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STUDY BY THE STAFF OF THE U.S.

General Accounting Office

Regulation Of The Poultry Industry Under The Packers And Stockyards Act

The Department of Agriculture's regulatory authority over the poultry industry has remained fairly stable since 1935. Technological and market changes, however, have moved the industry from one of small independent producers to a highly integrated industry which annually provides U.S. consumers with 50 pounds of poultry per capita. This study presents information on the industry, discusses regulatory differences between the poultry and livestock industries, and highlights issues concerning regulation of the poultry industry.

Between 1958 and early 1975, 167 livestock packers' bankruptcies left producers unpaid for some $43 million worth of livestock. These bankruptcies prompted an amendment to the Packers and Stockyards Act which introduced safeguards--bonding, trust, and prompt payment requirements--for livestock producers against losses due to nonpayment by packers.

During fiscal year 1983, bankruptcies of four poultry processors affected about 1,700 poultry growers who are owed about $14 million. These bankruptcies prompted calls for amending the act to provide the poultry industry protection similar to that for the livestock industry.

Processors generally oppose, while growers generally favor, legislative changes to provide similar safeguards to the poultry industry. The Department does not have any plans to seek legislation to change the act's poultry provisions.

UNITED STATES GENERAL ACCOUNTING OFFICE

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PREFACE

This study presents information on the poultry industry and its regulation under the Packers and Stockyards Act of 1921, as amended. It discusses changes in the structure of the poultry industry, describes regulatory differences between the poultry and livestock industries, and highlights issues and concerns affecting regulation of the poultry industry.

We made this study because of congressional and other interest in the issue of regulation of the poultry industry under the Packers and Stockyards Act. This study should be useful to the Congress and other policymakers as they debate the issues and consider whether the poultry industry is properly regulated.

The information presented in this study was obtained through (1) a comprehensive literature search, (2) interviews with and/or data obtained from officials of the Department of Agriculture, and (3) interviews with officials of farm and industry organizations.

We are sending copies of this study to the Secretary of Agriculture; the House Committee on Agriculture; the Senate Committee on Agriculture, Nutrition, and Forestry; and other interested parties.

Questions regarding this study should be addressed to William E. Gahr, Associate Director, Food Coordination and Analysis Staff (202) 275-5525.

Ralph Carlone for

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STUDY BY THE STAFF OF THE U.S. GENERAL ACCOUNTING OFFICE

REGULATION OF THE POULTRY INDUSTRY UNDER THE PACKERS AND STOCKYARDS ACT

D I G E S T

The Packers and Stockyards Act is a federal antitrust and trade practice statute that applies to both the poultry and livestock industries. Its primary objective is to ensure competitive marketing conditions and fair trade practices in all phases of livestock, meat, and poultry marketing by preventing fraudulent, discriminatory, or monopolistic practices in these industries. The act also protects livestock producers, through prompt payment, bonding, and trust requirements, from financial difficulties, such as bankruptcies, which may be incurred by livestock buyers. The act is administered by the U.S. Department of Agriculture's Packers and Stockyards Administration.

As enacted in 1921, the act regulated the livestock markets and the meatpacking industry. It also covered meatpackers' poultry operations. Because much of the live poultry marketing shifted from meatpackers to dealers and handlers in large metropolitan centers, the act was amended in 1935 to extend jurisdiction to all persons engaged in marketing live poultry.

GAO made the study because of congressional and other interest in how the poultry industry is regulated under the Packers and Stockyards Act of 1921, as amended.

During fiscal year 1983, several poultry processors had financial problems and declared bankruptcy. Because of these bankruptcies, 1,700 poultry growers were not paid for their production. In addition, the recent outbreak of avian flu in the poultry industry, which caused over 10 million birds to be destroyed as of February 1984, has also affected the industry. These problems have resulted in calls for a review of poultry industry regulations.

PAST AND CURRENT CONDITIONS AFFECTING THE POULTRY INDUSTRY

In 1982 the wholesale value of U.S. poultry and egg production was $9.34 billion. Broilers--generally young chickens weighing from 2.5 to 5 pounds live weight when marketed--made up 48 percent of the value; eggs, 37 percent;

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turkeys, 14 percent; and other chickens, 1 percent.

In this study, GAO concentrates on changes in the broiler industry. However, according to industry spokespersons, the turkey and egg industries are also moving toward greater vertical integration as in the broiler industry. In vertical integration, two or more stages in the production-processing-servicing system are combined under one management.

Since the end of World War II, the broiler industry has changed from an industry of small independent producers into a highly integrated agricultural industry where many producers grow broilers under contracts with processors. In 1982 about 95 percent of broiler production occurred under growout contracts. Under these contracts, farmers provide buildings, equipment, and labor and contractors, or integrators, provide the birds and the feed, process (dress and package) the birds, and market the end product.

