NORTH AMERICAN MEAT INSTITUTE

Testimony Submitted for the Record

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Hearing before the Senate Agriculture Committee Examining Markets, Transparency, and Prices from Cattle Producer to Consumer

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On behalf of the North American Meat Institute (NAMI or the Meat Institute) based in Washington, DC, and its 724 members around the country, thank you for the opportunity to submit this testimony.

The Meat Institute is the United States' oldest and largest trade association representing packers and processors of beef, pork, lamb, veal, turkey, and processed meat products. NAMI member companies account for more than 95 percent of red meat output and 70 percent of turkey production in the U.S. The Meat Institute provides legislative, regulatory, international affairs, public relations, technical, scientific, and educational services to the meat and poultry packing and processing industry.

Let me state at the outset, the members of the Meat Institute – and their livestock suppliers – benefit from, and depend on, a fair, transparent and competitive market. This testimony is offered to provide a comprehensive picture of the dynamic market in which cattle producers and beef packers operate.

<u>COVID-19 Affected the Cattle and Beef Markets.</u>

First, I would like to address the repercussions of the COVID-19 pandemic. A brief review provides some instructive context for this discussion of cattle and beef markets. It is worth noting that meat was not the only item affected; we saw similar situations in everything from toilet paper, to disinfectants, to hand sanitizer.

Last year, pandemic-related plant interruptions temporarily idled about 40 percent of slaughter capacity for cattle and hogs at the peak of its impact. This disruption happened in tandem with unprecedented retail demand for beef due to panic buying and freezer stocking as shelter-in-place orders were put in place. The situation was worsened by the operational changes needed to rebalance production, processing, and distribution away from food service toward retail.

In short, there was a significant "kink in the chain" in 2020 and the industry is still working to catch up harvesting and processing cattle with the supply of cattle and the demand for beef. Again, this is not unique to the cattle and beef sector; the whole of the U.S. economy is working its way back to normal.

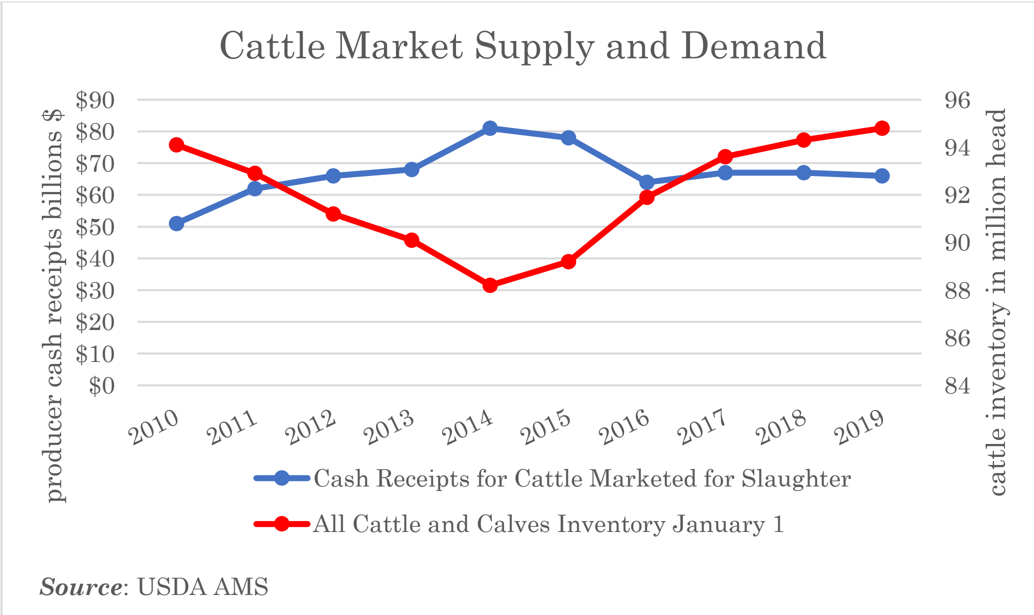
Early in the pandemic the National Cattlemen's Beef Association (NCBA) commissioned the Oklahoma Cooperative Extension Service and several distinguished agricultural economists to examine the impact COVID-19 was having and was expected to have on the beef cattle industry. That paper warned "the timeline for market recovery from COVID-19 is unknown, and cow-calf losses could expand into 2021 when the summer and fall 2020 calf crops would be marketed."[1]

Supply and Demand Fundamentals Are at Work.

