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To: Colin Woodall & Ethan Lane – National Cattlemen's Beef Association

From: Stephen R. Koontz

Re: Price Discovery Issues – April 28, 2020

Greetings gentlemen. I am aware of a policy proposal that is making the rounds at several state cattlemen's associations and that is being circulated through electronic media. The proposal would require beef packing companies to purchase at least 30% of individual plant fed cattle needs in the negotiated cash market and that those purchases would be delivered to the plant within 14 days. I have heard variation in the details of the proposal, but the commonality is a mandated percentage of negotiated cash purchases with a pickup in standard cash market windows. It is being recommended that the proposal would become part of the livestock mandatory price reporting legislation with its needed renewal this fall. I am also aware that my writing and presentation documents are being used as evidence supporting the need for this legislation.

My research does examine the impact of declining negotiated cash trade on price discovery in regional and national fed cattle markets. And it also attempts to make recommendations as to the needed volumes of cash trade for minimal and robust price discovery. But my work does not recommend, and I do not support, a mandate of a given percentage cash trade.

An aside issue I have with the policy proposal is that it would not address the current market situation in any manner. The current market situation is due entirely to the supply disruptions at meatpacking facilities – plants are being closed or operated at reduced speeds due to the human health event. Further, there have been disruptions to common domestic trade flows – from delivery to food-away-from-home providers and to at-home food outlets. Additionally, we entered 2020 knowing protein supplies would be abundant most of the year. None of these issues are related to price discovery.

The main issue I have with the policy proposal is that it would cost the cattle and beef industry millions and possibly billions of dollars per year. This is known from research in which I participated. The U.S. Congress funded the USDA-RTI Livestock and Meat Marketing Study in 2003 and the work was completed in 2007: https://www.gipsa.usda.gov/psp/publication/live_meat_market.aspx. The use of alternatives to the cash market are cost saving and revenue enhancing. The main beneficiaries of these relationships are the cow-calf producing sector and the U.S. consumer. We have known this for a long time, and we have solid empirical evidence. There is also strong evidence that the value-based marketing tools that were developed through alternatives to the cash market saved the beef industry. Beef demand halved from 1980 to 1998. Use of value-based marketing tools coincided with improvements in beef demand since.

The economic incentives found in the USDA-RTI study have not changed or diminished. I have conducted follow-up interviews as part of my work on price discovery and alternatives to the cash market are valuable to the cattle industry. The use of forward contracts benefits those that use them $15 to $25 per animal. The use of formula arrangements benefits those that use them $25 to $40 per animal. Mandating the use of the negotiated cash market will have negative economic consequences commensurate with these amounts and to the extent mandate. The members of the cattle and beef industry do what they do for reasons – and often solid economic reasons.

While I know that there are strong economic reasons for members of the cattle and beef industry to move away for negotiated cash market use, I also think it is possible that the industry has gone too far. Individuals, following what benefits their businesses and business models, have had a detrimental impact on the quality of price discovery in what remains of the cash market for fed cattle. There are not enough fed cattle traded in some of the five USDA AMS reporting regions. I believe that the cattle and beef industry needs cash fed cattle market price information. This information helps the industry value the services of producing fed beef cattle. Without this information then the value of this service is much less well-known and has the potential to impact the wellbeing of businesses closer to the ranch. Price discovery is a public good and there is just insufficient price information being produced.

However, there are many alternatives to mandates, and all would be more flexible, less costly, and be effective. Mandates are policy-efficient but have high economic costs in the short-run and especially the long-run. The alternatives I offered are summarized in a 2-page executive summary and a report to NCBA both with “Policy Prescriptions” in the title. First, I believe these are both a short-list of starting-point ideas. Certainly, there are others. Second, I believe that state associations are doing what is needed in that the issue has been made a priority and is part of association action. Association work is about representation and democracy. Follow-up, follow-through, and accountability are also needed. Third, I believe there are reasonably creative solutions that will be less costly. Several state associations are working on the idea of creating market-makers. Many asset markets do this. The industry participants working together to create, and compensate, a pool of cash market traders that are discovering price, are good at this service, and willing to do it within their business model and for the benefit of the industry is what is needed. It is one means to solve the public good problem of not enough quality price discovery. It would be less costly than a mandate and open to changes in how the industry does business in the future.

I am concerned my research is being used to advocate for the mandate policy. My research says simply, “If you want cash fed cattle prices then you need to trade cash fed cattle.” Importantly, it does say how much cash trade was needed in the past to have minimal and effective price discovery. This is unique. My research says that any percentage would be different across different regions. And I am concerned that how things are now is not how they were in the past – or in the data my research uses. More detailed research is needed with data that are not only USDA. A closer look is needed at the data that has been collected in Texas and in Nebraska that include information on the number of bidders and dynamics of the weekly bid and ask.

Finally, the industry needs to look hard at proposals it currently has. Joint research by Kansas State and Iowa State Universities shows that expanding the reporting regions would reduce the incidence of nonreporting due to confidentiality. The weekly fed cattle price is infrequently reported for Colorado and this is because there are only two packers that buy consistently in my state. Requiring more cash trade would not change this nor result in a Colorado cash fed cattle price being reported. And much of our price reporting problems are due to the confidentiality requirements that were not part of the original act. I am not aware of this proposal being offered but making this change would solve many price reporting problems immediately.

Thank you for the opportunity to perform the Land Grant University mission: use research to address real-world problems through education and communication.