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Economic and Regulatory Issues in the Use of Grower Contracts

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There is a lot of money at stake...

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Sometime next week, the jury will reach a verdict in the historic case of Pickett v. Tyson/IBP, marking a temporary end to eight years of legal wrangling between the plaintiffs —some 30,000 cattle producers —and the giant meatpacker IBP, which is now owned by Tyson Foods. The heart of the case is an enormous shift in the world of livestock over the past quarter-century. Cattle were once sold mainly at cash auctions to bidders who included buyers from different packing plants. But there are virtually no independent packers left. Four companies —the three largest are named in this suit — now control 82 percent of the slaughter market, up from 36 percent in 1980. The equilibrium between producers and buyers, reflected in a cash auction, has been replaced by buyers' dominance, a pattern that has prevailed in most sectors of the farm economy.

At any one time, thanks to advance contracts, packers own as much as 35 percent of the herd making its way to slaughter. That gives them the ability to wait out high prices and return to buying when prices drop. The result? Packers' profit margins have soared, while cattle producers get a smaller and smaller share of the retail beef dollar. The ranchers argue that such tactics violate the 1921 Packers and Stockyards Act, which prohibits packers from employing any "unfair, unjustly discriminatory, or deceptive practice or device" or from making preferential agreements. The Packers and Stockyards Act was passed expressly to break up the dominance of five major packing companies —but they, at that time, controlled a smaller share of the market than the big four in the beef-packing industry control now.

Packers claim that the recent boom in cattle prices, which ended with the discovery of mad cow disease in Washington State, proves that the market is working as it should. And the packers defend themselves by pointing out that beef prices for consumers have steadily dropped until recently. But the decline in beef prices may be as dependent on anticompetitive practices as it is on the economic efficiencies of consolidation. In the packing industry, at least, economic efficiency is often another word for unsafe working conditions, recurring problems with meat safety and a squeeze on independent cattle producers.

Agricultural Contracts: Why do we care?

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- **Equity.** Relative to alternative modes of coordinating the actions of multiple firms and individuals, contractual coordination may be “good” for some, and “bad” for others.
- **Efficiency.** A contract is a means of enforcing a promise. Having a well developed mechanism for contract enforcement that is not subject to corruption and influence is highly correlated with economic growth.

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- **Negotiated Exchange.** Also known as “spot market.”
 - Limits opportunities to engage in mutually beneficial *ex ante* “planning.”

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- **Incidence.** Prominent in fruit and vegetable markets, particularly so in processing commodities. Increasing use in some livestock commodities.
- **Consequences.** Virtually no formal empirical investigation.

What kinds of data do we need?

- **Description.** Discussions with industry participants. Careful articulation of contractual design.

