



United States  
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Grain Inspection,  
Packers and  
Stockyards  
Administration



2004 Report

# Assessment of the Cattle, Hog, and Poultry Industries

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2004 Report

United States Department of Agriculture  
Grain Inspection, Packers and Stockyards Administration

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## **List of Acronyms and Abbreviations**

AMS	Agricultural Marketing Service
APHIS	Animal and Plant Health Inspection Service
ASTM	ASTM International
BSE	Bovine Spongiform Encephalopathy
cwt	Hundredweight (100 pounds)
ERS	Economic Research Service
FSIS	Food Safety and Inspection Service
GIPSA	Grain Inspection, Packers and Stockyards Administration
HACCP	Hazard Analysis and Critical Control Point
HPAI	Highly Pathogenic Avian Influenza
HHI	Herfindahl-Hirschman Index
LPAI	Low Pathogenic Avian Influenza
NA	Not Available
NAIS	National Animal Identification System
NASS	National Agricultural Statistics Service
NIST	National Institute of Standards and Technology
P&S Act	Packers and Stockyards Act
P&SP	Packers and Stockyards Programs
SRM	Specified Risk Material
U.S.	United States
USDA	United States Department of Agriculture
VMO	Veterinary Medical Officer

## Executive Summary

This report has been prepared in response to a requirement in the Grain Standards and Warehouse Improvement Act of 2000 (Pub. L. No. 106-472), enacted on November 9, 2000. Specifically, the Grain Standards and Warehouse Improvement Act of 2000 states:

[n]ot later than March 1 of each year, the Secretary [of Agriculture] shall submit to Congress and make publicly available a report that—

- (1) assesses the general economic state of the cattle and hog industries;
- (2) describes the changing business practices in those industries; and
- (3) identifies market operations or activities in those industries that appear to raise concerns under this [Packers and Stockyards] Act.

The Secretary of Agriculture is responsible for administering the Packers and Stockyards Act (P&S Act) and delegated that responsibility, through the Under Secretary for Marketing and Regulatory Programs, to the Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA). The Packers and Stockyards Programs (P&SP), part of GIPSA, administers and enforces the P&S Act and monitors competitive, financial, and trade practices in the livestock, meatpacking, and poultry industries.

This is GIPSA's fourth report to Congress on the general economic state of the cattle and hog industries, changing business practices in those industries, and activities that appear to raise concerns under the Packers and Stockyards Act (P&S Act). This is the second report to include the poultry industry. This report also includes responses by the Packers and Stockyards Programs to apparent concerns under the P&S Act. The report covers events and data available as of September 30, 2004, the close of the Government's fiscal year (FY).<sup>1</sup>

In FY 2004, prices reached record levels in the cattle, hog, and poultry industries in the United States (U.S.). Meat demand remained strong despite food safety concerns brought on by a positive case of bovine spongiform encephalopathy (BSE) and the onset of both low pathogenic avian influenza and highly pathogenic avian influenza in the U.S. The hog industry, however, did not experience any industry-wide food safety concerns. Citing food safety concerns, numerous countries placed import restrictions on U.S. beef and poultry. While U.S. producers experienced weaker beef and poultry exports with the closing of major international markets, pork exports were strong.

FY 2004 was characterized by changing business practices in the cattle, hog, and poultry industries. In the cattle industry, industry participants throughout the supply chain modified their business practices in reaction to the BSE event and ensuing regulatory requirements. In the hog industry, the changing business practices relate to genetic coordination, risk protection programs, and changes in live hog trade with Canada. In the poultry industry, live poultry dealers and contract and independent growers also modified their business practices.

The report identifies some of the market operations or activities that appear to raise concerns under the P&S Act, including adequacy of bonding formulas for regulated entities; industry reaction to BSE; captive supply; Check Clearing for the 21<sup>st</sup> Century Act; poultry contract terms; formula pricing; joint livestock purchasing; and livestock, meat, and poultry electronic evaluation devices. The report identifies the applicability of the P&S Act to these concerns and GIPSA's planned response.

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<sup>1</sup> Fiscal Year 2004: October 1, 2003 – September 30, 2004

## Section 1: Cattle Industry

### General Economic State of the Cattle Industry

U.S. cattle demand was strong relative to supply, driving feeder calf and fed cattle prices to record levels in the fall of 2003.<sup>2</sup> On December 23, 2003, the discovery of a cow positively identified as having bovine spongiform encephalopathy (BSE) in the State of Washington was announced. The Chicago Mercantile Exchange took emergency action to expand daily trading limits in order to allow for liquidation of open positions in December live cattle contracts.<sup>3</sup> Some international trading partners immediately imposed bans on U.S. beef and live cattle.<sup>4</sup>

In 2003, the U.S. exported 2.8 billion pounds of beef and variety meats worth \$3.86 billion.<sup>5</sup> In 2003, U.S. beef exports of all beef (including live cattle) and beef by-products were worth just under \$6 billion.<sup>6</sup> Trade restrictions caused U.S. beef exports to decrease in 2004. Following the BSE announcement, several countries including Japan, Mexico, and Canada restricted the importation of U.S. cattle and beef products. By June 2004, the U.S. had exported just 11 percent of the 2003 year to date quantity of beef and veal products, and only 30 percent of the 2003 quantity of beef variety meats.

Leading up to the BSE event, cow-calf operations benefited from high feeder calf prices in the last quarter of 2003. In the 4<sup>th</sup> quarter of 2003, the average cash feeder calf price for Oklahoma City 600-650 pound steers was \$103.85 per cwt compared to \$84.41 per cwt in 2002.<sup>7</sup> After a brief drop in January 2004, following the BSE event, feeder cattle futures prices regained and then maintained their high levels, with nearby futures prices around \$100 per cwt in May 2004, and climbing above \$110 per cwt in August 2004, enticing some producers to sell calves at lighter weights.