Although the nominal average broiler production cost in the 1979-81 period (26.4¢/lb) was about the same as that in the 1947-52 period (27.1¢/lb), the average production cost in real dollars (1967 base year) declined from 35.6 cents a pound in 1947-52 to 9.7 cents a pound in 1979-81. The nominal average retail price of broilers increased from 48.9¢/lb. in 1956 to 73.7¢/lb. in 1981; however, the price in real dollars decreased from 60.1¢/lb. in 1956 to 27.1¢/lb. in 1981.

Per capita consumption of broilers increased from 4.1 pounds in 1946 to 50 pounds in 1982. In 1946 total annual broiler production was 293 million birds; in 1982 it was about 4.2 billion. In 1954 about 50,000 farms were involved in broiler production, averaging 16,000 broilers per farm. In 1982 about 32,000 farms averaged 125,000 broilers per farm. (See pp. 4 to 8.)

Poultry consumers have benefited from industrialization and integration primarily because of increased production, the steady decline in real (deflated) production costs, decreased real prices, and consistent quality. In the late 1940's, technological, market, and policy factors began to affect the broiler industry environment. Collectively, these factors created the potential for lowering production costs and increasing sales and provided the impetus for changes in the broiler industry. For example, new housing designs for growing broilers, competitive advantages of certain production areas, and new environmental and consumer protection laws and regulations all affected the industry. (See pp. 8 to 12.)

PACKERS AND STOCKYARDS ADMINISTRATION'S REGULATION OF THE POULTRY INDUSTRY

The Packers and Stockyards Administration's regulatory authority over the poultry industry has remained fairly stable since 1935 when the Packers and Stockyards Act was amended to cover dealers and handlers of live poultry. The Administration's regulatory authority over the livestock industry, whose production had a wholesale value of $51.6 billion in 1982, has been changed because of changing conditions in the industry.

In 1976 the act was amended to provide livestock producers safeguards against financial losses resulting from failure of meatpackers to pay for their purchases. The 1976 amendment, which did not apply to poultry dealers or handlers, was enacted because 167 livestock packers went bankrupt over a 17-year period (1958 through early 1975). These bankruptcies left livestock producers unpaid for over $43 million worth of livestock. One packer, which went bankrupt in January 1975, accounted for over $20 million of the unpaid amount.

The amendment requires meatpackers to be bonded; to hold livestock, meats, and receivables or proceeds therefrom in trust until producers are paid; and to promptly pay producers. Since the 1976 amendment, livestock sellers have been paid about $7.6 million from private packer bond funds and about $20.5 million from packer trust funds.

Two poultry firms went bankrupt during fiscal years 1978-82. During fiscal year 1983, the poultry industry was faced with circumstances similar to the livestock problems that prompted the 1976 amendment. Three broiler firms and one turkey firm filed for bankruptcy. The firms owed about 1,700 growers approximately $14 million; one of the firms owed 1,500 growers $10 million.

The Administration regulates the poultry industry primarily by ensuring that growout contracts between broiler growers and integrators are complied with. The Department of Agriculture does not have authority to administratively issue cease and desist orders for violations, such as nonpayment and discriminatory practices, in the poultry industry as it does in the livestock industry. In poultry cases, the Department reports violations to the Attorney General for possible prosecution before a U.S. district court, which is a much more time-consuming procedure during which violations may continue. (See pp. 13 to 17.)

PROPOSALS FOR REGULATORY CHANGES AFFECTING THE POULTRY INDUSTRY

Poultry growers and integrators have different views on whether changing industry conditions, such as vertical integration and bankruptcies, support legislative changes in regulatory authority over the poultry industry. GAO discussed the Packers and Stockyards Act's coverage of the poultry industry with officials of the Department of Agriculture and representatives of the American Farm Bureau Federation, the National Grange, the National Broiler Council, the National Turkey Federation, and the Poultry and Egg Institute of America.

The Assistant Director, National Affairs Division of the Farm Bureau, whose membership includes poultry growers, told GAO that the Bureau's 1983 program called for changing the act to (1) provide the same jurisdiction over the marketing of poultry as now exists for livestock and (2) give poultry growers the payment assurance protection now accorded livestock producers by the bonding, trust, and prompt payment requirements. The Legislative Director of the National Grange, whose membership also includes poultry growers, adopted a resolution in November 1983 that calls for providing live poultry growers the same financial protection as the livestock industry.

Officials of the National Broiler Council, which generally speaks for the integrators, and the National Turkey Federation and the Poultry and Egg Institute, which generally speak for both growers and integrators, said that their organizations are opposed to any revision to the act that would increase government regulation of the poultry industry.

The Department of Agriculture does not have any plans to solicit or seek legislation to change the Packers and Stockyards Act. According to Department officials, the Department believes that the initiative for legislation should originate at the grower level. The Department's Assistant Secretary for Marketing and Inspection Services told GAO that this reflects the Reagan administration's position not to increase government regulation. (See pp. 17 to 19.)

AGENCY COMMENTS

According to the Department of Agriculture, which reviewed a draft of this study, the study adequately covers the subject matter discussed. (See app. I.)