Before the pandemic, the supply of cattle was growing. For the first three months of 2020, the fed cattle supply experienced year-over-year growth. For each month, January, February, and March, the number of cattle and calves in feedlots with capacity of 1,000 or more head was larger than it was during the same months in 2019. The supply of fed market cattle remains high this year. USDA reports that in 2021, the cattle-on-feed inventory has been the second highest monthly total ever on record for four of the first five months of the year, February through May 2021.

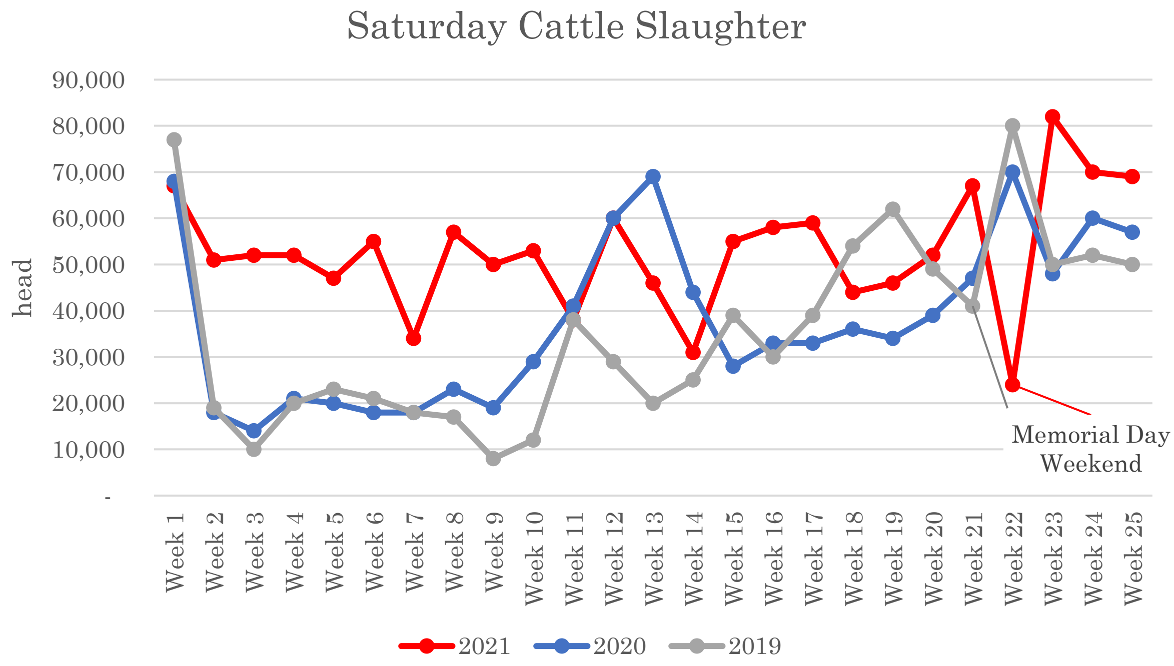
As expected, when supplies of cattle increase, prices decrease - and vice versa. The chart below shows how this has played out over the past 10 years, with or without such significant recent "black swan" events as COVID, the fire at the Holcomb packing plant in Kansas in 2019, or this year's cyber ransomware attack.

[1] Economic Damage to the U.S. Beef Cattle Industry due to COVID-19, OSU/NCBA, April 2020



Nonetheless, in the face of the many challenges, the beef packing sector has proven resilient. Total beef production in 2020 was slightly higher than 2019, based on heavier slaughter and carcass weights. As expected, cattle weights increased during the disruptions from COVID. Total head of commercial slaughter in 2020 was down just two percent from 2019, despite the dramatic disruption to the cattle harvest during the second quarter of 2020 resulting from the pandemic.

Packers adjusted to the combination of the large supply of cattle and constraints on their capacity by increasing their Saturday slaughter and processing operations to increase through put. Saturday slaughter year-to-date (through June 19, 2021) has been nearly 40 percent higher than 2020 and 50 percent higher than the more normal year of 2019.



Source: USDA AMS

Although there remains a large supply of fed cattle to be harvested, which has affected cattle markets and prices, it is still important to remember that, through May, year-to-date cattle slaughter is nearly six percent greater than the previous five-year average for the same period.

The Labor Supply Affects Cattle Markets.

Production in meat packing and processing plants are, in some respects, tied to the number of employees working the line. During the early phases of the COVID-19 pandemic, employee absenteeism, whether due to contracting COVID-19, or being sent home with symptoms, or quarantined because of exposure, or simply because of apprehension of coming to work as seen in some locations, caused processing lines in some plants to slow. Additionally, many packers were further challenged by the "hodge podge" of enforcement actions, however well-intentioned, taken at the state and local level.