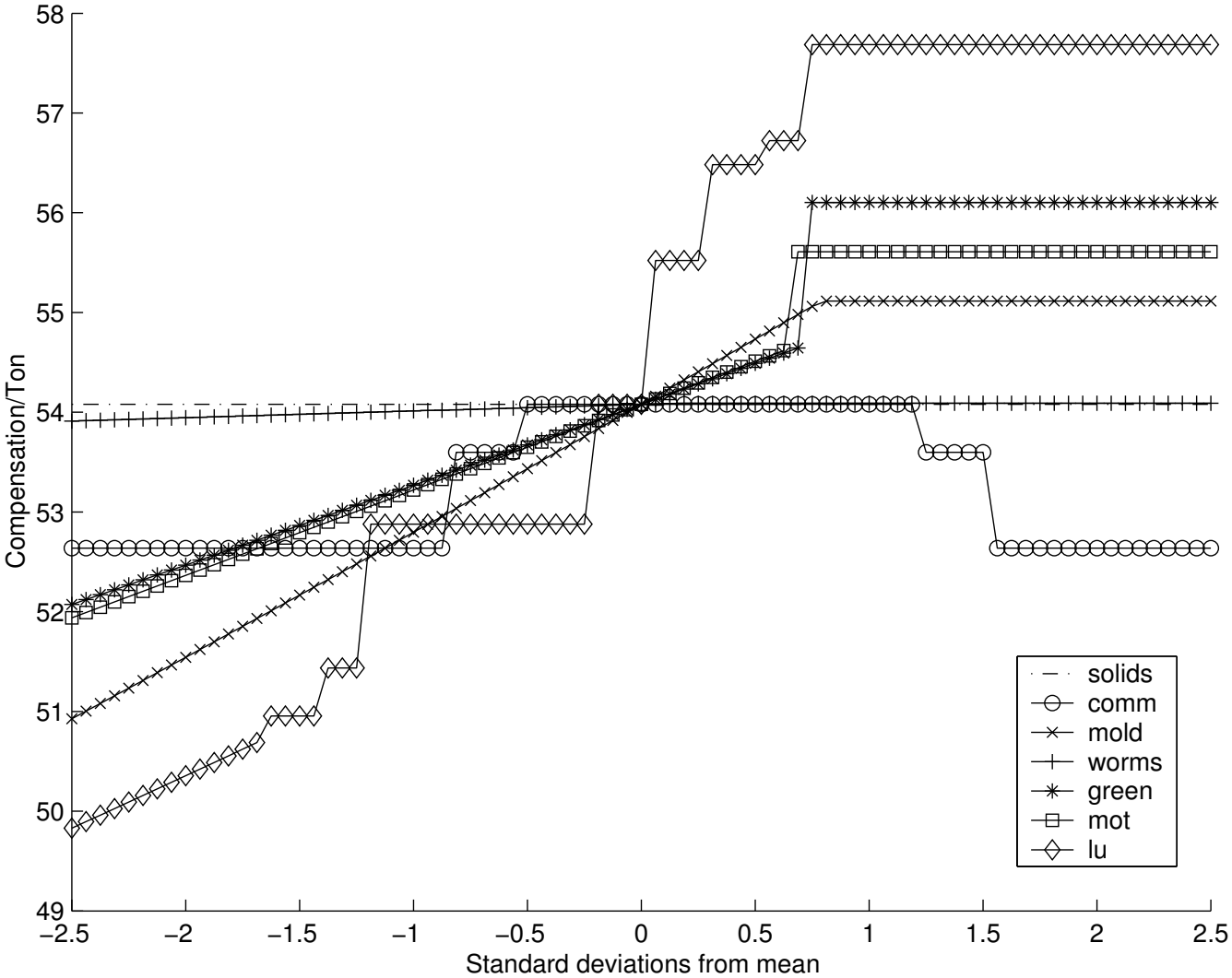
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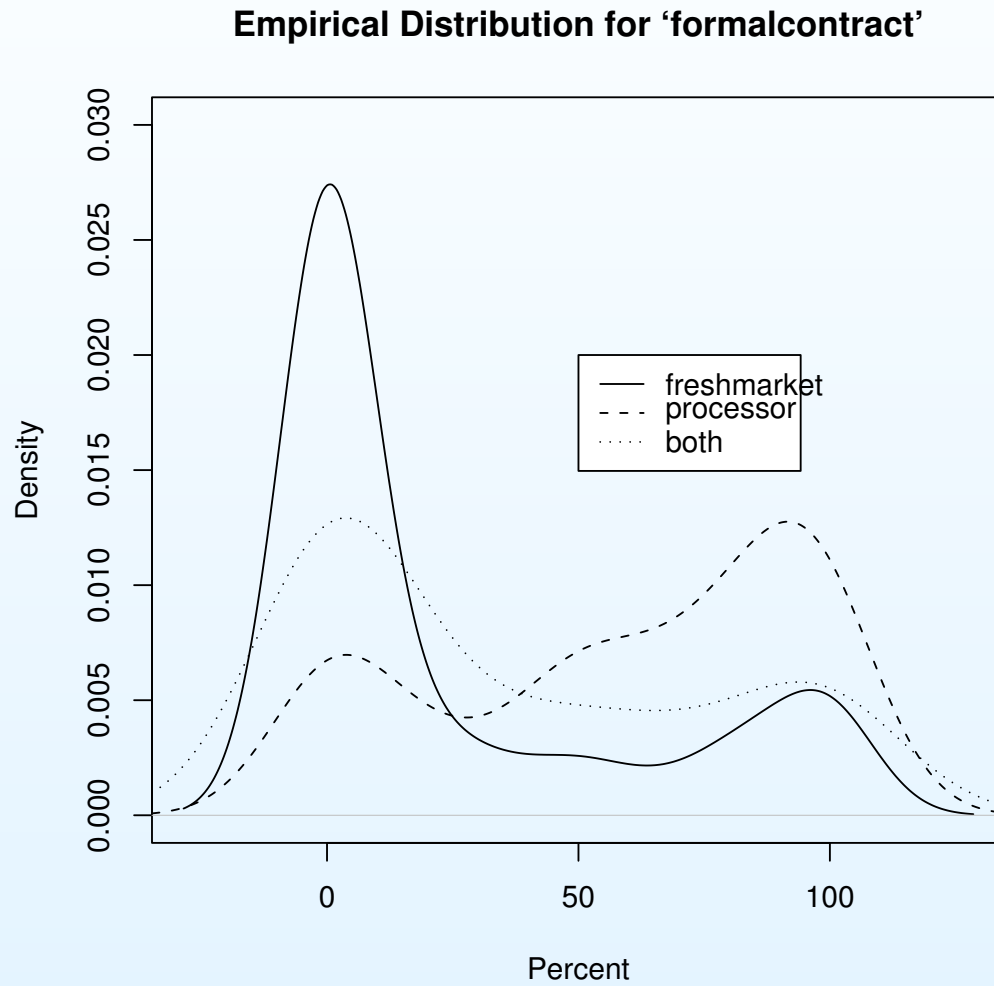
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- **Description.** Discussions with industry participants. Careful articulation of contractual design.
- **Incidence.** Some type of formalized survey to identify variation in the use of different forms of contract.
- **Consequences.** Financial and production outcomes under contractual arrangements; information about the issues and outcomes of legal disputes in the context of agricultural contracting.