Contents

ABBREVIATIONS

ERS	Economic Research Service
GAO	General Accounting Office
P&S	Packers and Stockyards
P&SA	Packers and Stockyards Administration
USDA	U.S. Department of Agriculture

CHAPTER 1

INTRODUCTION

This study presents information on the poultry industry and its regulation under the Packers and Stockyards (P&S) Act of 1921, as amended (7 U.S.C. 181 et seq.). It discusses changes in the structure of the poultry industry, describes regulatory differences between the poultry and livestock industries, and highlights issues and concerns affecting regulation of the poultry industry.

We made this study because of congressional and other interest in how the poultry industry is regulated under the P&S act. This study should be useful to the Congress and other policymakers as they debate whether the poultry industry is properly regulated.

The P&S act is a federal antitrust and fair trade practice statute. Its purpose is to assure that competitive marketing conditions and fair trade practices exist in all phases of livestock, poultry, and meat marketing by preventing fraudulent, discriminatory, or monopolistic practices in these industries.

The P&S act is administered by the Packers and Stockyards Administration (P&SA), U.S. Department of Agriculture (USDA). P&SA, with headquarters in Washington, D.C., has 12 regional offices and about 200 employees; its fiscal year 1984 budget is about $9 million.

REGULATION OF THE POULTRY INDUSTRY UNDER THE PACKERS AND STOCKYARDS ACT

As enacted in 1921, the P&S act was directed primarily toward the livestock markets and the meatpacking industry. It also applied to meatpackers' poultry operations. At that time, such operations constituted the bulk of the commercial poultry trade in the country. The meatpackers' position in the poultry industry declined, however, as live poultry marketing shifted to large metropolitan areas. Those poultry dealers and handlers engaged in poultry marketing in these metropolitan areas were not covered under the act. As their marketing operations grew, these poultry dealers and handlers complained about unfair and deceptive practices. As a result, the Congress amended the P&S Act in 1935 by adding title V, which extended the act's jurisdiction to all persons engaged in marketing live poultry in commerce.

After a P&SA study of the poultry industry showed that the growers' bargaining position with integrators[1] was limited, P&SA issued detailed poultry regulations in 1971. The regulations are designed to prohibit unfair practices in marketing poultry or in

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[1]Firms that contract for poultry production from farmers (growers), process (dress and package) the birds, and market the end product. The contractual agreement between the grower and the integrator is called a growout contract.

acquiring poultry from producers or growers. According to P&SA, the agency's primary concern, as reflected in its poultry regulations, is that growers receive fair and equitable treatment from integrators. P&SA does this by

--assuring that there are written contracts between growers and integrators,

--assuring that integrators provide full and complete accounting on contracts with growers to raise the poultry (growout contracts),

--assuring that scales have been tested and weigh accurately,

--assuring that poultry is weighed promptly and that weighing scale tickets are provided to producers, and

--preventing retroactively reduced contract payment terms and assuring that payments are made in accordance with contract terms.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our study objectives were to obtain information on the issues and concerns of those involved in the poultry industry and report on the status of the industry today. We made the study between January and December 1983 and in accordance with generally accepted government auditing standards. We obtained supplemental information in January and February 1984.

We reviewed our previous reports dealing with P&SA and/or the poultry industry.[2] We made a literature search and reviewed pertinent P&SA, USDA's Economic Research Service (ERS), and USDA's Statistical Reporting Service publications,[3] and congressional hearings to identify information that would assist us in our study. We discussed issues related to structural changes in the poultry industry and its regulation under the P&S act with the Assistant Secretary of Agriculture for Marketing and Inspection

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[2]Federal Regulation of Meat and Poultry Products--Increased Consumer Protection and Efficiencies Needed (GAO/RCED-83-68, May 4, 1983); The Packers and Stockyards Administration's Regulatory Reform Activities (CED-82-11, Nov. 16, 1981); Beef Marketing: Issues and Concerns (CED-78- 153, Sept. 26, 1978); and Information on Federal Agencies Having an Impact on Production and Marketing of Meat (B-136888, Mar. 25, 1974).

[3]The Broiler Industry: An Economic Study of Structure, Practices and Problems, P&SA, Aug. 1967; The Chicken Broiler Industry: Structure, Practices and Costs, ERS, Aug. 1977; The U.S. Poultry Industry: Changing Economics and Structure, ERS, July 1983; and Structural Change in Agriculture: The Experience for Broilers, Fed Cattle, and Processing Vegetables, Economics and Statistics Service, USDA, Apr. 1981.

Services; the Administrator and Assistant Administrator, P&SA; the Chief of P&SA's Poultry Branch; other P&SA headquarters personnel; and ERS economists in ERS' National Economics Division. We visited P&SA regional offices in Bedford, Virginia, which is responsible for a large poultry-producing area, and Fort Worth, Texas, which is responsible for a large livestock-producing area, and discussed with field personnel their views and concerns on issues affecting the poultry and livestock industries. At headquarters and both regional offices, we reviewed investigative files dealing with contract compliance and complaint reviews by P&SA staff and obtained supporting and statistical data when necessary.