Moreover, certain cuts of beef and pork require comparatively more labor to process compared to other cuts. These include boneless steaks, which are high value products in high demand. Labor shortages for fabricating these cuts exacerbate the economic impact on beef and cattle prices from plant slowdowns. A slowdown at any point in a beef packing plant creates a bottleneck through the whole plant. As explained previously, meat and poultry companies are utilizing capacity to the best of their abilities with COVID protocol constraints still in place and despite significant labor challenges.

To be clear, labor challenges were not caused by the pandemic; COVID-19 only exacerbated the issue. The meat industry has been facing a labor shortage for some time, and it continues today. Indeed, the pace of Saturday shifts has also strained available labor and adds to processing costs. Recent press stories report the industry's recruitment efforts, including wage increases, signing bonuses, relocation bonuses, retention bonuses and generous benefits. This labor shortage impact is not only on processing lines but also warehouse workers, maintenance positions, and other jobs also critical to maintaining the supply chain.

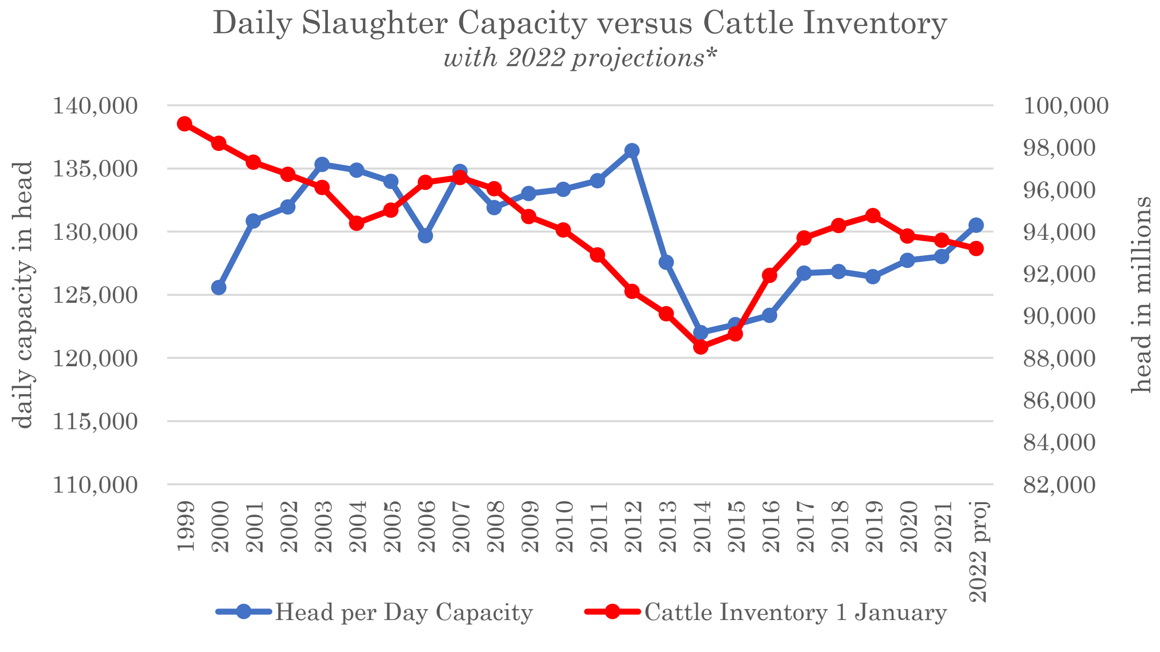
Virtually none of the calls for government intervention into the market acknowledge or address labor availability, even though it is, and is likely to remain, a significant factor that affects utilization of capacity. Packers cannot work through large supplies of market ready cattle when plants are not fully staffed with skilled labor.

The Private Sector is Adding Packing Capacity.

There have been calls for government programs and federal investments in expanded packing capacity. First, demands for more government supported harvest capacity ignore the fundamental issue of finding a sufficient labor pool. Second, adding considerably more capacity simply for the sake of added capacity for a notoriously cyclical cattle supply is short sighted.

The beef and cattle markets are not static, but rather regularly adjust to find balance as the chart below shows. The industry responds to market signals in terms of capacity and the size of the cattle herd. Ultimately beef demand.

Distorting the market through artificial government actions would likely lead to unintended consequences that benefit neither packer nor producer. Beef packing is not a public utility; it is an area best left to the considered judgement of those in the market.



* *publicly announced capacity expansions; cattle inventory implied from USDA May 2021 Livestock Dairy &Poultry Outlook*

Over the past 10 months, in response to market signals, one new plant has opened, and several expansions and new facilities have been announced – including those with investment from cattle producer stakeholders.

