Analysis of USDA's Boxed Beef and Fed Cattle Price Spread Investigation Report

The US Department of Agriculture's (USDA) Agricultural Marketing Service issued its Boxed Beef and Fed Cattle Price Spread Investigation Report detailing the agency's investigation into cattle and beef price margins.

In August 2019 USDA announced its intent to investigate the economic impact to the cattle market stemming from the loss of beef processing capacity after the fire at the Holcomb, Kansas, slaughter facility. In April of this year, USDA expanded the scope of that investigation to include the impact of the COVID19-related industry-wide plant slowdowns. According to a statement from Secretary of Agriculture Sonny Perdue, the inquiry was to

> *determine if there is any evidence of price manipulation, collusion, restrictions of competition or other unfair practices. If any unfair practices are detected, we will take quick enforcement action*.

However, the final report, clarifies that it "does not examine potential violations of the Packers and Stockyards Act."

Background

The fire that idled the Holcomb slaughter plant was a major disruption to both cattle and beef markets. There were a number of contributing factors that catalyzed the impact, including the concentration of fed cattle in Kansas, which on 1 August stood at about 21 percent of all cattle on feed in the country and 105 percent of the year before. Nationwide, for more than 30 consecutive months, the number of cattle in feedyards was larger than the same month in the previous year. The inventory of cattle was the highest for August since records were kept starting in 1996.

Adjusting for this loss of slaughter capacity resulted in increased through put in other plants and the related economic consequences of transporting cattle and adding shifts and labor. Additionally, this interruption came approximately one month before the high beef demand Labor Day holiday and the uncertainty the fire caused regarding supply affected wholesale beef prices as retailers secured supplies of beef. However, the packing sector was able to work through the situation and slaughter recovered, with more cattle harvested weekly within weeks after the fire than before.

The COVID19 pandemic has been an unprecedented disruption to all sectors of the U.S. and global economy and it was particularly detrimental to the livestock and meat packing sectors. As the American Farm Bureau Federation noted,

> *labor shortages and worker protection measures slowed throughput at plants around the country and even caused some facilities to shut down.*

During April and May of this year cattle slaughter dropped by about one-third from early 2020 levels and to 35 percent of 2019 levels. This situation unfolded going into the traditional seasonally high demand period for beef that starts with the Memorial Day holiday, which compounded the disruptions to normal marketing patterns for cattle and beef. Coupled with consumers' freezer stocking and panic buying, unprecedented spikes in retail demand for beef pushed wholesale prices to historic records, all while packing plants were forced to work at less than optimal efficiency.

Although cattle slaughter has resumed to near normal levels for this time of year, new worker health and safety protocols, plant layout, and other preventive procedures put in place by the industry are a limiting factor for near term production expansion, even as there remains a large number of unharvested cattle resulting from this production bottleneck.

In both the Holcomb plant fire and COVID impact instances, 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.

Much attention has been paid to the increase in apparent gross margins for beef packers, which was the impetus of the USDA investigation. However, this spread is a metric of just two factors, live cattle prices and wholesale beef prices. It does not reflect all costs incurred in harvesting and processing cattle into beef. The cattle-to-beef margin excludes other operating costs, such as labor costs. Because of the impact of COVID, including procuring personal protective equipment, redesigning plant operations, and other necessary adjustments, labor and other operating costs increased.

More importantly, the cattle-to-beef margin does not reflect fixed costs. Fixed costs constitute the largest percentage of overhead for meat packers. Overall, per head margins on processing cattle rise dramatically as slaughter throughput is decreased. Fixed costs must be spread out across the volume of cattle processed. Reducing the number of cattle processed by up to one-third, or idling a plant for several days, adds significantly to the per head cost of slaughter and processing.