We discussed industry views and concerns with representatives of the National Broiler Council, National Turkey Federation, Poultry and Egg Institute of America, American Farm Bureau Federation, and National Grange. The Council generally speaks for the integrators and the Federation and Institute speak for both growers and integrators. The Farm Bureau's and Grange's memberships include poultry growers. We also discussed the need for regulatory changes with two poultry growers who were referred to us by P&SA's Bedford, Virginia, regional office.

CHAPTER 2

PAST AND CURRENT CONDITIONS

AFFECTING THE POULTRY INDUSTRY

In 1982 the wholesale value of poultry and egg[1] production was $9.34 billion, of which 48 percent came from broilers,[2] 37 percent from eggs, 14 percent from turkeys, and 1 percent from other chickens. About 32,000 growers raised broilers, and about 7,000 growers raised turkeys. Nineteen states produced 96 percent of the broilers, and 17 states produced about 95 percent of the turkeys.

The broiler industry today is a highly industrialized and integrated agricultural subsector. Vertical integration[3] in the broiler industry is the greatest among all the animal product industries. In 1982 about 95 percent of broiler production occurred under contracts with integrators. The remainder came from independent farmers in the poultry business. Under a typical integrator/grower arrangement, the grower provides buildings, equipment, and labor and the integrator provides birds and feed. The functions of a typical integrated broiler firm are shown in figure 1.

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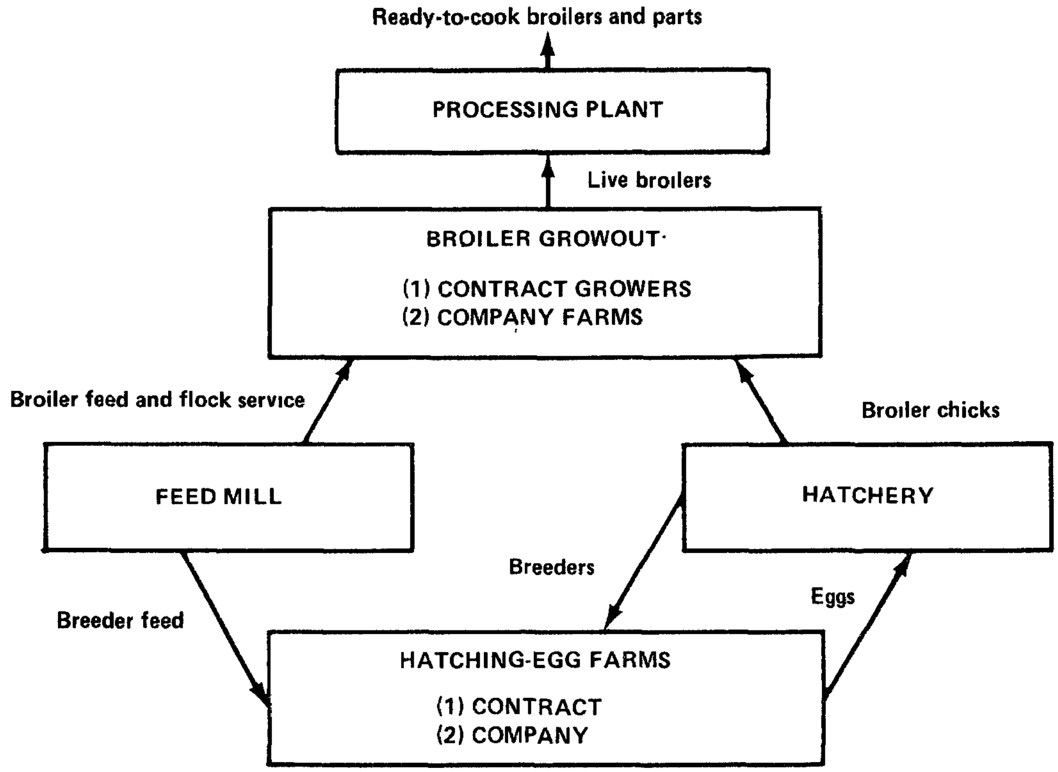
[1]This report deals with the regulation of poultry under the P&S act, which covers live poultry dealers, i.e., persons engaged in the business of buying or selling live poultry in commerce for slaughter. The egg industry, although a part of the poultry industry, is not covered by the P&S act.

[2]Young chickens that are marketed at 2.5 to 5 pounds live weight.

[3]To combine two or more stages in the production-processing-servicing system under one management. Vertical integration generally refers to ownership control, although other means of formal vertical coordination, such as contracting and joint ventures, are sometimes considered integration.

Figure 1
Functions of a Typical Integrated Broiler Firm



Source Economic Research Service, USDA

The turkey industry also has become more industrialized. Unlike broiler growers, however, turkey growers generally operate independently from the processors. The turkey growers provide their own birds and feed in addition to providing the buildings, equipment, and labor. Typically, turkey growers enter into contracts with processors to supply a certain quantity and quality of birds and receive payment at the wholesale price at time of delivery. The Executive Vice President of the National Turkey Federation told us that although the turkey industry has not become as integrated as the broiler industry, the trend is toward integration similar to that in the broiler industry. Likewise, according to the President of the Poultry and Egg Institute of America, the egg industry is also moving toward vertical integration.