2020-2021 Publicly Announced Beef Packing Capacity Expansion							
	Announced						
Packer	**Date**	**Action**	**Capacity** *hd/day*	**State**	**Est Investment**	**Ownership**	**Est on-line**
AgriBeef/ True West	Aug 2020	New Plant	500	ID		Producer	TBD
FPL	Oct 2020	Expansion	500	GA	$120 mln	FPL	Q42021
Iowa Premium/ National Beef	Mar 2021	Expansion	1,250	IA	$100 mln	National Beef	Q42022
Sustainable Beef	Mar 2021	New Plant	1,400	NE	$300 mln	Feeder	TBD
Missouri Prime	Mar 2021	Converted pork plant	500	MO		NexGen, feeders	Mar 2021
JBS	Jun 2021	Expansion	1,050	NE	$150 mln	JBS	Q42021
American Foods Group	Jun 2021	New Plant	TBD	WI		AFG	TBD
TOTAL			5,200 +	***Source***: company press releases and news coverage			

These new entrants or company expansions were based on decisions to build or expand based on market conditions, not because of government intervention. Government interference into the market could well undermine this industry growth.

This market-based expansion of the beef packing industry is what cattle industry analysts have identified and called for in various reports. As a Rabobank analysis stated in September 2020, "An additional daily packing capacity of 5,000 to 6,000 head of fed cattle could restore the historical balance of fed cattle supplies and packing capacity and still allow for positive packer margins."[2]

Second, policy proposals to give preference to smaller, "regional" plants to build "resiliency" into the system are ill-considered. The Rabobank report further stated "While many have discussed the need for more geographically dispersed, smaller plants, adding packing capacity in the name of supply chain resiliency is unlikely to work. It must be driven by long-run economics."[3] Dr. Steve Koontz of Colorado State University expressed similar concerns about building capacity that is not used when not needed but built "just in case."[4]

Small and midsize beef slaughter and processing companies endured the same challenges large companies faced, perhaps more so. Artificially creating more, smaller regional harvest facilities will not prevent future market disruptions nor protect cattle producers from cyclical or volatile markets. The unintended outcome could be the opposite.

Protecting Federal Meat Inspection: The Gold Standard of Food Safety.

Under the guise of "increasing capacity," there are various legislative proposals to allow the shipment of state inspected products across state lines without meeting federal standards, and even allowing uninspected meat from custom processors to be sold commercially intrastate. These ideas are ill-conceived.

Federal inspection is a food safety issue, and food security is not something to be waived for a short run economic inducement. Any company wishing to sell in interstate commerce should be willing and able to meet the food safety and other consumer protection standards set by the Food Safety and Inspection Service (FSIS).

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[2] *The Case for Capacity; Can the US Beef Industry Expand Packing Capacity?* Rabobank, Sept. 2020
[3] *Ibid.*
[4] *Economic Reasons for What was Observed in Fed Cattle and Beef Markets During the Spring of 2020,* Steve Koontz, Department of Agricultural & Resource Economics, Colorado State University, May 28, 2020.

First, these bills ignore the fact that there already exists a program, administered by FSIS, that allows state inspected establishments to ship meat and poultry products across state lines – the Cooperative Interstate Shipment (CIS) program. Nine states have elected to participate in the program, with two of those nine, Iowa and South Dakota, announced during the COVID-19 pandemic. CIS was created by Congress as part of the 2008 Farm Bill and ensures product moving in interstate commerce meets the requisite food safety standards. CIS also ensures level playing for companies that wish to sell in interstate commerce.

Second, assertions that meeting federal standards is too burdensome for small and very small plants is a specious argument. There are approximately 6,000 federally inspected meat and poultry establishments and more than 5,000 of them are small or very small.

Size of Facilities	Number of Federally Inspected Plants
Small (more than 10 but fewer than 500 employees)	2,329
Very Small (fewer than 10 employees or less than $2.5M in annual sales)	2,866

Source: FSIS

Allowing interstate shipment of state inspected meat further opens-up a Pandora's Box of potential trade concerns. Under World Trade Organization (WTO) rules that require "like treatment" the U.S. could be forced to accept imported meat and poultry regulated under local and provincial rules in foreign countries rather than the audited and verified national inspection systems in those countries. Moreover, important export markets, which have their own national inspection systems could deny market access to U.S. beef, pork, and poultry. Neither outcome is good.

Misconceptions and Mistruths about Beef Packing Industry Concentration need Correcting.

