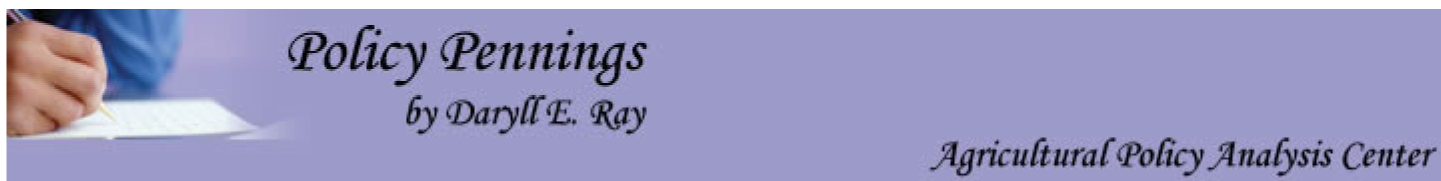
University of Tennessee Economist Cites Taylor Domina Work

Highly regarded and widely read University of Tennessee economist Dr Daryl Ray chose to devote a series of columns to the work of Dr Robert Taylor and David A Domina on problems affecting market concentration in American Agriculture.

This is the second of Dr Ray's columns, reprinted with permission of the author:



June 25, 2010

1. Information on poultry producers' pay and integrators' profits: Integrators have it, producers don't

This week, as a part of our series of articles on poultry production, we focus on the economic rationale and some of the factors that are at play in the integrated poultry market in the US as described by C. Robert Taylor and David A. Domina. Their full paper can be found at http://www.competitivemarkets.com/index.php?option=com_content&task=view&id=347&Itemid=50.

Taylor and Domina note that "After reporting integrator profits for over 25 years in *Livestock, Dairy and Poultry Outlook*, USDA changed its policy in 2004 and converted the estimated returns from cents/lb to indices." The reported reason for the change was a concern of industry participants.

They write, "The only 'industry participants' who have concern about USDA statistics on estimated integrator profits would be the integrators themselves. In

contrast, USDA did not change similar series for Great Plains cattle feeding or North Central hog farrow-to-finish operations. No policy justification for the estimates of integrator profits has surfaced to the authors' knowledge."

One of the requirements of a competitive market is information symmetry. But as Taylor and Domina write, "Poultry growers do not have public access to either grower pay or integrator profits, yet integrators have both. Information asymmetry strengthens the integrator's monopsony or oligopsony position."

While many have argued that contracting is of benefit to the grower because it shifts the risk from the grower to the integrator, Taylor and Domina argue that the opposite is true. They write, "Contracting changes risk but it does not give growers any real advantage because the grower lacks power to take advantage of a viable bargaining position during contracting. Indeed, contracts are not 'negotiated'; they are advanced by integrators on a 'take or leave it—and if the latter, we leave you stuck with your investment' basis. The contract allows the grower to subsist."

Each week all of the growers in a given complex who deliver flocks to the integrator are ranked against each other in terms of production as a means of holding growers accountable for poor management. Those ranked higher are paid more than those who rank low in a given week.

But Taylor and Domina argue that "often the grower's ranking changes more because of factors controlled by the integrator than by the grower's management." They assert that the serviceman assigned to a grower can have a significant impact on the grower's ranking. They look at average pay for flocks managed by individual servicemen, averaged over 5 years. It turns out that the average pay for flocks managed by different servicemen varies widely. In the chart they provide, the lowest serviceman averaged 4.15 cents per pound while the highest averaged 4.64 cents per pound.

They argue that using the tournament system double penalizes a grower at the bottom. First, they have less production to sell. And second, they get paid less per pound because of the tournament system. Taylor and Domina argue that "if growers were paid a fixed unit pay for all flocks, they would still have an incentive to properly manage flocks because poor management would result in less production" and thus lower pay.

"In a typical tournament system, if all growers are equally good managers they receive the same pay as they would if they were all equally bad managers. With the tournament ranking system, if 100% of the growers do an excellent job of raising their flocks, 50% or more of these highly efficient growers will fall below average for

that group and receive below average pay. In a competitive cash market, contract growers in one complex would benefit if they were all equally good managers relative to other complexes with growers who were not good managers."

With the tournament system, "the integrator benefits if all of their growers are good managers, as opposed to if they were all bad managers, but the growers do not benefit."

In addition, "economic risk for growers is imbalanced." They assert that "often the biggest risk of all is that of bankruptcy. Integrator acts and demands, not grower's mismanagement, is the problem. Delayed delivery of chicks, reduced placement, or similar actions by the integrator can have a devastating effect on the profitability of the contract poultry operation. A decision by the integrator to slow delivery of chicks to a grower can mean quick bankruptcy for that grower."

With regard to environmental issues, Taylor and Domina write, "integrators have used their economic control over growers to attempt to shift environmental costs and health risk costs from themselves to growers."

In commenting on our column on the USDA and Department of Justice hearing in Normal, Alabama one of our readers, Hugh Byrd, who viewed poultry contracting for three decades from behind a loan officers' desk before retiring, wrote the following comments, "It has been my experience…that most all poultry growers with new houses are 'happy' with their contracts. This is because they are 'living off the depreciation of their poultry houses.' I have never known any poultry farmer to budget for depreciation of their poultry equipment. If banks required poultry growers to fund a Reserve Account for equipment replacement as they do for commercial and industrial loans, there would be no poultry loans because the profit margin is much too thin and no operation would cash flow.

"Poultry integrators own their own feed mills, hatcheries, processing plants as well as truck fleets to transport the feed and chickens even though they could hire out these functions. The reason is because it is PROFITABLE for the company to own these components. My question is: If growing poultry is so profitable for the farmer, why don't the poultry companies also own poultry houses?"

As we write this column, the USDA has just proposed new rules to increase the fairness of the marketing of livestock and poultry. The rules will be published by the time you read these words, and comments will be received until August 23, 2010. We will begin commenting on these proposed rules after we finish reviewing Taylor

and Domina's paper. In the meantime, interested persons can obtain more information from the USDA website: http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=landing&topic=landing.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://www.agpolicy.org. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.

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