Poultry consumers have benefited from industrialization and integration primarily because of increased production, the steady decline in real (deflated) production costs, decreased real prices, and consistent quality. As shown in table 1, in a little more than three decades after World War II, broiler and turkey production costs, in real dollars, were reduced about two thirds.

Table 1

Average Production Costs for Broilers and Turkeys During Selected Periods

Period	Broilers/live weight		Turkeys/live weight	
	Nominal	Deflated[a]	Nominal	Deflated[a]
	(cents per pound)		(cents per pound)	
1947-52	27.1	35.6	34.7	45.5
1953-57	20.6	25.3	27.6	33.9
1958-62	16.0	18.2	22.2	25.3
1963-68	14.4	14.9	20.8	21.6
1969-72	14.2	12.3	20.4	17.8
1973-75	21.8	13.1	31.5	19.0
1976-78	21.3	10.1	31.2	14.9
1979-81	26.4	9.7	38.0	14.0

[a]Deflated or "real" cost equals nominal (actual) cost divided by index of items used in production, including interest, taxes, and wage rates, 1967=100.

Source: Economic Research Service, USDA.

Likewise, real (deflated) retail prices of broilers also decreased. Although the nominal average retail price of broilers increased from 48.9¢/lb. in 1956 to 73.7¢/lb. in 1981, the price in real dollars decreased from 60.1¢/lb. in 1956 to 27.1¢/lb. in 1981.

The remainder of this chapter concentrates on changes in the broiler industry--by far the largest segment of the live poultry industry.

STRUCTURAL CHANGES IN THE BROILER INDUSTRY

Since the end of World War II, the broiler industry has been transformed from an industry of small, widely scattered, and independent producers into a highly integrated and industrialized agricultural industry.

Per capita consumption of broilers increased from 4.1 pounds in 1946 to 32 pounds in 1966 and 50 pounds in 1982. In 1946 total annual production of broilers was only 293 million; in 1966 it amounted to about 2.6 billion birds, and in 1982 it totaled about 4.2 billion birds. Table 2 shows broiler production and consumption for selected years.

Table 2

Broiler Production and Consumption

Year	Production: Number (million)	Production: Live weight (million lbs.)	Average price per pound received by producers (cents)	Value of production (million dollars)	Civilian per capita consumption (pounds)
1934	34	97	19.3	19	0.5
1935	43	123	20.0	25	0.7
1936	53	152	20.6	31	0.8
1941	192	559	18.4	103	2.8
1946	293	884	32.7	289	4.1
1951	789	2,415	28.5	689	10.4
1956	1,344	4,270	19.6	838	17.3
1961	1,991	6,832	13.9	947	25.9
1966	2,571	8,989	15.3	1,372	32.0
1971	2,945	10,818	13.7	1,487	36.7
1976	3,280	12,506	23.6	2,951	40.4
1981	4,150	16,530	28.5	4,703	48.6
1982	4,151	16,770	26.9	4,506	50.0

Source: Economic Research Service and Statistical Reporting Service, USDA.

In 1954 about 50,000 farms were involved in broiler production, averaging 16,000 broilers per farm. In 1982 about 32,000 farms averaged 125,000 broilers per farm. Table 3 shows the long-run trend of fewer farms producing broilers and fewer firms processing broilers.

Table 3

Broiler Industry Patterns

Year	Number of farms[a]	Broilers per farm[a]	Number of processing firms[b]
1954	50,000	16,000	286 (1960)[c]
1964	35,000	55,000	201
1974	33,000	72,000	191
1982	32,000	125,000	137 (1981)[d]

[a]Numbers have been rounded to nearest thousand and include independent and contract producers and farms that integrated firms own or lease.

[b]The exact number of firms processing broilers is not known because of inadequate information on the ownership of broiler processing plants. Numbers reported in this table are estimates reported by ERS and P&SA studies.

[c]Information on number of firms was not available for 1954. However, P&SA reported that 286 firms were processing broilers in 1960.

[d]Information on number of firms was not available for 1982. However, according to a representative of the National Broiler Council, 137 firms were processing broilers in 1981.

Source: Economic Research Service and P&SA.

In the late 1940's, technological, market, and policy factors began to affect the environment in which the broiler industry operated. These factors created the potential for lowering production costs and increasing sales. Collectively, the factors provided the impetus for changes in the broiler industry. Consequently, the broiler industry began to change from a backyard or sideline activity to the vertically integrated structure it is today.

Technological factors

Technological factors that affected the industry included mechanical and biological advances. Major mechanical advances included (1) new housing designs that provided a better environment for growing broilers and allowed the use of mechanical cleaning and waste removal equipment, (2) automated feed-handling and watering equipment, and (3) high-capacity mechanized killing and processing lines. Biological advances included developing (1) fast-growing strains of chicken bred for meat production, (2) rations formulated for poultry in starter, growout, and finishing stages of growth, and (3) antibiotic feed additives and vaccines to control diseases. To realize the full potential of the mechanical and biological advances, a new method was needed to organize and control broiler industry production resources and coordinate practices. As a result, new forms of business organization, including various forms of contracting and vertical integration, were devised to meet the broiler industry's requirements.

