are higher than the prices for cattle sold on a carcass weight basis and a cash grid with quality and yield premiums and discounts, why? Do these results suggest price manipulation by packers?

Answer: These particular results were from one econometric equation reported in table 2-24 on page 2-41 of the report *Volume 3: Fed Cattle and Beef Industries Final Report*. This equation was used to measure the relationship between average cash market prices and the quantity of AMA use. The price differences observed, in this case, derive from the statistical estimates of the average cash market price and price variables included in the equation for cattle sold on a carcass weight and a cash grid. As such the values are measuring the incentive by packers to substitute between the differing forms of procurement. The gap in prices is being pushed by two factors: tight supplies during the time period of the study for fat cattle and the fact that most grid pricing schedules typically include larger discounts for an undesirable quality than the premium for an equal amount of the desirable feature. The result does not suggest price manipulation by packers.

Question 16: Haven't other studies found that AMAs cause a net loss to livestock producers? How can you explain the different results from this Study?

Answer: We have seen results of a limited number of other analyses that use the coefficient from single-equation estimates of the negative association between spot prices and use of AMAs, and multiply that coefficient times the total volume of livestock to arrive at an alleged "loss" to producers due to use of AMAs. Such estimates assume nothing else would change if AMAs were somehow eliminated from the economy, and ignore the totality of interrelationships such as were modeled in this Study. For example, those estimates don't consider the effects on procurement and processing costs and on quality that are modeled in this Study, and resulting changes in demand and supply that would occur as industry participants adjust in response to restrictions on use of AMAs. More comprehensive studies do not support the conclusions drawn from the restricted analyses. The Study was unique in the amount of data that was available for analysis, its use of models that linked supply and demand in the respective market channels, and the quality of the analytical approach to evaluate the net effects of AMAs on the livestock and meat economy. As a result the Study set a scientific standard by which other study results will be judged.

Question 17: Does GIPSA intend to take legal action against any packers as a result of the Study?

Answer: The Study was not intended or designed as an investigation of individual packers. The Congressional mandate was a request for research into the overall costs and benefits of alternative marketing arrangements to provide objective information for possible legislative action. In order to facilitate industry cooperation and ensure confidentiality, data collected for the Study are protected from disclosure by the provisions of the Confidential Information Protection and Statistical Efficiency Act of 2002 (CIPSEA). CIPSEA provide assurances of confidentiality to all entities that provided data by requiring that the data be used for statistical or research only, and the assurance that no legal action can be taken against any individual entity based on data provided for the Study.

Question 18: Much of the benefit of AMAs is supposed to be related to improved quality. Can't the same benefits be obtained from cash sales on a grid basis?

Answer: In principle perhaps, but in actuality, AMAs often include additional quality terms that are difficult to build into grids such as specified genetics and feeding practices. This is especially true in hog procurement, but increasingly true in fed cattle procurement as well. While in theory even these types of quality terms might be made a part of grids used in spot market purchases, assurance to the packer that the livestock possess these characteristics, and assurance to the producer of appropriate payment for committing to provide these characteristics, is facilitated by use of AMAs. This may be evidenced by the existence of numerous alliances that incorporate more detailed quality criteria in their production and marketing programs.

Question 19: Some have asked if the Study were too heavily influenced by economic criteria rather than based on broader legal criteria. How does GIPSA respond to this criticism?

Answer: The Study was not designed as nor intended to be an investigation of specific firms' behavior. Congress did not ask GIPSA to determine whether one or more firms were breaking the law. Congress asked GIPSA to identify and evaluate the costs and benefits of AMAs. GIPSA believes the methods used for the analysis were appropriate for this objective. GIPSA relied on independent peer reviewers to ensure that the research met standards of scientific analysis.

Question 20: Does the Study results provide support for the argument that there is potential competitive harm from the use of AMAs with base prices tied to spot market prices. Why did the Study not examine ways of addressing this concern?

Answer: GIPSA agrees that the Study highlights the critical role of price discovery in spot markets, not only for pricing the livestock traded in those markets but additionally for establishing base prices of many AMAs. The results reveal a need for continued focus on pricing in spot markets, and as noted in several of the earlier responses, GIPSA will be devoting continued attention to this. There is merit in additional work in exploring possible alternatives to use of spot markets for establishing base prices of AMAs. However, GIPSA did not believe it appropriate for the Agency or the researchers to independently propose specific alternatives since this could have been construed as a bias that would negatively affect credibility of the overall results of the Study.