Much of the rhetoric about concentration in the beef packing sector wrongly implies that consolidation is on-going and that packers' market power is becoming more and more concentrated. That is not the case. The four-firm packer concentration ratio for fed cattle slaughter has not changed appreciably in more than 25 years. According to the Agricultural Marketing Service's (AMS) Packers and Stockyards Division (P&S), the four firm concentration ratio was 82 percent in 1994; today it is 85 percent.

The meat packing industry has been, and continues to be, one of the most highly scrutinized industries when it comes to antitrust review. P&S is uniquely charged, by statute, to provide on-going oversight for fair business practices and to ensure competitive markets in the livestock, meat, and poultry industries. Additionally, any potential merger or acquisition regulators believe threatens "too much market power" is subject to review by the Justice Department or the Federal Trade Commission. The last proposed merger of two the "big four" fed cattle slaughterers occurred in 2008 – and it was blocked by the Department of Justice.

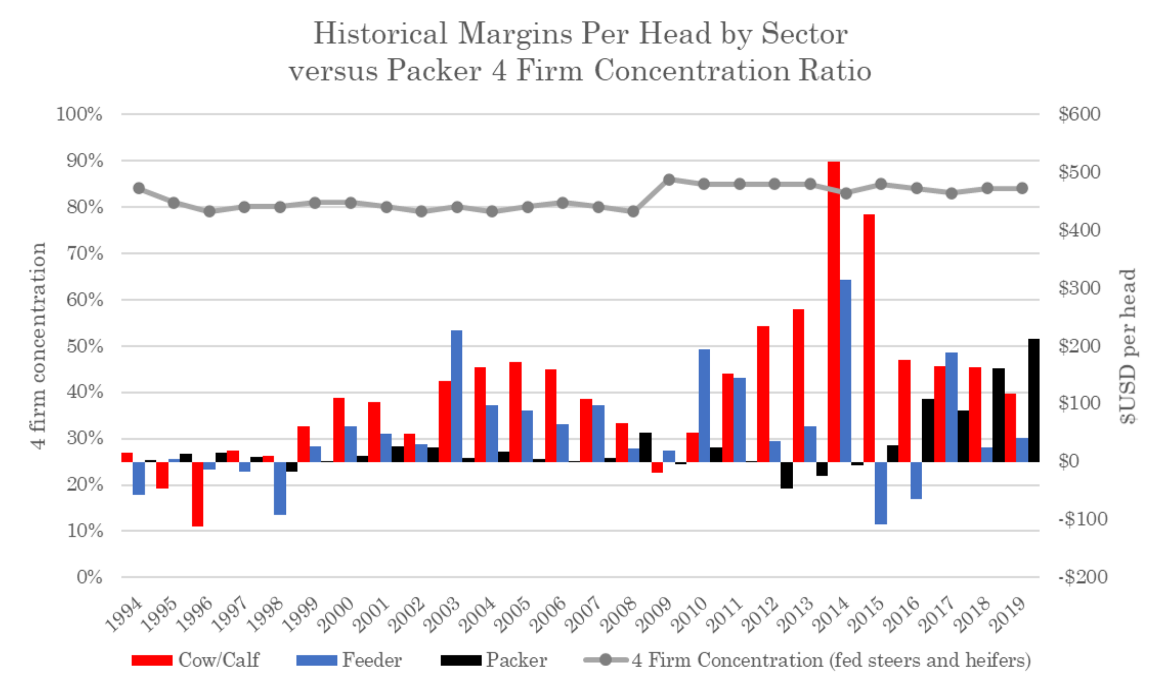
Another clarification is needed. The claim often made is that the big four packers control 85 percent of beef production in the U.S. Again, that is not the case and a misleading exaggeration. Fed cattle make up 79 percent of the total cattle slaughter. Cows and other non-fed cattle, make up the balance, primarily slaughtered to be made into hamburger. The lean meat from these animals is a necessary ingredient to be made into America's supply of hamburger produced in combination with the less demanded muscle cuts from the fed cattle. This distinction is important because up to 50 percent of all beef in the U.S. is consumed as hamburger. Even factoring in the non-fed slaughter plants they own; the four largest beef packers represent about 70 percent of total U.S. beef production.

Critics of the industry frequently mistake individual packing plant size with overall industry concentration. The size and location of plants, however, reflect basic economic factors like the cattle supply and the economics of plant operations. Indeed, the cattle supply itself is concentrated. The farms and ranches that produce about half of all beef cattle in the U.S. are in just seven states. Further, more than 70 percent of all fed cattle are in just five states. Economies of scale drive the capacity and production of a packing plant. That is especially true in areas with large numbers of fed cattle.