The new technologies' effect on the broiler industry was to lower production costs, increase the economies of size, attract new entrants into the industry, and introduce new coordination methods. Production efficiency increased not only because of the biological advances but also because of the mechanical innovations in poultry housing, feed handling, and watering which improved the environment for raising broilers and reduced labor requirements. Structurally, new mechanical technology resulted in substituting capital for labor and increasing the size of production units.

A central feature of the new organization technology was the growout contract between growers and integrators to coordinate broiler raising with other stages in the industry. It made large-scale broiler raising attractive to both farmers and feed suppliers.

Market factors

Market factors that changed the poultry industry included changes in production areas, market growth potential, market price risks, ease of entry, and sources of credit and capital. Although broiler production traditionally had been widely dispersed, economically depressed farming conditions and availability of resources in certain regions of the country created an opportunity for increased broiler production. Until the mid-1940's, growing chickens had been largely a backyard or farmyard enterprise with small flocks as a by-product of egg production, and production had been seasonal and erratic. As a result, market growth was slow, and generally consumers purchased chicken only for special occasions on a seasonal basis. Consequently, a good potential existed for market expansion, provided that more stable (year round) production patterns and a higher level of product uniformity (consistent quality) could be attained than with traditional production practices.

Since the late 1940's, the main broiler production areas have changed. In 1950 the South Atlantic region accounted for 45 percent of the total output and the Western region 8 percent. The remainder was about equally divided among the North Atlantic, North Central, and South Central regions. (Fig. 2 shows the states in each broiler producing region.) By 1982 the two southern regions together produced more than 78 percent of the U.S. broiler output.

Figure 2

Broiler Producing Regions

Source: Economic Research Service, USDA.

Surplus labor available from underemployed farmers and favorable climate were further incentives to expand broiler production in rural areas of the South Atlantic and South Central regions. As new production areas gained a competitive advantage over older areas, new processors began developing regional and national marketing strategies in contrast to the local marketing strategies of processors in the traditional areas. The industry in the traditional production areas began to decline because independent producers were unable to compete with larger scale, lower cost producers in the new areas. Expanding lower cost production in the South Central and South Atlantic regions reduced the market access and increased the price risk for the traditional production areas.

Along with the growth and structural changes in the broiler industry, the level and nature of risk associated with production and marketing activities also changed. Market risks are either product or input risks. Product market risks are those associated with price variability and with gaining access to markets. The major input risk is access to operating capital by potential large-scale broiler producers.

Integrators faced a sometimes substantial market price risk. As the industry developed, wholesale prices of broilers varied more than the cost of production. Also, prices tended downward as production costs dropped and output rose and a number of larger integrators increased their market share, causing periods of overproduction. At such times, even the most efficient producers suffered periodic losses. As a result, several firms that were either financially unable or otherwise unwilling to absorb such losses withdrew from the industry. In most cases, the surviving firms acquired the nonsurviving firms' physical assets, which increased both the level of concentration and the size of firms in the industry.

To deal with market price and market access risks, several integrated firms have tried to differentiate their product through branding and promotional activities. By doing this, a firm can achieve some control over the price it can receive for its product.

Changes also have occurred in the nature of the risks as the structure of the industry changed. The market structure for live broilers changed significantly for processors. With increasing integration, the broiler market's supply of uncommitted live broilers dwindled significantly. As a result, independent processors found it increasingly difficult to obtain enough live broilers to keep their operations going. They were forced to either develop affiliations with the feed dealers that had initially integrated the growers or develop their own grower contracts. This was one factor that led to developing the fully integrated production/processing firms that now characterize the industry.

The basic broiler production contracts were modified as integrators attempted to deal with the risks inherent in the new structure. As the integrators' objectives shifted from sales to managing the risks of the industry, contracts with growers were modified to give integrators virtually complete management control over the growout stage. Current contracts basically are devices integrators use to lease production facilities and hire labor. The integrators retain title to the birds, and their ownership of other production inputs makes the integrators rather than the growers the real producers. This risk-management change has caused the development of a highly industrialized industry with firms having central management control over all phases of production and marketing, and a high degree of firm concentration.

<u>Policy factors</u>

Policy factors that have contributed to the changes in the broiler industry include USDA's feed grain programs, consumer protection and environmental laws and regulations, and antitrust policies.

During the 1950's and 1960's, the operation of USDA's feed grain commodity programs, which provide price support to feed grain producers, contributed to relatively stable feed prices and led to large feed grain surpluses. As a result, low feed grain costs prevailed and the feed grain programs had the effect of reducing a major input risk, namely the cost of feed used in a typical broiler raising operation.