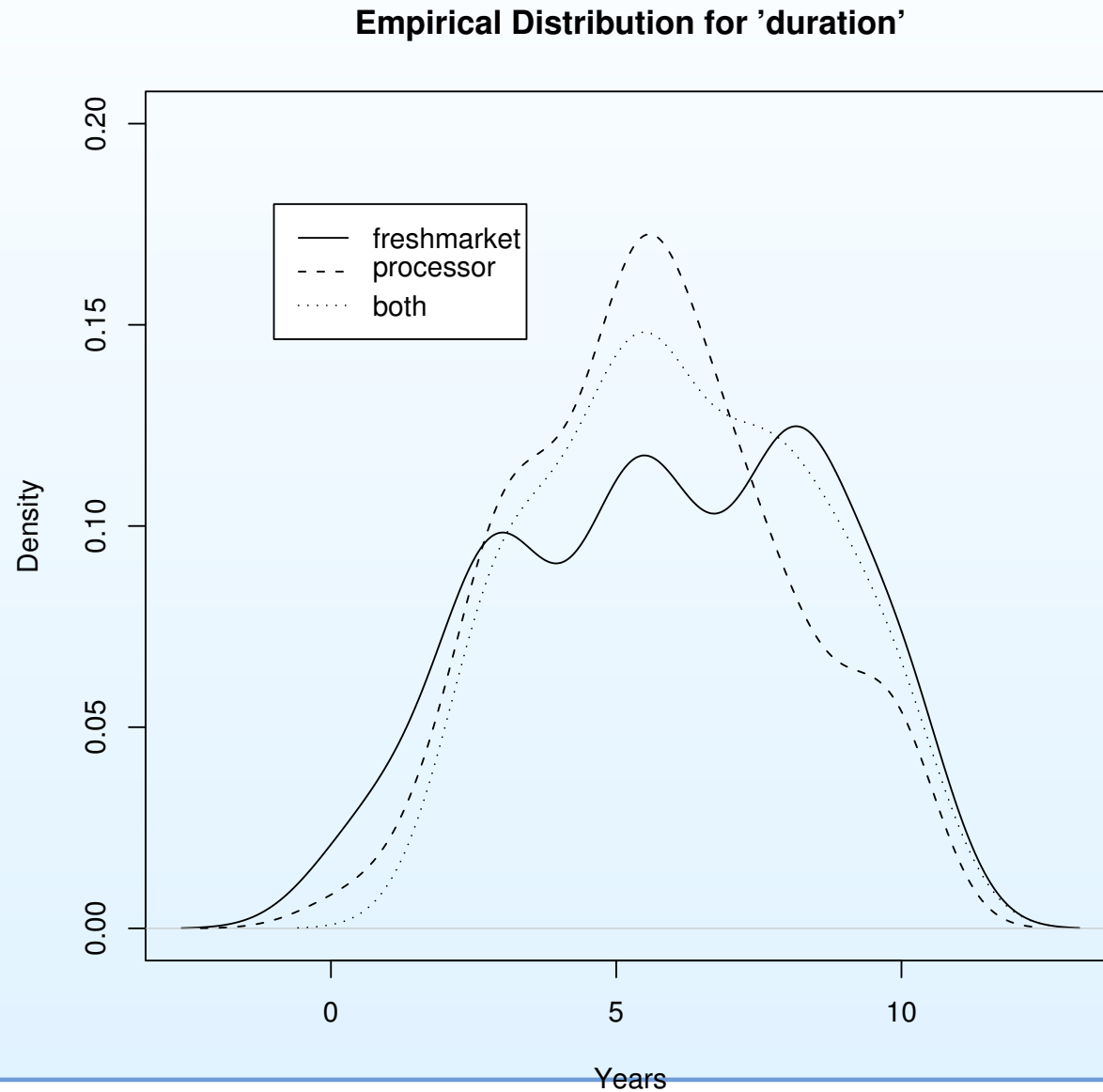
The beginning of research in this direction...