The record-high prices also acted to move fed cattle at lighter weights from feedlots to slaughter. Fed cattle were slaughtered at lower average weights during late 2003 and the first half of 2004. In October 2003, the average carcass weight of slaughter steers was 807 pounds, 35 pounds lighter than in October 2002.<sup>8</sup> In September and October 2003, 44 percent of the total loads of Choice and Select cuts graded Choice, compared to 54 percent in 2002, and 50 percent in 2001.<sup>9</sup> The five-area weighted average direct slaughter steer price averaged \$83 per cwt for the first 4 months of 2004 and \$86 per cwt from May to August.<sup>10</sup> Breakeven prices for fed cattle were high at approximately \$90 per cwt in August 2004.<sup>11</sup> In March 2004, the weight was 780 pounds, 12 pounds lighter than in 2003 and 26 pounds lighter than in 2002. Towards the end of the summer, the Choice-Select spread began to narrow and the weekly average Choice-Select spread was \$6.07 per cwt in August 2004.<sup>12</sup>

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<sup>2</sup> "Amazing Market Makes Historic Highs," *Cattle Buyers Weekly*, September 15, 2003; "Better Demand Adds Huge Amount of Value." *Cattle Buyers Weekly*, September 8, 2003.

<sup>3</sup> "Chicago Mercantile Exchange Accelerates Expanded Daily Price Limit Schedule in Cattle Contracts." Chicago Mercantile Exchange, News Releases, December 24, 2003, [www.cme.com](http://www.cme.com).

<sup>4</sup> [http://www.aphis.usda.gov/lpa/issues/bse/trade/bse\\_trade\\_ban\\_status.html](http://www.aphis.usda.gov/lpa/issues/bse/trade/bse_trade_ban_status.html)

<sup>5</sup> *Ibid.*

<sup>6</sup> U.S. Meat Export Federation, *Total U.S. Beef Exports*, 1994-2003.

<sup>7</sup> USDA, ERS, *Red Meat Yearbook*, Livestock Prices, 1970-2003.

<sup>8</sup> USDA, AMS, Market News, *Meat Production and Actual Liveweight and Dressed Weight*, WA\_LS711.

<sup>9</sup> USDA, AMS, Market News, *National Weekly Boxed Beef Cutout and Boxed Beef Cuts*, LM\_XB459.

<sup>10</sup> USDA, AMS, Market News, *5 Area Weekly Weighted Average Direct Slaughter Cattle*, LM\_CT150. The five areas are Texas/Oklahoma/New Mexico, Nebraska, Kansas, Colorado, and Iowa/Minnesota.

<sup>11</sup> USDA, ERS, *Livestock, Dairy, & Poultry Outlook*, LDP-M122, August 18, 2004.

<sup>12</sup> *Ibid.*

## Acquisition and Concentration

In 2004, a private equity firm, Hicks, Muse, Tate & Fuse Inc., exercised its option to buy ConAgra Foods Inc.'s minority stake in Swift Foods. Swift was created in 2002, when Omaha-based ConAgra sold a controlling stake in its fresh beef and pork operations to a group led by Hicks. This was the only major acquisition that took place in the cattle industry during FY 2004.

Concentration of the top four-firm steer and heifer slaughterers increased from 1980 to 2000; however, over the last several years it has remained stable, fluctuating between 79 and 82 percent (table 1). The U.S. Department of Justice and the U.S. Federal Trade Commission consider markets with Herfindahl-Hirschman Index (HHI) values below 1,000 to be unconcentrated, and markets with HHI values over 1,800 to be highly concentrated.<sup>13</sup> The HHI value in 1995, for all reporting packers, was 2,036 and declined to 1,842 in 2002, the most current information available (table 1).

Table 1.—Concentration of the top four-firm steer and heifer slaughterers and HHI for all reporting packers<sup>1</sup>

	1980	1985	1990	1995	2000	2001	2002	2003
Four-firm								
Concentration (percent) <sup>2</sup>	35.7	50.2	71.6	80.8	81.4	80.4	79.2	80.3
HHI <sup>3</sup>	561	999	1,661	2,036	1,939	1,909	1,842	NA

<sup>1</sup> Data for 1980, 1985, and 1990 are based on firms' fiscal years as reported to P&SP. Data for 1995–2003 are based on calendar year for federally inspected slaughter.

<sup>2</sup> Percentage of total commercial slaughter accounted for by the four largest firms.

<sup>3</sup> HHI (Herfindahl-Hirschman Index) equals the sum of each firm's squared percentage share of total commercial slaughter.

## Changing Business Practices in the Cattle Industry

### Changing Business Practices as a Result of BSE

The BSE discovery led to many changes in business practices in the cattle industry. Many of the changes were results of actions taken by the industry to comply with policies published by USDA's Food Safety and Inspection Service (FSIS).

### Distinguishing Cattle 30 Months of Age and Older

The FSIS notice, "Interim Guidance for Non-Ambulatory Disabled Cattle and Age Determination" (FSIS Notice 5-04), provides veterinary medical officers (VMO) guidance on distinguishing cattle 30 months of age and older from younger cattle. VMOs are to use records to determine cattle age or if the VMOs find significant reason to question the validity of the records, they are to verify age through dental examination (dentition).

P&SP observed packers utilizing dentition to determine the age of cattle. Packers initiated training programs and hired additional personnel to perform dentition. Packers have procedures in place so that in the event dentition determines the cattle to be over 30 months of age, the carcass can be identified for special handling on the kill floor and segregated in the cooler.

<sup>13</sup> "Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines." Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, [http://www.usdoj.gov/atr/public/guidelines/horiz\\_book/15.html](http://www.usdoj.gov/atr/public/guidelines/horiz_book/15.html), April 2, 1992 (as amended April 8, 1997).

P&SP verified that some packers are discounting the price paid for cattle determined to be 30 months of age or older. A packer also reported the loss of a contract to deliver hamburger since the packer could not verify that the entire product came from animals younger than 30 months of age.

### **Non-Ambulatory Disabled Cattle**

FSIS issued a regulation that defined “downers” as non-ambulatory disabled livestock; these livestock, including cattle, cannot rise from a recumbent position or cannot walk, and include, but are not limited to, those with broken appendages, severed tendons or ligaments, nerve paralysis, fractured vertebral column or metabolic conditions. This regulation requires that non-ambulatory disabled cattle be condemned. Consequently, these cattle cannot enter the slaughter establishment.<sup>14</sup>

Prior to the discovery of BSE in the U.S., some packers’ primary business was the slaughter of non-ambulatory cattle. Non-ambulatory cattle are often healthy animals, just injured. These packers reported to P&SP that their slaughter numbers have significantly declined; they have had to reduce their employee numbers and are considering shutting down operations. P&SP found that a few packers who formerly processed non-ambulatory cattle have changed the species or the class of livestock that they slaughter.