What Other Studies Have Concluded

In an analysis of the current COVID situation, Dr. Stephen Koontz of the Department of Agricultural and Resource Economics at Colorado State University 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.*

The Koontz paper also says:

> *What began in the U.S. as novel coronavirus (COVID-19) demand disruptions turned into the worst-case scenario by the emergence of huge supply chain constraints.*
>
> *If packers cannot run or cannot run at typical throughput levels – especially if animal supplies are abundant – then the marginal value of that last group of animals is that is not sold is close to zero.*

Koontz further illustrates the economic forces at work in another commodity sector:

> *At one point, the futures price for oil during the delivery month was negative – as in less than zero. That was a more than a 100% decline in price. This was a unique and singular event, but the economics are clear ….*

Drs. Glynn Tonsor of Kansas State University and Lee Schulz of Iowa State University in a paper titled COVID-19 Impacts on the Meat Processing Sector observe:

> *The disruptions presented by COVD-19 to-date have been truly historic and never experienced by most involved. These disruptions occurred globally as multiple countries have been similarly challenged in harvesting animals and sustaining pre-COVID-19 desired meat production volumes.*

> *Given the global nature of the pandemic, it is our opinion that the meat processing sector's ability to adapt and begin the process of recovery has been remarkable*.

As for long term policy reactions to this temporary situation, Tonsor and Schulz write:

> *The calculus involved in making such changes is complicated, and care should be taken to appreciate the economic forces driving the industry's development to date. In each case, we encourage these and other possible adjustments to reflect sound research-based information to guide final decisions.*

USDA Policy Suggestions

While making no conclusions or examinations about the "evidence of price manipulation, collusion, restrictions of competition or other unfair practices*"* the report does include a number of suggested policy considerations unrelated to the Holcomb fire and the COVID pandemic. As stated by AMS, "the preceding summary of market conditions is only one component of a larger discussion within the cattle, beef, and related industries …."

Per the report

> *At the core of many of these discussions is the desire by many market participants for improved price discovery, reinvigorated competition, and a more transparent relationship between the prices for live cattle and the resulting products*

Price Reporting and Transparency

USDA notes, "One of the underlying concerns about price discovery is the declining number of participants in the negotiated cash market."

Typically, when market prices are low or falling, there are increased concerns expressed about "price discovery." Moreover, there is 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 usually result from "price determination" factors, such as supply of cattle, the capacity to process cattle, the overall demand for beef and other proteins as well as other market fundamentals. This was the case during the market conditions that existed after the Holcomb fire and are ongoing with the COVID pandemic.

The report argues that the statutory confidentiality requirements under the Livestock Mandatory Reporting (LMR) limits the agency's ability to report information to the market in some circumstances and some regions. The report further states, a "reduction in non-reporting will provide improved price discovery" but makes the illogical leap to increase reporting by regulating purchase transactions.

AMS suggests linking its LMR reporting abilities to "minimum purchase thresholds" for cash transactions - despite packers already complying with the requirements to submit data on both a company and plant basis, broken down by purchase type. The report suggests "proper legislative authority" to

> *track and inform packers of the requirement to make an additional percentage of (cash basis purchases) in the following week to allow for reporting.*

Such a policy change would go far beyond the intended objective of market transparency and price discovery to regulating how packers procure cattle and how producers and feeder market cattle. Moreover, this proposal would do nothing to remedy the situation USDA was investigating after the Holcomb fire or during the COVID pandemic. Mandating more cash purchases does nothing to remedy interrupted slaughter capacity which in turn reduced the overall volume of cattle purchased.

Packers and Stockyards Act Updates and Enforcements

The report further states

> *Interested stakeholders and legislators may also consider targeted amendments to the P&S Act that would provide USDA with investigative and enforcement tools on par with those of our Federal partners. For example, the ability to issue Civil Investigative Demands ("CIDs") with respect to unfair or deceptive acts or practices would bring USDA's authorities in line with those of the Federal Trade Commission (FTC) and DOJ*

This proposal is a wholly unnecessary and duplicative expansion of authority. The Packers and Stockyards Division (PSD), which is part of AMS' Fair Trade Practices Program (FTPP), has the authority to monitor industry activities and conduct regulatory compliance reviews and investigations. It may do so administratively or through the courts and regularly pursues punitive actions and remedies independently and in coordination with the Department of Justice (DOJ) and Federal Trade Commission (FTC).

Moving Forward

USDA's report describes in significant detail two consecutive unprecedented disruptive "Black Swan" events in the cattle and beef markets, yet offers a number of policy suggestions that would not have led to any different outcomes nor provide assurances for potential future unforeseen events.

As Tonsor and Schulz correctly advise

> *Ultimately a careful balance must be struck between efficiency in desired protein production during "normal times" with increased system resiliency during pandemics and other possible major disruptions.*

Cattle producers, packers, and policy makers need to work together to address the issues at hand.