Likewise, cow slaughter plants rely on a supply of cull cows from pasture-based cow-calf farms or dairy farms and are structured based on those factors. Each packing plant has its own cost structure. Packers bid on cattle based on the supply and demand factors in their own region. Owning a plant in Texas does not change the bottom-line to a company's operation in Iowa or Colorado.

Finally, given that the structure of the beef packing industry industry is driven by supply and demand factors, the false premise regarding concentration providing undue market power for beef packers must be corrected. The bottom-line is, the current level of four-firm concentration has existed for more than 25 years and it has not ensured packer profitability at the expense of producers.

No sector – cow-calf, feedlot, nor packer – has realized positive margins every year. For example, the four-firm ratio in 2014, when cow-calf and feedlot margins were at record highs, was the same as in 2017 when all three sectors showed positive margins. However, over this 25-year timeline, the cow-calf sector incurred negative margins the fewest number of years of the three as the chart below shows.



Source: USDA Packers and Stockyards Divison (concentration); Sterling Marketing (margin)

Fed Cattle Marketing and Price Discovery.

From ranch to the slaughter plant rail, live cattle typically change ownership two to three times. Cow-calf producers market their cattle to feeders, or to backgrounders who in turn move those cattle to feeders, who then market to packers. The price for cattle at any of those three most common points of transactions is a function of how many cattle are in each respective market segment. In other words, the price is determined by supply of cattle to sell from one segment and the demand to buy cattle by the next segment. That explains why each segment can experience different margins and why there is a futures contract for two types of cattle: feeder cattle and fed cattle. When any of those segments are out of balance, prices move, and that move can be dramatic as the chart above shows.

Considerable attention has been focused on packer margins hitting historic levels after the 2019 fire at the beef packing plant in Holcomb, Kansas (which happened right before Labor Day weekend, a point of high seasonal beef demand) and during COVID. These events put that cattle supply chain temporarily out of balance. In both cases due to a temporary loss of processing capacity, the interrupted demand for cattle led cash market fed cattle prices to fall, while the reduced and uncertain supply of beef led wholesale beef prices to rise dramatically.

In his analysis of the COVID situation, Dr. Koontz wrote,

> *To expect historical relationships between meat price and livestock prices to persist when major facilities in the packing sector are at times closed and in others operating at reduced capacity has no economic foundation.*[5]

Nonetheless, calls for investigations into market transparency, collusion, and the structure of the beef packing industry were made. In August 2019 USDA announced its intent to investigate the economic impact to the cattle market stemming from losing beef processing capacity after the fire at the Holcomb slaughter facility. In April 2020 that investigation was expanded to include the impact of COVID-19 to "determine if there is any evidence of price manipulation, collusion, restrictions of competition or other unfair practices."[6]

In July 2020, USDA's AMS released its Boxed Beef and Fed Cattle Price Spread Investigation Report detailing the agency's investigation into cattle and beef price margins, finding no wrong-doing and confirming the disruption in the beef markets was due to devastating and unprecedented events.

Further, per that report, AMS said "One of the underlying concerns about price discovery is the declining number of participants in the negotiated cash market."[7] Since then, there have been several proposals, including legislation introduced in Congress, to restructure and regulate the cattle market through significant government intervention. Prominent among the proposals is to require cattle feeders to sell cattle to packers, and packers to buy from feeders, a mandatory minimum volume of fed cattle on a cash, spot market basis, or "negotiated" basis to improve price discovery. These proposals threaten the industry with numerous adverse, unintended consequences.

There is robust price discovery in the cattle and beef markets. Congress established and USDA implemented the Livestock Mandatory Reporting Act (LMR) to facilitate open, transparent price discovery and provide all market participants, both large and small, with comparable levels of market information for slaughter cattle and beef, and other species. Under LMR, AMS publishes 24 daily and 20 weekly cattle reports each week. Weekly reports start Monday afternoon and end the next Monday morning. These reports cover time periods, regions, and activities. Data includes actual cattle prices. Slaughter data represents cattle harvested during a specified time period and includes net prices, actual weights, dressing percentages, percent of beef grading Choice, and price ranges.