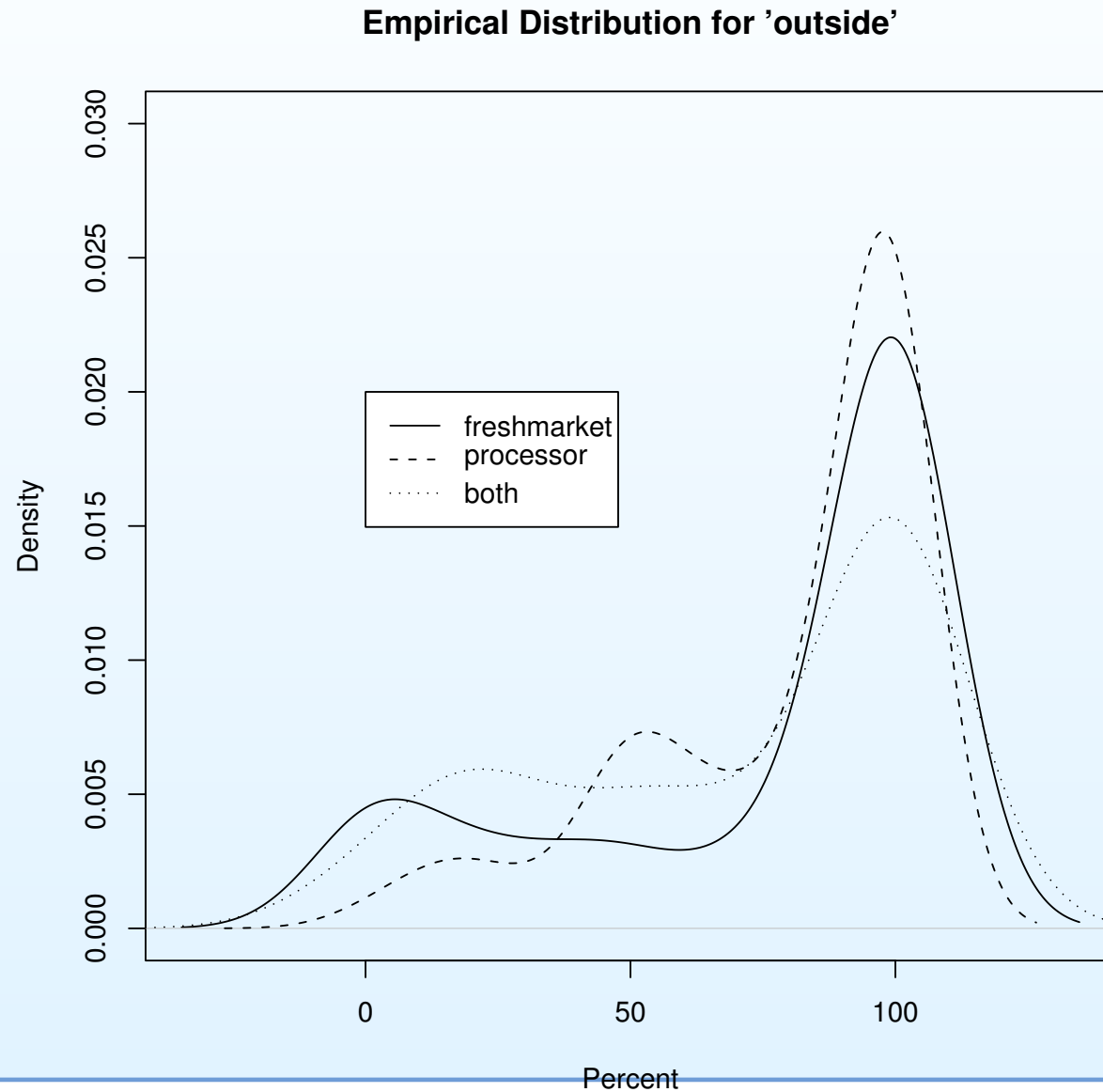
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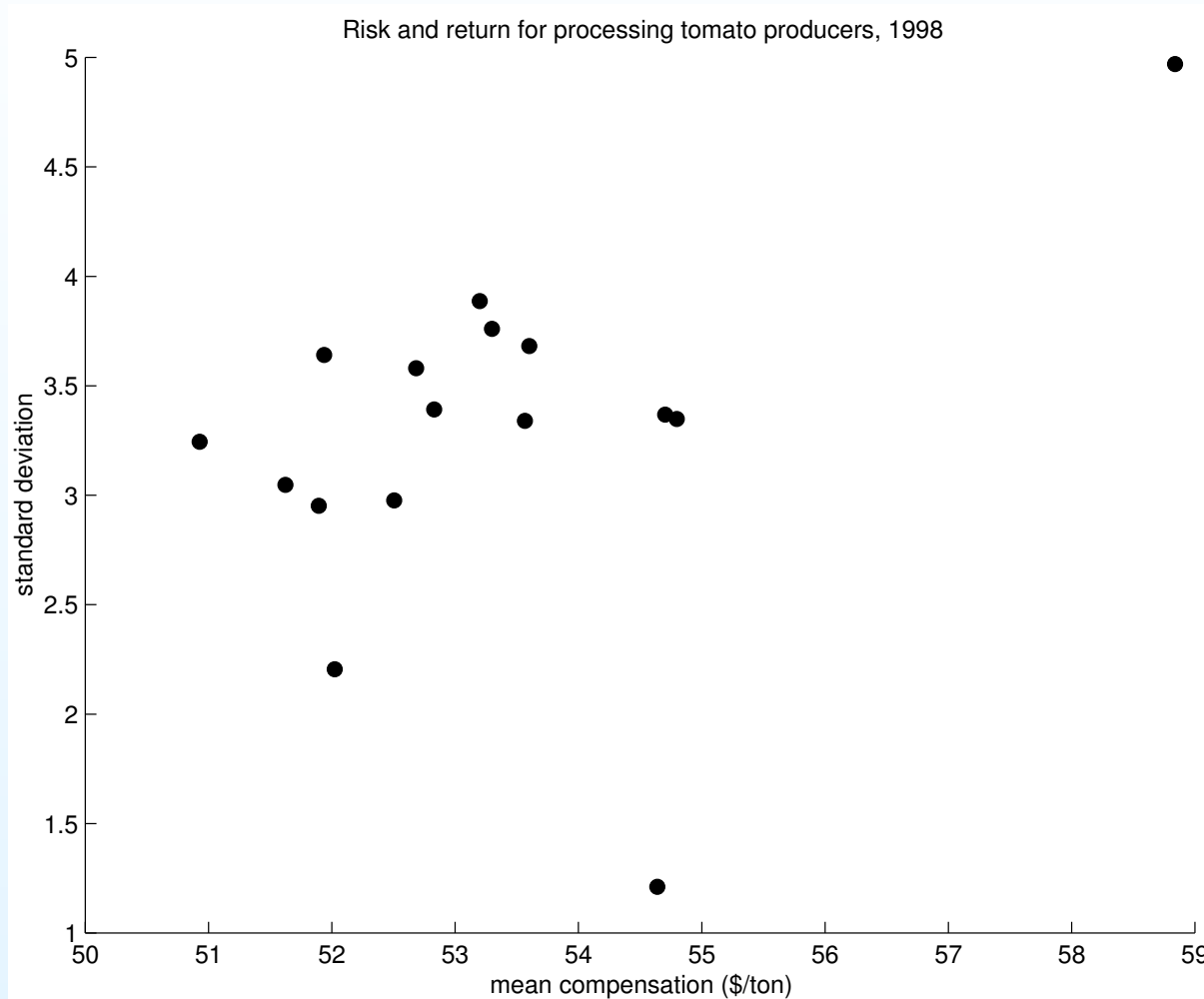
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- Blanket contractual and organizational restrictions seem like crude regulatory instruments.
- Look to the fruit and vegetable sector for guidance: grower organizations, marketing orders, bargaining legislation, regulatory enforcement (e.g., Market Enforcement Branch, CDFR).

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- The search goes on...