Most auction markets are no longer allowing the unloading or consignment of non-ambulatory cattle. Some dealers report that they have discontinued buying slow or weak cattle for fear that these cattle may result in non-ambulatory cattle.

### **Removal of Specified Risk Material**

FSIS Notice 9-04, “Verification Instructions for the Interim Final Rule Regarding Specified Risk Materials (SRM) in Cattle”, provides VMOs with the methodology to use when verifying that an establishment has properly designed procedures to meet requirements for the removal, segregation, and disposition of SRM.<sup>15</sup> In BSE-infected cattle, specified risk materials may contain the agent that may transmit the disease. Often, in diseased animals, the infective agent is concentrated in tissues identified as SRM. Also, this FSIS Notice provides inspection program personnel with instructions for verifying that an establishment is executing its programs so that there is proper removal, segregation, and disposal of SRM. SRM are defined as:

“(1) the brain, skull, eyes, trigeminal ganglia, spinal cord, vertebral column (excluding the vertebrae of the tail, the transverse processes of the thoracic and lumbar vertebrae, and the wings of the sacrum), and dorsal root ganglia (DRG) of cattle 30 months of age and older, and

(2) the tonsils and the distal ileum (for which removal of the distal ileum must be achieved by disposing of the entire small intestine) of all cattle.”

Along with the additional processes of age identification and SRM removal, P&SP witnessed a reduction in chain speeds in plants to accommodate the additional processes. Many packers are reporting to P&SP that the SRM removal policy has led to an increase in rendering fees due to the increased volume of inedible product. Some packers who previously harvested SRM for sale from animals over 30 months of age stated that they will no longer harvest the materials from any animals because it is not cost effective to separate the SRM from cattle over and under 30 months of age.

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<sup>14</sup> USDA, FSIS, <http://www.fsis.usda.gov/Frame/FrameRedirect.asp?main=http://www.fsis.usda.gov/OPPDE/rdad/FSISNotices/5-04.htm>

<sup>15</sup> USDA, FSIS, <http://www.fsis.usda.gov/Frame/FrameRedirect.asp?main=http://www.fsis.usda.gov/OPPDE/rdad/FSISNotices/9-04.htm>

## Natural Beef

Natural is defined by FSIS as follows: “A product containing no artificial ingredient or added color and is only minimally processed (a process which does not fundamentally alter the raw product) may be labeled as natural.” Natural Beef is often advertised as containing no hormones or antibiotics.<sup>16</sup> Natural Beef packers are reporting an increase in business as a result of the discovery of BSE. One packer publicly announced that it is increasing the premium offered for natural cattle from \$5 per cwt to \$10 per cwt. The premium is available for all “natural” cattle finished in its licensed feedlots.<sup>17</sup>

In conclusion, the BSE discovery set in motion many changes in business practices throughout the cattle industry. Meat demand remained strong despite food safety concerns brought on by the BSE discovery.

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<sup>16</sup> USDA, FSIS, Meat and Poultry Labeling Terms, [www.fsis.usda.gov/oa/pubs/lablterm.htm](http://www.fsis.usda.gov/oa/pubs/lablterm.htm). FSIS defines “no hormones” in beef products as, “The term *“no hormones administered”* may be approved for use on the label of beef products if sufficient documentation is provided to the Agency by the producer showing no hormones have been used in raising the animals” and the term “no antibiotics” in red meat and poultry as, “The terms “no antibiotics added” may be used on labels for meat or poultry products if sufficient documentation is provided by the producer to the Agency demonstrating that the animals were raised without antibiotics.”

<sup>17</sup> Drovers Alert: CAB Natural packer raises premiums, July 27, 2004.

## Section 2: Hog Industry

### General Economic State of the Hog Industry

Prices received by hog producers increased in the fall of 2003 and continued to increase through the spring of 2004. The United States average 51-52 percent lean equivalent carcass base price averaged \$49 per cwt<sup>18</sup> during the October through December period. By early February, the market surpassed \$60 per cwt and by May approached \$80 per cwt before stabilizing in the upper \$70's per cwt through July and most of August 2004.

While domestic retail pork prices remained similar to 2003,<sup>19</sup> wholesale cutout prices and market hog prices achieved gains in spite of weekly hog slaughter and pork production running 3 to 4 percent ahead of the previous year.<sup>20</sup> Higher prices also returned profitability to hog production. Estimates show positive returns to farrow-finish producers beginning in February 2004, after showing losses on hogs marketed in 20 of the previous 24 months.<sup>21</sup>

Total exports grew at an annual average rate of 11.6 percent between 2000 and 2003. During the first months of 2004, pork exports were up 26 percent from the same period the year before. Mexico emerged as the leading growth market in late 2003. From September 2003 to July 2004, exports to Mexico grew 65 percent over the same period the year before.<sup>22</sup>

Early in 2004, USDA National Agricultural Statistics Service (NASS) surveys reported renewed breeding herd liquidation, yet modest growth in the market hog inventory.<sup>23</sup> In December 2003, the breeding herd inventory was down 1.5 percent and the market hog inventory up 1.7 percent. The March and June 2004 inventory surveys both reported the rate of breeding herd liquidation remaining in the 1.5 to 2.0 percent range and the market hog inventory up 2.4 and 1.1 percent, respectively. The September 2004 quarterly survey, however, offered evidence that the industry may finally be expanding. The September 1 breeding herd inventory rose 1.1 percent while the market hog inventory grew 0.9 percent.<sup>24</sup>

### Acquisition and Concentration

In 2003, Smithfield Foods, Inc. (Smithfield) acquired Farmland Foods, Inc., raising Smithfield's slaughter capacity to more than 100,000 hogs per day. The acquisition, valued at \$480 million, increased Smithfield's market share to 27 percent, rivaling Tyson Foods, Inc., market share of 18 percent.<sup>25</sup>

Concentration of the top four-firm hog slaughterers increased by 9.1 percent, from 55.4 percent in 2002 to 64.5 percent in 2003. The HHI value, for all reporting packers, increased from 436 in 1980 to 1,033 in 2000, however, the HHI value decreased from 1,035 in 2001 to 1,005 in 2002, the most current information available (table 2).

