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Buyer Power in U.S. Hog Markets: A Critical Review of the Literature

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Executive Summary

The U.S. Departments of Justice (DOJ) and Agriculture (USDA) have focused attention recently on rising levels of corporate concentration in agricultural markets and the challenges that may pose to U.S. anti-trust enforcement and agricultural policies. Both agencies have raised particular concerns about dominant firms' exercise of buyer power over farmers, especially in livestock markets controlled by a shrinking number of large multinational meat packers.

U.S. hog markets have undergone rapid concentration in the last twenty-five years, with the top four packers now controlling two-thirds of the market. Mergers and acquisitions have left Smithfield Foods, the industry leader with 31 percent of the market, as the only buyer in the Southeastern part of the country. While President Bush's Justice Department approved the 2007 merger that made that possible, questions remain about how independent hog farmers in the region can receive a fair-market price for their animals in such concentrated buyer markets.

Buyer power can operate in many ways. With one or two buyers, farmers may have little competitive bidding for their animals. Direct packer ownership or control of hogs through production contracts may thin the spot market to the point that packers can manipulate prices to their advantage through their own sales and purchases. Packers may offer lower prices to farmers delivering smaller loads of hogs. Bank financing may become harder to secure without a contract from a packer, and contracts themselves present a variety of issues, as they can become take-it-or-leave-it propositions for farmers lacking other offers.

Despite the rapid structural changes in the U.S. hog industry, the literature on buyer power in hog markets is quite limited. In this paper, we review the available literature, which has generally been presented as demonstrating that buyer power is not yet a significant problem. We find that interpretation to be poorly justified.

The U.S. General Accounting Office (GAO) contributed to the problem with its 2009 study, "Agricultural concentration and agricultural commodity and retail food prices." Though the authors concluded from the six studies reviewed that there was little cause for concern, several of the studies presented evidence of market power on both the seller and the buyer sides of the market. While the studies were less clear on the specific causes, there seemed little basis for drawing such a firm conclusion from such a limited literature.

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The GAO also excluded from its review one of the most comprehensive and recent examinations of the issue. RTI International, in an exhaustive report for the USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA), found:

- Unusually large variation in the prices paid for live hogs, often a sign of buyer power.
- Clear evidence of buyer power in hog markets, though they could not conclusively determine if that was caused by the rise in marketing contracts.
- Clear evidence that spot market prices dropped as packer-owned or contract production increased.

We found several consistent methodological problems with many of these studies, with GAO's interpretation of them, and with the ways in which DOJ has analyzed evidence in its anti-trust-related merger reviews:

- Researchers and regulators often discount buyer power using standards and methodologies more appropriate to seller power, when the power to set selling prices in national markets is quite different from the power to force down producer prices in buying markets.
- Researchers and regulators often dismiss findings of seller power by pointing to offsetting "efficiency gains" from concentration. Yet such apparent efficiency gains in seller markets can include reductions in the prices concentrated firms pay for animals through their exercise of buyer power.
- Researchers and regulators generally treat the live hog market as a national market, while most independent producers experience the market as local or regional. The DOJ allowed the 2007 Smithfield-Premium Standard Farms merger even though it left farmers in Virginia, North Carolina and South Carolina with one buyer. DOJ argued that a second buyer 400 miles away would ensure competitive pricing.
- Researchers and regulators have generally ignored reports that contract production has thinned spot markets to the point that packers can influence prices through the timing of their own purchases as well as the sales of packer-owned animals. Just in the last fifteen years, the share of hogs sold on open markets has declined from 62 percent to 8 percent.
- Researchers and regulators often ignore the interactions between buyer power in increasingly concentrated retail markets and buyer power by packers. The top four food retailers went from 19 percent control of the market in 1997 to 59 percent in 2009. We see evidence that retail buyer power may compound packer buyer power, with hog farmers losing out in an uncompetitive market environment.

The paper concludes with a set of recommendations for further research, including the refinement of methodologies for the study of buyer power and improved public access to market information. No market can function competitively without transparency, and the current levels of concentration and the prevalence of proprietary information in livestock markets threaten to undermine true price discovery.

Given the high levels of concentration and the evidence of anti-competitive practices, regulatory action is urgently needed. We conclude with a brief assessment of proposed new USDA regulations on packer buying practices, which represent a good first step toward better regulation of highly concentrated livestock markets.

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