During the same period, new environmental and consumer protection laws and regulations affected the broiler industry's processing stage. Consumer protection laws and regulations, which included the Poultry Products Inspection Act, as amended (21 U.S.C. 451 et seq.), and the Federal Meat Inspection Act, as amended (21 U.S.C. 601 et seq.), were concerned with plant sanitation, packaging, and labeling. Environmental regulations issued during the 1960's were concerned with the processing plants' waste disposal. Because most of the older broiler processing plants needed to be modernized to meet these waste disposal and sanitation standards, many closed down rather than incur the costs. As a result, the market access of local producers was further limited in the traditional production areas.

CHAPTER 3

THE PACKERS AND STOCKYARDS ADMINISTRATION'S

REGULATION OF THE POULTRY INDUSTRY

P&SA's regulatory authority over the poultry industry has remained fairly stable since 1935. The P&S act has been amended because of changing conditions in the livestock industry, whose production in 1982 had a wholesale value of $51.6 billion.

P&SA's regulation of the poultry industry is limited when compared with its regulation of the livestock industry, although both industries fall under the purview of the P&S act. Although the act's overall intent is the same for livestock and poultry, the act's specific provisions covering each are different. As a result, P&SA's responsibilities for administering the act's poultry and livestock provisions are different.

The changes in the poultry industry have led some interest groups, mainly those representing integrators, to advocate eliminating references to the poultry industry from the P&S act. Others, including grower representatives, have advocated increased P&SA regulatory authority.

P&SA's REGULATORY RESPONSIBILITY AND EXPERIENCE UNDER THE P&S ACT

Under the P&S act, P&SA is primarily responsible for ensuring open and free competition in the livestock marketing, meatpacking, and poultry industries. The agency does this mainly by reviewing complaints and correcting the problems. It also works toward developing and maintaining good working relationships with members of the trade to achieve compliance informally whenever possible. P&SA's authority to regulate the poultry industry differs from its authority to regulate the livestock industry.[1]

P&SA's regulation of poultry consists primarily of ensuring compliance with growout contracts between broiler growers and integrators. The regulations require that the grower receive a written contract from the integrator and that all information necessary to compute payment be specified. The regulations also prescribe the types of records that must be maintained, the records that must be furnished to grower or seller, and the requirements for weighing live poultry. The fundamental principle of the growout contract regulations is disclosure, and the purpose is to provide the grower with all the facts necessary to compute the amount

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[1]In May 1983 we reported to the Congress in Federal Regulation of Meat and Poultry Products--Increased Consumer Protection and Efficiencies Needed (GAO/RCED-83-68, May 4, 1983) that USDA's Food Safety and Inspection Service had different standards for meat than it had for poultry to protect the public against certain substances that may be injurious to health and to ensure the products' nutritional quality.

to be received from the integrator. For this reason, all terms relating to grower pay are to be disclosed in the contract. Most of P&SA's investigations relating to the poultry industry involve elements of the growout contracts.

Most complaints received from the poultry industry alleging violations of the act are from growers and pertain to integrator practices. P&SA's policy guidance provides that the agency promptly investigate complaints and that, where appropriate, make the investigations along with P&SA's scheduled reviews of integrators' contract compliance. During fiscal years 1982 and 1983, P&SA handled 37 and 42 poultry complaints and investigations, respectively.

Unfair practices that the agency reviews include integrators' boycotting growers and arbitrarily terminating growout contracts. The general guideline that P&SA follows is that a grower contract cannot be terminated unless there is an economically justifiable reason and even then a grower should not be discriminated against.

The act does not provide P&SA with administrative authority to issue cease and desist orders against poultry industry participants to stop violating provisions of the act--although P&SA has such authority related to the livestock industry. Before 1969 the agency thought that it had such authority in the poultry area, and it issued five cease and desist orders against live poultry dealers and handlers. In 1969 and 1970, the 8th and the 5th circuit courts, respectively, ruled that the agency did not have such authority. Accordingly, to proceed against poultry violators, P&SA must report violations to the Attorney General for possible prosecution in a U.S. district court. The Chief of P&SA's Poultry Branch told us that this is a much more time-consuming procedure during which violations may continue. Between 1969 and 1983, nine cases seeking judicial action were referred to the Attorney General, who chose not to prosecute one of the nine cases. Of the eight cases that were prosecuted, seven were decided in favor of the government.

CHANGING CONDITIONS THAT HAVE RESULTED IN CHANGES TO THE P&S ACT

When the Congress passed the P&S act in 1921, it was primarily concerned with the monopoly power of the five largest meatpackers at that time. Structural changes in the livestock and poultry industries since then have resulted in various changes to the act. The major change affecting poultry occurred in 1935 when title V was added to the act to cover dealers and handlers of live poultry. Since then, no major changes affecting poultry have been enacted. On the livestock side, significant changes have been made to the act.

Between 1958 and 1976, the pattern of livestock marketing changed as packers increasingly purchased slaughter livestock directly from producers rather than through market agencies and dealers. Direct purchasing placed increased risks on livestock producers because packers were not bonded under the act as were market agencies and dealers.

A major legislative change affecting the livestock industry occurred in 1976 when the act was amended to provide livestock producers strong safeguards against financial losses due to the failure of meatpackers to pay for their purchases. The amendment was enacted because, from 1958 through early 1975, 167 packers went bankrupt, leaving cattle producers unpaid for over $43 million worth of livestock. One large packer went bankrupt in January 1975, which left cattle producers in 13 states unpaid for a total of over $20 million in livestock sales. Specifically, the 1976 amendment provides the following safeguards.