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<sup>18</sup> USDA, AMS, *National Direct Lean Hog Prices, Prior Day Slaughter National.xls*, LM\_HG201.

<sup>19</sup> USDA, ERS, *Retail Meat Scanner Prices*. <http://www.ers.usda.gov/Data/Meatscanner/>.

<sup>20</sup> USDA, AMS, *Livestock Meat & Wool Summary Statistics*, various issues, 2004.

<sup>21</sup> Lawrence, John. Estimated Returns for Farrowing and Finishing Hogs or Producing Feeder Pigs in Iowa, Addendum to M-1284b Cooperative Extension Service, Iowa State University.

<sup>22</sup> USDA, ERS, *Monthly US Meat and Livestock Trade*, <http://www.ers.usda.gov/Briefing/AnimalProducts/Data/MonthlyLivestockTable.xls>.

<sup>23</sup> USDA, NASS, *Quarterly Hogs and Pigs Report*, September 2003, December 2003, March 2004, and June 2004.

<sup>24</sup> USDA, NASS, *Quarterly Hogs and Pigs Report*, September 2004.

<sup>25</sup> Cattle Buyers Weekly: Marketing and Business News for the Beef Industry, 2003.

Table 2.—Concentration of the top four-firm hog slaughterers and HHI for all reporting packers<sup>1</sup>

	1980	1985	1990	1995	2000	2001	2002	2003
Four-firm								
Concentration (percent) <sup>2</sup>	33.6	32.2	40.3	45.7	56.4	56.7	55.4	64.5
HHI <sup>3</sup>	436	456	593	769	1,033	1,035	1,005	NA

<sup>1</sup> Data for 1980, 1985, and 1990 are based on firms' fiscal years as reported to P&SP. Data for 1995–2003 are based on calendar year for federally inspected slaughter.

<sup>2</sup> Percentage of total commercial slaughter accounted for by the four largest firms.

<sup>3</sup> HHI (Herfindahl-Hirschman Index) equals the sum of each firm's squared percentage share of total commercial slaughter.

## Changing Business Practices in the Hog Industry

### Genetic Coordination

In FY 2004, hog packers continued to work with genetic breeding companies to ensure product traceability and to better meet consumer preferences. By aligning with a genetic company, a hog packer can control development of a high-quality consistent product. Access to particular genetic lines provides a packer with the ability to introduce branded products. For decades, individual ear tags, skin tattoos, ear notching, and other individual identifying markers have been used as a means of traceability; however, no generally accepted method of unique identification of each individual animal from farm to retail has been adopted. Hog packers stated that aligning with genetic firms improves the potential for traceability and provides them the ability to produce high-quality pork products that meet the highest standard for food safety.

### Risk Protection Programs

Some pork packers have begun offering their own risk protection programs to livestock producers instead of relying on private insurance companies to provide coverage. Generally, coverage offered by packers is for animals which die in transit. Not included in the coverage is loss due to mishandling and trucker negligence.

### Canada and Live Hog Trade

Imports partially offset the downward trend in the U.S. breeding herd inventory. Since 1994, Canada's breeding herd has grown an average of 3.6 percent per year and has not posted a back-to-back yearly decline since 1996.<sup>26</sup> Canada's pig crop has grown at a rate considerably faster than its breeding herd, posting a 6.0 percent average growth rate.<sup>27</sup>

With the growth in the breeding herd inventory, Canada has become a major source of feeder pigs for the Eastern and Western Corn Belt regions of the U.S. In 2000, feeder pig imports averaged 44,000 head per week to the Eastern and Western Corn Belt Regions.<sup>28</sup> By 2003, the figure had climbed to 93,000 head per week, an average growth rate of 29 percent per year.<sup>29</sup> From January through September 2004 imports were up 19 percent from the same period last year.<sup>30</sup>

In conclusion, in FY 2004 prices reached record levels in the hog industry. The hog industry, however, did not experience any industry-wide food safety concerns.

<sup>26</sup> Statistics Canada, *Hog Statistics*, <http://www.statcan.ca:8096/bsolc/english/bsolc?catno=23-010-X>.

<sup>27</sup> Ibid.

<sup>28</sup> USDA, APHIS, *Canadian Live Animal Imports into US by Destination*, WA\_LS637.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

## Section 3: Poultry Industry

### General Economic State of the Poultry Industry

Broiler prices increased throughout FY 2004, reaching a peak by midyear. Retail prices increased throughout the year, the retail broiler composite price in September was \$1.67 per pound.<sup>31</sup> In September, prices for whole birds were higher than the previous year, but prices for boneless/skinless breasts dropped and in August averaged less than the previous year.

Turkey prices declined during the first part of 2004, but during the second half turned around and increased to reach levels 10 to 15 percent higher than 2003. Stronger prices can be explained, in part, by strong domestic demand and restraints in the number of placements of chicks (young broilers) and poults (young turkeys).<sup>32</sup>

The United States is the world's largest exporter of broilers.<sup>33</sup> In 2003, U.S. broiler exports totaled 4.93 billion pounds (15 percent of total U.S. production), valued at \$1.5 billion. Demand for U.S. broiler products fluctuated over the last several years due to changing economic conditions and currency exchange rates in other major exporting countries. Poultry exports decreased by nearly 14 percent in 2004 compared to the previous year. In FY 2004, key U.S. export markets closed, primarily Asian, due to the discovery of avian influenza in the U.S. Prior to the avian influenza outbreak, exports to China had made up 10-12 percent of U.S. broiler meat exports and the U.S. supplied 90 percent of the broiler meat imported by China. Following the import bans, total U.S. broiler export volume fell by 6.6 percent in the first 10 months of 2004 compared to the same time period the previous year. Much of the decrease in exports to China was made up by increased exports to Eastern Europe and countries of the former Soviet Union.

In 2004, broiler production was higher in the third quarter, 8.8 billion pounds, compared to 8.4 billion pounds in 2003. Production is expected to reach 34.0 billion pounds in 2004, representing an increase of 4 percent over 2003. Turkey production is estimated to be 5.4 billion pounds, which is 5 percent below previous year's level. U.S. turkey production totaled 3.13 billion pounds during the first 7 months of 2004, down 5.5 percent from the same period in 2003.<sup>34</sup>

While 2005 U.S. broiler production is forecast at 35.13 billion pounds, a 3.1 percent increase from the previous year, placements in the first quarter of 2005 are predicted to slow from recent months. Domestic U.S. broiler meat consumption is also forecast to increase 3 percent in 2005.

