Below-Cost Feed Crops

An Indirect Subsidy for Industrial Animal Factories

Summary

Making a living these days is a challenge for the average U.S. farmer. Prices for major agricultural commodities have fallen over the last 20 years while input costs have risen, leaving farmers with declining net incomes even as government subsidies hit record highs. Many analysts believe that government subsidies are the culprit behind low prices. But this perspective overlooks dramatic changes to U.S. agriculture policy that have occurred since the mid-1990s, which have deregulated agricultural markets, allowing for overproduction and leading to the collapse of market prices.

The consequences of low commodity prices are serious: farmers' bottom lines suffer, while multinational corporations that procure cheap commodities win big. Among the biggest buyers of U.S. agricultural commodities are industrial animal factories that now dominate the livestock industry. Feed costs make up a large percentage of the industry's total production costs. As a result, corporately owned, vertically integrated, industrial animal factories have reaped major gains at the expense of U.S. farmers and taxpayers.

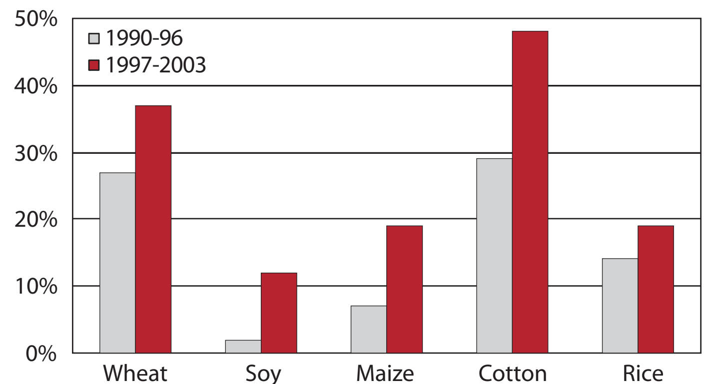
What's the Discount?

Exactly how much do corporate animal factories benefit from low feed prices? Although few researchers have examined this question, we can start by estimating the cost of production for feedgrains and oilseeds, and compare those costs to the price of feed on the market. IATP has calculated dumping margins—the difference between a crop's cost of production based on calculations from USDA and the Organization for Economic Cooperation and Development (OECD), and the market price—for five major farm program crops. From 1997 to 2003, soybeans and corn were exported at 12 percent and 19 percent respectively below what the USDA estimates the crops cost to produce. The dumping margin for program crops grew after the passage of the 1996 farm bill, as crop prices fell to new lows.

If we take these figures to represent a rough estimate of the discount to market purchasers of grains and soy, they suggest that industrial animal factories are benefiting from a reduction of around 15 percent on their most significant operating cost. Assuming that feed accounts for 50-65 percent of operating costs for poultry and hog producers, these corporations' overall costs could be as much as 7-10 percent higher if they compensated farmers fairly for the feed components that they produce.

Another way to look at it is through the subsidy lens. Between 2000 and 2004, an average of $4.5 billion in U.S. government support went to corn each year, and $2 billion to soy, to partially compensate farmers for low market prices that have been forced well below the cost of production. Around 60 percent of corn and 47 percent of soy produced in the United States is used in domestic livestock production for feed. That works out to over $3.6 billion each year, or $18 billion over five-years, in implicit input subsidies to industrial animal factories that purchased most of these cheap feedgrains.

Dumping margins and 1996 Farm Bill: Percentage export price is below cost of production



Source: IATP, "The WTO Agreement on Agriculture: A Decade of Dumping," 2005

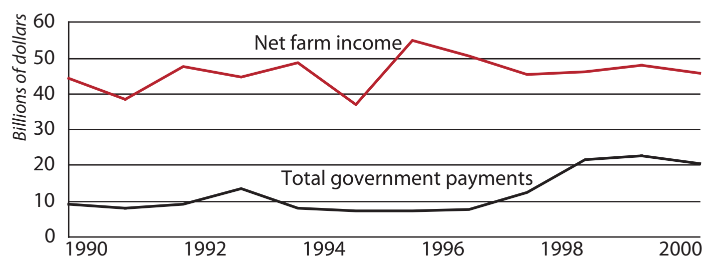
The Big Squeeze

Congressional budget negotiations have repeatedly targeted U.S. agriculture policy as growing subsidy payments have become more difficult to defend. Some members have introduced legislation to cap government payments received by farmers, while others have called for the elimination of subsidies altogether. Although the original intent of the 1996 Farm Bill was to phase out farm payments by 2002, government spending on farm programs has instead more than doubled. U.S. farmers are now more dependent then ever on the federal government for their income. The 1996 deregulation policies failed because the resulting lower prices didn't translate into a greater share of export markets for U.S.-based agriculture trading companies. Despite a 40 percent reduction in market prices, overall exports have remained flat, and the U.S. is projected in the next few years to become a net importer of agricultural products for the first time since 1959.

