

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

A GIPSA study and its analysis

In anticipation of potential Congressional action and the issuance of the GISPA rule by USDA, we have been rereading Informa Economics' "An Estimate of the Economic Impact of GIPSA's Proposed Rules," prepared for the National Meat Association. It can be accessed at: http://www.beefusa.org/uDocs/Gipsa-Report_2010-11-09.pdf. According to Informa's analysis, as a result of the implementation of the proposed GIPSA rule, the annual economic costs for the meat industry will total \$1.6 billion and result in the loss of 22,843 jobs. These numbers are in contrast to the initial estimate by the USDA that the cost of the proposed rule would be negligible.

As in any study of this sort, the results are often determined by the methodology, so particular attention must be paid to the methodology used by Informa in this study. As Informa reports, "Gaining first-hand input from industry stakeholders was considered to be essential for identifying and measuring the financial and business impacts from the proposed GIPSA rules." They said that they interviewed "stakeholders at all levels of each supply chain"—poultry, pork, and beef. They also looked at the costs of implementing the various proposals, conducted a literature review, and engaged in macroeconomic modeling using an input-output model.

From the material presented in the study, it appears that the interviews of stakeholders were concentrated among the large packers and suppliers with little evidence that the concerns of the small producers were taken into consideration. There were no stories of packer interference with growers attempting to watch their chickens being weighed, or the fear of chicken producers to speak out against integrator policies that were so evident at the USDA-Justice Department hearings that were conducted in the summer of 2010.

This study is an analysis of what it would cost the industry if the worst fears of the packers were to come true. These numbers then result in the cost of a worst-case scenario and assume that the packers made no change in their operational model that would respond to the calls for fairness that are embodied in the rules. By examining an analysis that looks at the costs of a worst-case scenario from the perspective of the packers and large feeders, Informa fails to take into account the losses that small producers are incurring under present conditions.

By offering premiums to "favored" feedlot operators on lot size and delivery times and denying these premiums to groups of smaller finishing operations that could band together to meet the same lot size and delivery time, the smaller operations receive a lower

cost for their cattle than do the larger operators. Especially in times when feed costs are rising, these lower costs result in the loss of small finish operations and the costs associated with the end of their enterprises. These smaller operators are driven out of business, not because they are inefficient operators, but because their competition receives a subsidy in the form of premiums that they are denied.

The costs of the unfolding of these smaller operations and the associated job losses that are taking place in the industry are not included in the study. Also not included is the profit these smaller operations would create and the employment they would provide if they were competing with the larger operations on a level playing field.

The industry expressed to Informa the fear that the loss of the use of premiums would result in an unpredictable supply of animals that would then result in an inefficient use of their plants. By making the premiums available to any operator or combination of operators that can meet the lot size, and time of delivery, the implementation of the rules could result in an increase in the stability of supply.

It would appear that all of the losses associated with the loss of lot size and delivery time premiums is premised on the industry eliminating these premiums—a problem the industry could eliminate simply by making the premiums available to all.

Informa spends some time talking about the poultry tournament system and the rationalization for forcing growers to make upgrades to their chicken houses that some growers think are unnecessary. In the end, it seems to us that the legitimate concern of the integrators is in factors like the daily rate-of-gain, feed conversion to pounds of meat, total pounds produced, and animal death rates. That would suggest that growers be paid on the basis of those items and charged for feed use above the average.

Our observation is that under those conditions, farmers will make the changes that will result in higher net income—payment for higher yield minus the cost of improvements. It should matter little to the integrator whether the grower uses an old barn or a new one with all of the latest tunnels and monitors as long as the grower provide healthy animals with a good daily rate-of-gain and total feed conversion rate, and pounds of meat because ultimately what the integrator is selling and profits from is broiler meat and not chicken barns.

Informa asserts that "the most extensive interpretation of the rules could potentially break up a settlement group of 15 or 20 growers into 6 or 7 groups

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with no more than 2 or 3 growers apiece. This would be done to ensure that growers were competing with farmers with similar barns. By looking past barns and paying for healthy animals, good daily rate-of-gain, total feed conversion rate, and meat produced—all farmers have these in common—there is no need to break up tournament groups.

Again with chickens, Informa writes, “interviews with chicken dealers revealed an incredible amount of concern...if discounts to the base pay were no longer allowed, it would have the effect of lowering the base pay for everyone and severely restricting their ability to give premiums to new growers...to help them as they make significant capital investments.”

This makes little sense from an economic perspective. In a true competitive market—like a functioning auction market—the amount paid for a pound of product is the cost of bringing online the last unit of production. If demand is up and it costs more to bring additional production to the market then all growers ought to benefit for that increase in demand instead of

being asked to accept a “lowering of base pay” so that the integrator can “give premiums to new growers.”

The integrators enjoy a monopsonistic market structure. Typically the growers, though they own the buildings, have only one integrator that will buy their chickens. The growers form what is called a captive supply and are at the mercy of the integrator.

There will be economic winners and losers if the GIPSA rules are placed into effect—that is to be expected. It’s the justification of continued use of practices that result in unequal treatment of some participants because the elimination of these practices would cause economic costs by participants who have greater economic and political power that seems illogical and counter to the purpose of rules.

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