### Acquisitions and Concentration

Acquisitions and consolidations among broiler processors contributed to a higher level of concentration in 2003 compared to previous years. The four-firm concentration ratio in broiler slaughter rose from 48 percent in the years 2001 and 2002 to 55 percent in 2003 (table 3). The turkey slaughter concentration ratios did not change between 2002 and 2003 (table 4).

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<sup>31</sup> USDA, ERS, *Livestock, Dairy and Poultry Outlook*. LDP-M-123

<sup>32</sup> USDA, ERS, *Livestock, Dairy and Poultry Outlook*. LDP-M-115 to LDP-M-122. These series were only designed to show the net returns to broiler or turkey producers for specific products. In both cases the products covered were whole birds and the net returns are not appropriate for the full range of products sold. ERS has since modified this series to reflect that feed prices were the drivers of costs, and ERS no longer calculates overall net returns for poultry.

<sup>33</sup> The U.S. Poultry and Egg Association defines a broiler as a young chicken raised for meat and meat products. Broilers weigh 4 to 5 pounds. Broilers are considered mature at 42 to 49 days old. The terms "broiler" and "fryer" are sometimes used interchangeably.

<sup>34</sup> USDA, ERS, *Livestock, Dairy and Poultry Outlook*. LDP-M-123

Table 3.—Concentration of the top four-firm broiler slaughterers and HHI for all reporting packers<sup>1</sup>

	1985	1990	1995	1997	2000	2001	2002	2003
Four-firm Concentration (percent) <sup>2</sup>	34	41	46	44	49	48	48	55
HHI	NA	NA	NA	611	772	728	722	897

<sup>1</sup> Based on pounds of ready to cook production reported in Watt Poultry USA Rankings, various years.

<sup>2</sup> Percent of total commercial slaughter accounted for by the four largest firms.

Table 4.—Concentration of the top four-firm turkey slaughterers and HHI for all reporting packers<sup>1</sup>

	1982	1987	1992	1997	2000	2001	2002	2003
Four-firm Concentration (percent) <sup>2</sup>	40	38	45	41	41	55	54	54
HHI	NA	NA	NA	496	437	812	783	746

<sup>1</sup> Data for 1997 and after from Watt Poultry USA. "WATT Poultry USA Rankings," various years. Earlier data from Ollinger, M.; J. MacDonald; and M. Madison. 2000. "Structural Change in U.S. Chicken and Turkey Slaughter," Economic Research Service, USDA, Agricultural Economic Report No. 787, Washington, D.C.

<sup>2</sup> Percent of total commercial slaughter accounted for by the four largest firms.

Following a trend established over the past four decades, expansion has continued among several broiler processing companies mainly through acquisitions, although a few companies have expanded by increasing existing capacity or by building new facilities.<sup>35</sup> Further processing, also known as value-added processing, continues to be one of the most important profit sources for the poultry industry.

Among broiler processors, the most significant acquisitions in FY 2004 were:

- Empire Kosher Poultry, Inc. was purchased by E.K. Holdings, Inc., which is owned by a group of private investors led by Palisades Associates, Inc. of Bethesda, Maryland.
- Perdue Farms, Inc. purchased the Cagle's, Inc. processing complex in Perry, Georgia. The \$45 million purchase included a 500,000-square-foot broiler processing plant, a feed mill, and a hatchery in Forsyth, Georgia.
- Keystone Foods, LLC purchased a plant in Barbour County, Alabama, from Charoen Pokphand USA, Inc.

No significant expansions, consolidations, mergers, or acquisitions occurred in the turkey industry during FY 2004.

## Changing Business Practices in the Poultry Industry

### Multi-Year Contracts

As poultry processors build new processing plants and update older facilities, they are offering incentives to growers such as multi-year contracts. A recent example is a live poultry dealer in Mississippi, who currently is constructing a new fully integrated poultry processing plant in southern Georgia. In several articles published in March and April of 2004 in area newspapers, company officials announced they would be looking for approximately 420 broiler houses, 48 broiler breeder houses, and 24 pullet houses. In an

<sup>35</sup> Watt Publishing Company, 2003 and 2004, Watt Poultry USA, multiple issues, and www.meatingplace.com, daily news, December 2003 to September 2004 and ConAgra Foods, Inc. and Subsidiaries, SEC filing 10Q, "Notes to Condensed Consolidated Financial Statements for the Thirteen Weeks ended August 29, 2004." *Chicken Business Divestiture*.

effort to secure growers needed to satisfy processing capacity, company officials stated they would offer 15-year contracts to potential growers in order to entice growers to grow broilers for the company.

Three of the four largest broiler processing companies currently offer multi-year (3 and 5 year) contracts depending on the type of housing that the individual grower is presently using to grow broilers. These contracts are part of the incentive companies use to encourage contract poultry growers to upgrade broiler production housing. At least seven other poultry (broiler and turkey) processing companies also offer multi-year contracts.

### **Avian Influenza**

Outbreaks of avian influenza were reported in several countries in 2004. A highly pathogenic avian influenza (HPAI) virus was reported in Asia in December 2003, immediately resulting in restrictions on imports to the U.S. from the region.<sup>36</sup> In FY 2004, the presence of low pathogenic avian influenza (LPAI) and HPAI was detected in the U.S. Testing was conducted systematically on farms located within a 6-mile range around the farms where infected flocks were located. Test samples were sent to nearby laboratories for preliminary analysis and to the APHIS National Veterinary Services Laboratory (NVSL) in Ames, Iowa for final confirmation of the presence and strain of the virus. Changing business practices associated with the outbreaks included quarantines, restricted mobility among farms and production centers, and transportation prohibition. Public events and meetings were also cancelled as a result of the outbreaks.