So who actually benefits from this failed policy? Although farmers are the direct recipients of government payments, net farm

income has nevertheless steadily fallen. Production costs continue to rise, while market prices trend downward. As research by the University of Tennessee's Agriculture Policy Analysis Center shows, low prices and high costs are squeezing farmers' budgets, leaving them with stagnant or declining net farm income, despite dramatic increases in direct government subsidy payments.

U.S. net farm income and government payments



Source: University of Tennessee Ag Policy Analysis Center, 2003

Hogging the Rewards

Multinational meatpacking companies, which procure large quantities of agricultural commodities through easily manipulated, non-transparent and increasingly exploitive contracts, have reaped record profits as commodity prices have collapsed. These companies have grown larger, fewer in number, and more powerful as the livestock sector has consolidated. Four companies—Cargill, ConAgra, Tyson and Smithfield—control the vast share of livestock markets at all stages of production—from milling the feed, to breeding and raising animals, to slaughtering, packing, and marketing. University of Missouri Professor Bill Heffernan and others have found that the share of the retail dollar captured by these few giant meat-processing corporations has increased exponentially over the last 20 years as livestock markets have become more concentrated and less competitive. As corporations capture more of the retail value, less is paid to farmers, while consumer prices remain high.

Economists measure the market power of corporations in "concentration ratios," which show the share of the market that is controlled by the top four companies in a given sector. When the concentration ratio is higher than 50 percent, the market is considered highly concentrated.

As the ratio goes up, competition between firms declines, price manipulation becomes a more serious concern, and barriers to entry grow for new firms. As the table below illustrates, concentration in the livestock sector is incredibly high.

Selected Agri-food CR4 Concentration Ratios, 2004
(percent of the market controlled by the top 4 firms)

Beef Packers	84%
Pork Packers	64%
Pork Production	49%
Broiler Production	56%
Turkey Production	51%
Animal Feed Processing	34%
Flour Milling	63%
Soybean Crushing	71% (top three firms)

Source: Hendrickson and Heffernan, 2005

Because a high percentage of meat processing companies' input costs is spent on feed, it is easy to see how these huge firms benefit from low feed prices. Reducing their operating costs through access to cheap grains and oilseeds has provided these multinational corporations with an economic advantage that has allowed them to expand their share of the global agri-food market. Feed is typically the largest single variable expense in vertically integrated industrial animal factories: the U.S. Department of Agriculture has estimated that feed costs account for 60-64 percent of total production costs for poultry and eggs, 47 percent for hogs, and 17 percent for beef. The total amount of feed purchased by these multinational corporations has grown in recent years, too, as U.S. and international consumption of meat has grown. In fact, the value of livestock and meat production in the United States is now roughly equal to the value of production for all other crops combined. Meat also accounts for a growing share of the U.S. export market: in 2001, the U.S. exported 9 percent of its beef, 8 percent of its pork, and 18 percent of its broiler chicken meat. Half of the soy produced in the United States, and more than half of the corn, is fed to domestic livestock. Vertically integrated multinational agribusinesses export most of the rest of U.S. corn and soy production to be fed to industrial livestock facilities in other countries. These two major feed crops are among the most heavily subsidized.

Much of the livestock available on the U.S. market used to be produced by independent, diversified family farms that used animal husbandry as a way to add value both to grass grown on their pasturelands for meat and dairy, and to the grains they produced for finishing livestock. Between 1994 and 2001, however, the number of farms raising livestock in the U.S. declined by over 60 percent.

The majority of livestock on the market is now produced under contract with vertically integrated, corporately owned animal factories that bear little resemblance to the independent family farm of old. The contract system compromises farmers' independence and the transparency of the price discovery process all along the livestock supply chain. The exploitation of contract farmers by corporate animal factories is a growing problem. Over half of all hogs in the United States are now raised in industrial animal factories housing at least 5,000 animals, according to the USDA.

Losing Out

If industrial animal factories benefit from policies that depress the prices of grains and oilseeds on the U.S. market, then who loses? The answer is independent, diversified family farmers. Whereas animal factories procure feed from the market at below the cost of production, diversified farms tend to grow much of their own feed—whether it is grass from pasturelands, feedgrains or oilseed—for their own livestock. When grain and oilseed prices are low, these farms take an economic hit on several levels.