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[5] Koontz

[6] USDA Statement on Beef Processing Facility in Holcomb, Kansas, August 28, 2019

[7] Boxed Beef and Fed Cattle Price Spread Investigation Report, USDA AMS, July 22, 2020

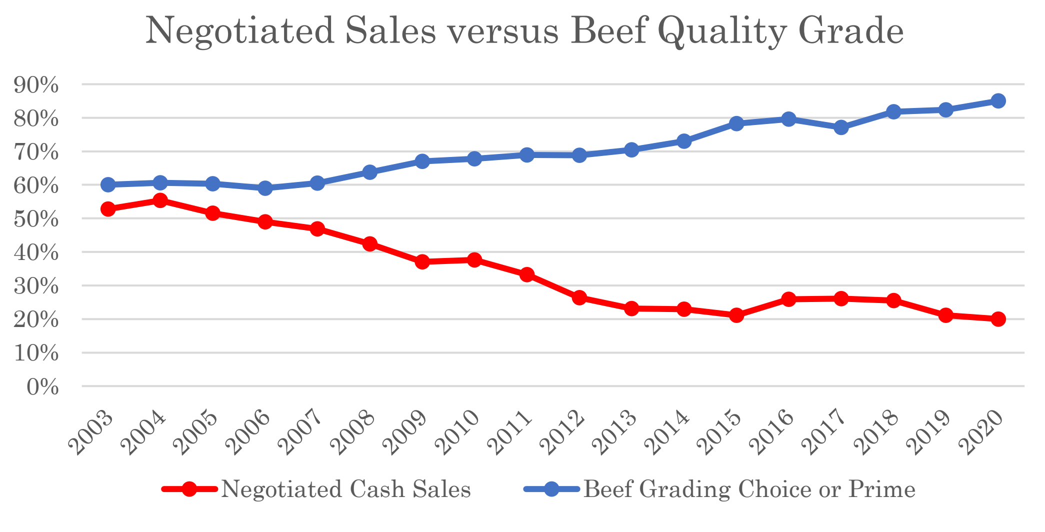
The mandatory volume of negotiated cash sales goes far beyond the purported objective of market transparency and price discovery to regulating terms of sale in a private transaction between producers and packers. It represents the "camel's nose under the tent" for regulating more – or all – terms of sale in the cattle market. That should be concerning to producers given the number of transactions among the segments of the cattle production supply chain described earlier.

Further, many of these proposals would amend the confidentiality provisions in the Agricultural Marketing Act applicable to LMR. The amendment would prohibit USDA from withholding any "information, statistics, and documents." This concept has data privacy implications for both packers and feeders.

By design, such a mandate would limit a producer's ability to use other types of cattle procurement and marketing tools, including forward contracts and various formula-based purchases that comprise the majority of transactions for market-ready cattle. These pricing methods – collectively known as alternative marketing arrangements (AMAs) – combined with the negotiated cash market pricing, have served U.S. cattle producers, the beef industry, and consumers well over the past two decades by:

- Providing producers and cattle feeders with an effective risk management tool;
- Reducing marketing costs for cattle feeders and producers;
- Improving efficiency though the supply chain;
- Improving the quality of U.S. beef;
- Meeting U.S. consumer demand and building trust by incentivizing not only quality, but the safety, sustainability, and consistency of U.S. beef; and
- Enhancing the competitiveness of U.S. beef in global export markets.

Greater utilization of AMAs has coincided with a significant improvement in beef quality. The percent of beef grading at the top two levels, Choice and Prime, has increased from 60 percent in 2000 to 85 percent in 2020.



Source: AMS

There are economic and business reasons why the types of cattle transactions have evolved in the way they have. In its 2018 Report to Congress,[8] AMS said "Stakeholders were in general agreement that formula-based purchases provide greater benefits, in terms of operational efficiency, for both packers and feedlots." Proponents of mandatory negotiated cash sale volumes have not addressed such fundamental questions as which producers would be forced to give up their AMAs, and what effect on beef quality and demand could result.

Analysis of this impact has been done, however. The Research Triangle Institute (RTI) conducted the definitive study about the use of and benefits that flow to all sectors regarding AMAs.[9] For the record, the study was mandated and funded by Congress, published in six volumes, by 30 researchers in four teams, conducting nearly three years of research and was fully peer reviewed. In the executive summary RTI said:

> Many meat packers and livestock producers obtain benefits through the use of AMAs, including management of costs, management of risk (market access and price risk), and assurance of quality and consistency of quality.[10]

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[8] Report to Congress, Livestock Mandatory Reporting, USDA AMS, 2018

[9] See United States Dept. of Agriculture. Grain Inspection, Packers and Stockyard Administration. *GIPSA Livestock and Meat Marketing Study*. Vol. 1. Research Triangle Park: RTI International, 2007

[10] *Id*. at ES-3.