### **Technology**

Poultry houses are traditionally 40 to 42 feet wide and approximately 500 feet long, yielding an approximate 20,000 square feet per house. To lower construction and production operating costs, many companies are opting for new poultry houses approaching or even exceeding 60 feet in width.<sup>37</sup> With the efficiency issues of tunnel ventilation satisfied by the extension of poultry houses from 200 to 300 feet in length to 500 feet, the movement to 60 plus feet wide housing is now addressing construction cost and labor efficiency concerns. Changes in construction materials are also allowing producers to move to wider poultry houses. With traditional wood pre-constructed trusses, 50 feet was the outer limit in the width of housing. The advent of affordable steel trusses are allowing poultry houses to be constructed at widths of 60 to 66 feet.

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<sup>36</sup> USDA, APHIS, [www.aphis.usda.gov](http://www.aphis.usda.gov).

<sup>37</sup> The Poultry Engineering, Economics & Management Newsletter, Auburn University in cooperation with the U.S. Poultry and Egg Association, Issue No. 27, January 2004. Simpson, Gene and Jim Donald. Poultry Times, August 16, 2004, Simpson, Gene and Jim Donald.

## **Section 4: Operations or Activities in the Livestock and Poultry Industries That Raise Concerns under the Packers and Stockyards Act**

### **Adequacy of Bonding Formulas for Regulated Entities**

P&SP prescribes bond requirements and bonding formulas through regulations promulgated under the P&S Act. Market agencies buying or selling on commission, or acting as clearing agencies, and dealers and packers purchasing over \$500,000 of livestock annually, must execute and maintain bonding equivalents for the benefit of livestock sellers.

The existing bonding formulas do not provide full coverage to livestock sellers when bonded entities fail financially. Between FY 2000 and FY 2003 sellers who were not paid as a result of financial failures by market agencies selling on commission recovered 31–47 percent of their total claim amounts each year. During the same period, the recovery rate was 15–28 percent for dealers and market agencies buying on commission that failed financially.

**GIPSA Response:** In FY 2004, P&SP formed an internal bond task force to evaluate the effectiveness of P&SP's bond requirements in today's regulated industries. After reviewing the task force's recommendations, P&SP will initiate appropriate action.

### **Concentration**

The level of concentration throughout the industries regulated by P&SP is often raised as a concern.

**GIPSA Response:** Concentration is not a violation of the Packers and Stockyards Act. Concentration, vertical integration, and other changes in industry structure may cause heightened interest among industry participants leading GIPSA to focus more attention on particular firms or behavior but these industry changes, in and of themselves, are not prohibited by the P&S Act. GIPSA cooperates regularly with, and lends its industry expertise to, the U.S. Department of Justice (DOJ) as it reviews mergers in the livestock, meatpacking, and poultry industries.

Congress appropriated \$4.5 million to GIPSA in the FY 2003 Omnibus Appropriations Bill to study issues surrounding a ban on meat packer ownership of animals. Because packer use of various marketing arrangements is intertwined with marketing arrangements at other stages of the supply chain, the study will examine a broad range of marketing arrangements throughout the cattle, hog, and lamb supply chains.

### **Industry Reactions to BSE**

On December 23, 2003, a positive case of BSE, in an animal of Canadian origin, was discovered in a cow located in the State of Washington.<sup>38</sup> Industry participants and P&SP were concerned about fair and open competition, fair trade practices, and financial protection issues that may develop after the discovery of a presumptive positive of BSE.

**GIPSA Response:** P&SP acted quickly in order to ensure fair and open competition, fair trade practices, and financial protections in the livestock and meat packing industries after the BSE announcement. P&SP created Competition, Financial Protection, and Trade Practices Task Forces to monitor and respond to concerns that developed from the BSE announcement.

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<sup>38</sup> USDA, Veneman Announces Additional Protection Measures to Guard Against BSE, <http://www.usda.gov/news/releases/2003/12/0449.htm>.

In FY 2004, the Competition Task Force completed 22 investigations, including 16 undue price preference investigations in the fed cattle markets, one collusion investigation, one price manipulation investigation, and four investigations of apportionment of territory. P&SP found no evidence of any violations.

The Financial Task Force completed 56 investigations, including payment investigations of packers, auction markets, and dealers in FY 2004. Several apparent violations of the P&S Act were detected, and appropriate corrective action is being taken.

The Trade Practices Task Force completed 10 investigations in FY 2004. Some of the investigations involved contract changes made after the BSE announcement. One investigation was closed after P&SP negotiated a settlement that was accepted by the parties involved. One investigation involved multiple complaints about contract changes from livestock sellers. This investigation was closed when the packer ceased operations.

P&SP continues to work informally with the regulated industries to promote compliance with the P&S Act as they institute changes necessitated by the BSE announcement.

### **Captive Supply**

Packer use of captive supply continues to concern many industry participants. There is much confusion about what the term “captive supply” means. Some define captive supply in terms of procurement; some define captive supply in terms of pricing. Those who define captive supply in terms of procurement focus on whether the livestock are committed to a packer prior to the time the livestock are ready for slaughter. Using this definition, some industry participants believe that any livestock procured by a packer 7, 10, or 14 days (depending on the industry participant) prior to slaughter is captive supply. Those who define captive supply in terms of pricing focus on whether the price is known at the time of purchase. If the final purchase price is unknown, the livestock are considered captive supply. P&SP considers captive supply to be livestock that a packer owns or has an agreement to purchase before the animals are ready for slaughter. More specifically, P&SP defines captive supply as: 1) livestock owned or fed by a packer more than 14 days prior to slaughter; 2) livestock procured by a packer through a contract or marketing agreement that has been in place for more than 14 days; or 3) livestock otherwise committed to a packer more than 14 days prior to slaughter.

**GIPSA Response:** In FY 2004, GIPSA awarded RTI International (RTI) a contract to conduct the Livestock and Meat Marketing Study.<sup>39</sup> The study was funded by Congress in the FY 2003 Omnibus Appropriations Bill. USDA awarded a single contract to RTI for \$4,319,373 to study the cattle, hog, and lamb industries. RTI is a nonprofit corporation that conducts business in scientific research and technology development. It specializes in bringing a multidisciplinary approach to research projects. RTI developed a coalition of researchers, with representatives from: Colorado State University, Iowa State University, Montana State University, North Carolina State University, and The Wharton School at the University of Pennsylvania.

