

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Negative reaction to GIPSA rule may actually reinforce its justification

The reaction to part of the proposed GIPSA rule that was issued on June 22, 2010 may in itself suggest the need for Section 201.211. This is the section that addresses the issue of packers offering premiums to some producers and not others. The proposed rule is designed to ensure that packers offer the same premiums to all producers who can provide the required volume, kind, and quality of livestock, either individually or collectively.

Participants in some premium programs have argued against the rule fearing that the packers would eliminate the premium programs rather than keeping paperwork that would justify price differentials offered to different producers or sets of producers. As Ken Grecian, President of the Kansas Livestock Association and member of the Board of Directors of the National Cattlemen's Beef Association, has said, "The proposed regulations ultimately may remove from the marketplace products consumers prefer. Producers have responded to consumer demand by finding innovative ways to develop and market premium quality and branded products. Programs like Certified Angus Beef, U.S. Premium Beef, 'naturally raised' and others would be jeopardized."

From an economic perspective, we find Grecian's argument—the rule could result in the elimination of premium programs—interesting. As every student who takes an introductory course in economics learns, in a competitive market one would expect that if a packer eliminated a premium program that was supported by consumer demand, producers would have little to worry about. The reason for this is because they would be justified in anticipating that another packer would be quick to pick up a premium program that would offer them access to an additional market.

The fact that producers are repeating the arguments of the packers that if the rule is implemented they (the packers) may have to eliminate premium programs because of the burden of paperwork or the fear of lawsuits by those who feel they have unjustly been denied a premium suggests that the producers are aware that they are selling into a market that is not competitive.

And, the producers would be correct. In the proposed rule, the USDA describes the packers in the poultry, swine, and livestock markets as having monopsonistic power. That's economic-speak that means

that many producers, instead of having multiple buyers competing for their animals, have only one buyer (or very few buyers in some cases) for their product. As a result, even though the packers may not offer a producer a premium they feel they deserve, the producer is obligated to sell at the offered price, because of lack of alternative buyers. Producers are faced with a take it or leave it deal.

If for no other reason than that, the USDA would be justified in issuing a final rule—including Section 201.211—on economic grounds.

That being said, we seriously doubt that the packers would carry through on their threat to eliminate premium programs if the rule were to be finalized.

To start with, there is only one reason the packers are currently offering various premium programs; they are making more money with these programs that they do with generic meat offerings.

Second, in the course of their business activities, packers already keep records on their transactions and most certainly have documented their rationale for offering higher payments for various premium programs. Therefore the recordkeeping requirements are not likely to incur significant additional costs.

Third, various restaurant chains and grocery retailers have made a significant investment in marketing various premium meat offerings. They have done this because they believe that these products are attractive to their customers and give them an advantage over their competitors. Given this level of commitment, it is likely that the packers would run into significant resistance if they were to try to eliminate the premium programs. Besides that, the retailers have a significant degree of leverage with their suppliers when it comes to the products they make available to the end consumer.

Given all this, could it be that the packers are trying to bluff both the producers and the USDA?

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