RTI also concluded:

> In aggregate, restrictions on the use of AMAs for sale of livestock to meat packers would have negative economic effects on livestock producers, meat packers, and consumers.[11]

RTI also found, for cattle, that

> Hypothetical reductions in AMAs, as represented by formula arrangements (marketing agreements and forward contracts) and packer ownership, are found to have a negative effect on producer and consumer surplus measures. … Over 10 years, a hypothetical 25% restriction in AMA volumes resulted in a decrease in cumulative present value of surplus of
>
> - 2.67% for feeder cattle producers;
> - 1.35% for fed cattle producers;
> - 0.86% for wholesale beef producers (packers); and
> - 0.83% for beef consumers.

A hypothetical 100% restriction in AMA volumes resulted in a decrease in cumulative present value surplus of

- 15.96% for feeder cattle producers;
- 7.82% for fed cattle producers;
- 5.24% for wholesale beef producers (packers); and
- 4.56% for beef consumers.[12]

Finally, "price discovery" should not be confused with price determination, *i.e.* supply and demand. Typically, when market prices are low or falling, there are increased concerns expressed about "price discovery." There appears to be a widespread perception that a reduction in cash trade is, by definition, bearish. In fact, in times of market disruption, formula and contract pricing can prevent precipitous drops and support quicker recovery. From an economic perspective, bearish cattle prices result from "price determination" factors, such as supply of cattle in each segment of the supply chain and the capacity to process cattle into beef, but also the overall demand for beef and other competing proteins.

Mandating more cash purchases does nothing to remedy bearish price fundamentals. The volume of cash sales is less relevant than is the type and quality characteristics of the cattle sold being representative of the market. Additionally, the types of cattle transactions vary greatly over time, even week to

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[11] *Id.*

[12] *Id.* at ES-8-9.

week. Imposing mandatory minimum volumes creates an incentive to alter transaction types that could result in less price discovery.

Proposed Regulatory Actions by USDA Under the Packers and Stockyards Act will Adversely Affect Producers and Packers.

On June 11 USDA announced it planned to propose rules to "strengthen enforcement" of the Packers and Stockyards Act (PSA).[13] These regulations are problematic for several reasons, including their impact on cattle marketing options described above.

The concepts expressed in the press release and reported in the media are not new and were considered and rejected in the past. When proposed, they will conflict with legal precedent in no less than eight federal appellate circuits, and will hurt livestock producers, packers, and consumers.

USDA plans on re-proposing a rule to clarify that a plaintiff need not demonstrate harm to competition to bring and prevail in Packers and Stockyards Act litigation. Additionally, USDA indicates that it intends to "propose a new rule that will provide greater clarity to strengthen enforcement of unfair and deceptive practices, undue preferences, and unjust prejudices."[14]

It is beyond dispute that eliminating the need for a plaintiff to show harm to competition, or likely harm to competition, will encourage litigation, most of it likely specious litigation. That threat will severely limit or terminate AMAs with all the adverse unintended consequences discussed previously.

Beef Imports and Country of Origin Labeling.

Much like USDA's proposed rules, another issue seemingly settled legally and discredited economically has been revived: mandatory country of origin labeling (COOL). In four rulings, each of which the U.S. lost, the World Trade Organization (WTO) concluded that COOL was discriminatory and illegal under WTO rules, and if left in place would have triggered more than $1 billion in retaliatory tariffs. That is why Congress repealed COOL for beef and pork in 2015. Despite COOL being in place at the time, the largest and fastest growth in beef imports was in 2014 – which was the year the size of the U.S. cattle herd was at its lowest, as would be expected based on supply and demand fundamentals that drive the cattle and beef industry.

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[13] https://www.usda.gov/media/press-releases/2021/06/11/usda-begin-work-strengthen-enforcement-packers-and-stockyards-act
[14] Ibid

When COOL went into effect, per capita consumption of beef in the U.S. was 60.8 pounds; by the time COOL was repealed in 2015 beef consumption per capita had dropped to 53.8 pounds. As explained earlier, up to half of U.S. beef consumption is as hamburger and ground beef. Most of the beef imported into the U.S. is lean, grass fed trim and lower value cuts, which supplements the beef from non-fed cattle making up 21 percent of annual slaughter as a necessary ingredient in into processed meat and ground beef. Because of this balance with imports, steaks, loins and higher value cuts are not forced into such lower value products, which helps support prices both domestically and through exports of U.S. beef. According to the U.S. Meat Export Federation, the per pound price of U.S. beef exports has averaged a 68-cent premium over the price of imports that go into lower value beef products.

Conclusion

The discussion above demonstrates that market fundamentals drive the cattle and beef markets and that what we have seen before and during the course of the pandemic was to be expected. The North American Meat Institute is prepared to discuss these issues and work with the Committee on the issues facing the industry. Thank you for the opportunity to provide this testimony.