The study will address many questions and concerns that have been raised about changes in the structure and business practices in the livestock and meat industries, including captive supply issues. The study is designed to provide an objective analysis of the costs and benefits to industry participants of alternative types of marketing arrangements. The information is needed to develop foundation information needed to understand what economic changes are occurring, why they are occurring, what changes are likely to occur

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<sup>39</sup> For more information on the Livestock and Meat Marketing Study, please visit our website at [http://www.usda.gov/gipsa/psp/issues/livemarketstudy/livestock\\_marketing\\_study.htm](http://www.usda.gov/gipsa/psp/issues/livemarketstudy/livestock_marketing_study.htm).

in the future, and their implications for market participants and the structure of the livestock and meat industries.

RTI is scheduled to complete two reports that will each address specific project objectives. The first (interim) report will include descriptive findings that will meet the objectives to: (1) identify the types of marketing arrangements that are used; (2) describe their terms and availability; and (3) describe the reasons market participants give for their use. The first report is scheduled to be completed in FY 2005. The second report will present the results of economic analysis that address the objectives to (1) determine the extent of use of different arrangements; (2) examine price differences among types of marketing arrangements; (3) assess relationships between advance procurement arrangements and short run spot market prices; (4) measure differences in costs, efficiencies, livestock and meat quality, and risk levels associated with different types of marketing arrangements; and (5) assess the implications of future changes in the use of various types of marketing arrangements. The second report is scheduled to be completed in FY 2006.

### **Check Clearing for the 21<sup>st</sup> Century Act**

The Check Clearing for the 21<sup>st</sup> Century Act,<sup>40</sup> Check 21, is a Federal law that became effective October 28, 2004. The Federal Reserve Board's July 26, 2004, press release indicates the purpose of Check 21 is to "facilitate . . . electronic check exchange . . ." by U.S. banks. An outcome of Check 21 is a reduction in the time required for checks to clear. According to a letter from the American Bankers Association, for those banks using electronic imaging the float may shrink for out-of-town checks, but local checks will clear in virtually the same time as they do today.

Check 21's effect on the livestock, meat and poultry industries cannot be known with certainty prior to implementation. In some cases, Check 21 could provide both benefits and hardships to businesses' financial operations by accelerating the payment of checks issued and checks deposited. Auction markets may experience a reduction in "float" time for its checks issued to livestock sellers without reducing the time required for the auction markets to collect funds from their livestock buyers. As of September 30, 2004, P&SP was aware of at least one auction market that had already notified its buyers of accelerated payment requirements.

**GIPSA Response:** P&SP has been actively engaged in educational activities and discussions with regulated industry leaders, organizations, and businesses leading up to the October 28, 2004, effective date of Check 21 and beyond. Businesses are encouraged to contact P&SP with questions or concerns about the impact of Check 21 on P&SP statutory and regulatory requirements, as well as their respective banks and trade associations. P&SP will handle concerns or complaints with Check 21 implications on a high-priority basis.

### **Formula Pricing**

Slaughtering cattle packers are increasingly using formula-based procurement methods with price discovery processes that are more complex. The formulas establish a base price and incorporate premiums or discounts in computing the final payment amount. The base price may be a stated index value or be an in-house plant average figure. The livestock seller may have the ability to discover the applicable base price amount by viewing a publicly available report. In other cases, the seller has no means to determine the base price value.

**GIPSA Response:** P&SP engages in compliance investigations in which P&SP investigators sample each type of purchase made by a packer. The investigators independently recalculate the payment amount due

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<sup>40</sup> Pub. L. 108-100, approved October 28, 2003.

the livestock sellers under each of the purchase types and confirm the correct amount was paid. In the replication process, investigators verify the data used as variables in the formulas are accurately transferred into the formulas, and that computations are handled properly. The investigators also confirm that the factors used to determine the final payment amounts are clearly disclosed on the sellers' settlements and that any adjustments are explained in an appropriate manner.

### **Joint Livestock Purchasing**

P&SP is aware of several situations in which two packers have used the same agent to procure livestock of similar type and quality, packers have bought livestock of similar type and quality for each other, and dealers and order buyers have orders from multiple packers for similar type and quality of livestock. These are potential violations of the P&S Act.

**GIPSA Response:** P&SP investigates all complaints about the use of shared agents, packers buying livestock for each other, and dealers or order buyers having orders from multiple packers for the same type and quality of livestock. Whether the P&S Act is violated depends on the circumstances of each case. Regulation §201.69 prohibits packers, dealers, and market agencies from furnishing information to competitor buyers for certain purposes. Regulation §201.70 requires every packer and dealer to conduct his or her buyer operations in competition with and independently from other packers and dealers similarly engaged.

### **Livestock, Meat, and Poultry Evaluation Devices and/or Systems**

In the livestock and meatpacking industries, packers and producers are expanding beyond USDA grading to determine the value and appropriate prices to pay for livestock purchased on a carcass merit basis. The industries are developing sophisticated electronic evaluation devices and/or systems to measure live or carcass merit characteristics on which payment is based. Before 2003, there was no accredited (by the government or any other organization) procedure to evaluate the accuracy of electronic devices and/or systems used to evaluate beef or pork carcasses.

In the pork industry, packers pay most producers based on the lean percent of their hogs, estimated by formulas using measurements taken by electronic carcass evaluation devices. Many forms of evaluation devices and/or systems and in-house graders have taken the place of USDA graders. Due to the lack of performance standards for evaluation devices and/or systems, producers receive information from packers that is not comparable when marketing to multiple packers that use different evaluation devices for lean measurement.

In the beef industry, at least 50 percent of market ready slaughter cattle are sold on a value-based marketing grid, meaning that premiums and discounts are paid for carcass attributes that affect the total value of the products derived from that carcass. In contrast to the pork industry, these evaluations are based on visual appraisals from USDA graders alone or in combination with information garnered from the evaluation devices and/or systems.

USDA's Agricultural Marketing Service (AMS) is involved in developing standards for approval of evaluation devices. In 2003, for example, AMS developed a standard for approval of a vision-based system for evaluating the size of a beef ribeye, one of the most important factors in determining the estimated yield of boneless beef product. These standards establish the level of accuracy that systems must meet in order to be certified by USDA.

**GIPSA Response:** The ASTM F10 Committee on Carcass Evaluation Systems was formally created in November 2001 when P&SP and a diverse group of stakeholders<sup>41</sup> voted to create a committee to “develop standards for carcass evaluation systems for livestock.” While developing these standards, the committee changed its name from Carcass Evaluating Systems to Livestock, Meat and Poultry Electronic Evaluating Systems to reflect the different types of evaluating equipment being used in the livestock, meat, and poultry industries.