First, they are at a disadvantage compared to industrial animal factories because they pay the actual, full production cost to cultivate feed for their own livestock; while the vertically integrated industrial animal factories use their growing market power to

procure feed at below the actual cost of production.

Second, industrial animal factories drive down market prices for livestock through the manipulation of markets by using secretive and exploitive captive supply contracts. These contracts further reduce the added value that independent, diversified farms would otherwise capture. Finally, diversified farms also receive prices that are below the cost of production for the feedgrains and oilseeds they sell on the market to multinational buyers. Government payments make up for some but not all of these losses, as illustrated by the 16.5 percent decline in net U.S. farm income between 1996 and 2001 despite a tripling of government payments over the same period.

The result is that independent, diversified farms cannot compete with an industrial livestock production system based on below-cost feed. Struggling to maintain their livelihoods, many independent farmers plow up pasturelands formerly used to graze livestock and begin to intensively farm monocultural row crops on that acreage. This further exacerbates the problem of overproduction, and drives commodity prices even lower. The fate of many family farmers has been to go out of business when the squeeze becomes too tight, selling their farms to larger operations. But the outcome is the same: overproduction, low prices, and increasing market concentration.

Tipping the Balance

After more than a decade, U.S. agricultural market deregulation has facilitated the vertical integration, consolidation, and industrialization of the U.S. livestock sector. At the same time, deregulation has failed to reduce direct government subsidy payments; failed to increase overall U.S. export market shares; and failed to provide a fair price to farmers or to bring economic prosperity to rural communities. It is time to rethink this destructive policy. Lawmakers should instead consider policies that would curtail costly and unsustainable overproduction of feedgrains and oilseeds, fairly compensate farmers by bringing market prices for feed closer to actual production costs, and break up the growing market power wielded by a small number of vertically integrated industrial livestock corporations. Such policies could include, but are not limited to, the following:

1. Bolster anti-trust enforcement to reverse current trends towards the concentration of agricultural markets by banning packer ownership of feedlots; restoring price discovery and market transparency through the reform of captive supply contracts; prohibiting undue preference for certain buyers over others; closing loopholes that exempt poultry producers from protection under the Packers and Stockyards Act; closing loopholes in the Agricultural Fair Practices Act of 1967 to allow livestock producers to join producer organizations to negotiate livestock contracts with processors without being threatened with retribution; and securing increased funding for more effective enforcement of all antitrust laws.
2. Provide farmers with new economic incentives to shift existing industrial monoculture crop acreage into sustainable biomass crop reserves that would help curtail overproduction of feedgrains and oilseed crops and reduce U.S. dependence on unsustainable energy sources.
3. Expand conservation, wetlands and grassland reserve programs to reduce the overproduction of feedgrains and oilseeds on marginal lands and to restore biodiversity.
4. Establish regional emergency food reserves to help stabilize prices for farmers and ensure against food shortages during droughts, floods and other crop disasters.
5. Replace loan deficiency payments with non-recourse loans. This switch would reestablish a price floor for major commodities; reduce government subsidy payments; allow farmers to receive more of their income from the marketplace; curtail costly and unsustainable overproduction; and reduce current levels of U.S. agricultural dumping on world markets.
6. Reform federal food procurement programs—such as the school lunch program—to allow preferential purchasing of locally grown food and increase farm-to-school programs.
7. Ban all direct government subsidies to industrial animal factories—including a ban on any Environmental Quality Incentives Program payments.
8. Strengthen and more effectively enforce environmental laws to require industrial animal factories to pay to reduce the air, land and water pollution caused by their operations.

It is time we recognize that corporate agribusinesses, not farmers, are the main beneficiaries of U.S. policies that have driven the price of feed below what it costs farmers to produce. The expiration of the current farm bill in 2007 provides an historic opportunity to formulate a new approach to U.S. agriculture policy. The changes outlined above would effectively reduce current market distortions that provide unfair economic advantages to unsustainable, corporately owned industrial animal factories, and tip the scale back towards more sustainable, decentralized livestock production based on independently owned, diversified family farmers whose economic output sustains resilient and prosperous rural communities.

Written by R. Dennis Olson
IATP Trade and Global Governance Program

This fact sheet draws heavily on the Global Development and Environment Institute's Working Paper 05-07, "Identifying the Real Winners from U.S. Agricultural Policies," by Timothy A. Wise, which was adapted for IATP by GDAE Research Assistant Elanor Starmer. The original paper is available at: http://www.ase.tufts.edu/gdae/policy_research/RealWinners.htm.

RESOURCES

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2105 First Avenue South | Minneapolis, Minnesota 55404 | USA | (612) 870-0453 | iatp.org

Published June 2006