Because there were no standards governing the use or accuracy of electronic evaluation devices in the livestock and meatpacking industries, P&SP developed a task force to develop voluntary industry standards. Over the last four years, the P&SP Task Force, with assistance from the National Institute of Science and Technology (NIST), AMS, personnel from State Weights and Measure departments, equipment manufacturers, academicians, and others, developed voluntary industry standards that were recently adopted and published by ASTM International.

Currently, there are four published voluntary industry standards:

- **Design of Device:** Sets out certain criteria for the design of the evaluation devices (impacts manufacturers);
- **Device Performance:** Sets out criteria for the performance of the evaluation devices and systems (impacts manufacturers, meat packers, and live poultry dealers);
- **User Requirements:** Sets out requirements for users, including maintenance, operation, inspection, etc. (impacts meat packers and live poultry dealers); and
- **Predictive Accuracy:** Sets out a standardized method to collect and analyze data and develop a formula used to determine payment (impacts meat packers and live poultry dealers).

The National Conference on Weights & Measures, Inc. (NCWM) is considering the ASTM standards for inclusion in Handbook 44. If NCWM incorporates these voluntary standards into Handbook 44, the standards would become mandatory requirements which would be enforceable by State weights and measure divisions. In addition, P&SP is developing a draft of a regulation to address the use of these new technologies under the Packers and Stockyards Act.

### **Organization for Competitive Markets Lawsuit**

The Organization for Competitive Markets (OCM) filed suit against the Department of Agriculture and Grain Inspection, Packers and Stockyards Administration (GIPSA) over GIPSA’s response to its plan to implement a program funded through voluntary contributions received from cattle producers. OCM’s program calls for livestock markets to automatically deduct funds from sellers’ proceeds for the benefit of the OCM program unless the seller opts out of the program.

**GIPSA Response:** Regulations under the P&S Act require the markets to obtain written authorization in advance before deducting funds from sellers’ proceeds. Sellers may authorize deductions for any purpose.

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<sup>41</sup> ASTM F10 committee members include: National Pork Producers Council (NPPC), National Institute of Standards and Technology (NIST), USDA Agricultural Marketing Service (AMS), USDA Agricultural Research Service (ARS), weights and measures inspectors, academia, several meat packers, and evaluation device manufacturers.

U.S. DEPARTMENT OF AGRICULTURE  
 GRAIN INSPECTION, PACKERS AND  
 STOCKYARDS ADMINISTRATION  
 PACKERS AND STOCKYARDS  
 PROGRAMS

**ANNUAL ASSESSMENT REPORT COMMENT FORM**

Thank you for your interest in GIPSA's Report, *Assessment of the Cattle, Hog, Poultry, and Sheep Industries*. As a means of both improving the publication and gaining insight on the issues arising in the cattle, hog, poultry, and sheep industries we invite your comments and ideas for future publications.

**1. Please indicate which area of the report you found to be the most useful (please check one box):**

- General Economic State     Changing Business Practices     Operations or Activities that Raise Concerns

**2. Please indicate which area of the report you found to be the least useful (please check one box):**

- General Economic State     Changing Business Practices     Operations or Activities that Raise Concerns

**3. Please rate your overall satisfaction with the report (please check one box):**

- Excellent     Good     Average     Poor     Very Poor

**4. Please identify each industry you are involved with (please check all that apply):**

- Cattle     Hog     Poultry     Sheep     Other: \_\_\_\_\_

**5. Please identify your primary role(s) in the industry:**

- Producer     Processor     Packer     Stockyard     Feedlot     Other: \_\_\_\_\_

**6. What changing business practices have you witnessed in the livestock, poultry, or meat industry?**

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**7. What concerns in your industry would you like us to address in future publications?**

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**8. Additional comments or suggestions:**

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**9. If you would like to provide your contact information, please do so below.**

Name: \_\_\_\_\_  
Last Name First Name

Business Name (if applicable): \_\_\_\_\_

Mailing Address: \_\_\_\_\_  
Street

City/Town State Zip Code

E-mail Address: \_\_\_\_\_

Telephone Number: (including area code) \_\_\_\_\_

**Thank you for your response to this questionnaire.**

Please submit the completed questionnaire using one of the following methods:

- 1) Mail the document to the following address:  
Grain Inspection Packers and Stockyards Administration  
Packers and Stockyards Programs, CMAR  
1400 Independence Ave. SW, Stop 3647  
Washington, DC 20250-3647
- 2) E-mail the form to: [pspess@usda.gov](mailto:pspess@usda.gov) with the subject line as "CMAR," or
- 3) Fax the form to: (202) 690-1266, ATTN: Jaime Adams.

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**Instructions for Completing  
the Annual Assessment Report Comment Form P&SP-6020**

You may use any of the following methods to submit the form:

- 1) Mail the document to the following address:  
 USDA Grain Inspection Packers and Stockyards Administration  
 Packers and Stockyards Programs, CMAR  
 1400 Independence Ave. SW, Stop 3647  
 Washington, DC 20250-3647
- 2) E-mail the form to: [pspeess@usda.gov](mailto:pspeess@usda.gov), with the subject line as "CMAR," or
- 3) Fax the form to: (202) 690-1266, ATTN: Jaime Adams.

Line No.	Subject	Instruction
1.	Most Useful Part of the Report	Check the appropriate box to indicate which part of the report you found most useful.
2.	Least Useful Part of the Report	Check the appropriate box to indicate which part of the report you found least useful.
3.	Overall Satisfaction	Check the appropriate box to indicate your overall opinion of the report.
4.	Industry Segment	Check the appropriate box(es) to indicate each livestock category you work with.
5.	Industry Roles	Check the appropriate box(es) to indicate your primary roles in the livestock, poultry, or meat industries.
6.	Changing Business Practices	Enter a description of the changing business practices that you noticed during the past year.
7.	Industry Concerns	Enter a description of the concerns you experienced in the livestock, poultry, or meat industries over the past year that you would like us to address in future publications.
8.	Additional Comments	Enter any additional comments that will help to improve future annual assessment reports.
9.	Contact Information	Enter your name, business name, mailing address, e-mail address, and telephone number.

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