--Bonding provisions are required for packers with average annual livestock purchases of over $500,000, and such packers are required to hold all livestock, meats, and receivables or proceeds therefrom in trust until all producers who have not expressly extended credit to the packers have received full payment for their livestock.

--The Secretary of Agriculture is authorized to order an insolvent packer to cease and desist from purchasing livestock while insolvent.

--The Secretary of Agriculture can request the Attorney General to seek a temporary injunction or restraining order if any person subject to the act's livestock provisions (1) does not have the required bond, (2) has failed to pay or is unable to pay for livestock, meats, meat food products, or livestock products in unmanufactured form, (3) is operating while insolvent, or (4) is otherwise violating the act in a manner expected to cause irreparable damage. These temporary remedies are intended to stop violations until the Secretary issues a complaint under the act or until the Secretary's cease and desist order has become final and effective within the meaning of the act.

--Packers, market agencies, and dealers purchasing livestock are required to pay for livestock promptly unless the parties otherwise expressly agree in writing.

--All wholesale brokers, dealers, and distributors marketing meats, meat food products, or livestock products in unmanufactured form in commerce are brought under regulation as packers under title II of the act.

--The Secretary is authorized to assess in an administrative proceeding a civil penalty of not more than $10,000 for each violation committed by any packer, stockyard operator, market agency, or dealer.

These financial safeguards do not apply to poultry growers.

Since the 1976 amendment, livestock sellers have been paid about $7.6 million from private packer bond funds and $20.5 million from packer trust funds.

CURRENT CONDITIONS AFFECTING REGULATION OF THE POULTRY INDUSTRY UNDER THE P&S ACT

Prior to fiscal year 1983, P&SA did not routinely maintain data on bankruptcies in the poultry industry. However, at our request, P&SA obtained data on bankruptcies for fiscal years 1978 through 1982. According to the data, two firms had filed for bankruptcy during that 5-year period--one in 1979 and the other in 1981. Both firms were in Maine, an area where broiler production has declined.

Within the past fiscal year, bankruptcies in the poultry industry increased. During fiscal year 1983, three broiler firms and one turkey firm filed for bankruptcy, affecting about 1,700 growers. The growers, who have not been paid about $14 million that the firms owed them for their growout operations, are treated as any other creditor in a bankruptcy. One of the broiler firms owes $10 million to its 1,500 growers.

In the poultry industry, the grower is primarily a furnisher of labor and facilities; in the livestock industry, the grower is generally an individual entrepreneur. Both are subject to financial risks relative to their investments. One of the poultry grower's primary investments is in the buildings used for growout operations. These buildings are usually built and equipped to an integrator's specifications and, according to a P&SA Poultry Branch document, the grower's investment in the buildings can only be recovered through continuous use of them for growing poultry. Generally, however, growout contracts are on a flock-to-flock basis with no guarantee that the grower will receive more than one flock. Conversely, the cattle growers' primary investment is in the product--the cattle. Cattle growers usually own their product until the time title is transferred because of sale.

Although the poultry industry's integration reduced the growers' exposure to the risks of fluctuating market prices, it also reduced their options as poultry growers. According to the P&SA Poultry Branch document, a grower has two options in a growout contract: to accept the contract or to refuse it. The grower generally cannot change the contract but rather must take it or leave it. Because the integrator is responsible for marketing the product and establishing quality control, a grower generally exercises no control over contract terms; type and quality of chicks; type, quantity, and weight of feed; medication; date of placement and pickup; computation and date of payment; and type of broiler house and equipment.

Although the broiler industry's integrated structure is firmly in place, other structural and performance factors can change the industry's condition. For example, conditions in the industry can be altered as changes occur in such structural factors as the size of poultry firms, market shares of individual firms, ease of entry into the industry, and competition with other industries--in this case the livestock industry. Structural changes can also involve geographic location patterns of firms. Performance factors--the general economic results flowing from the industry--can also change conditions in the industry. The primary indications of how well an industry performs are the prices paid for its output and the quality of the output.

P&SA's last study of the broiler industry's structure, practices, and problems was in 1967. P&SA made that study in response to several complaints it had received from southern broiler growers alleging unfair trade practices. The study examined whether any broiler firms had violated the P&S act and whether firms had monopolistic advantages resulting in weak bargaining positions for growers. The study concluded that consumers had benefited from improved industry performance, which had resulted in increased production, decreased prices, and increased quality, but that a grower's bargaining position with an integrator was limited because of the lack of alternatives available to the grower, and therefore, the equity of business relationships between growers and integrators needed monitoring. The study served as the basis for P&SA's poultry regulations issued in 1971 and discussed in chapter 1.

PROPOSALS FOR REGULATORY CHANGES AFFECTING THE POULTRY INDUSTRY

Not surprisingly, poultry growers and integrators have different views on whether changing industry conditions, such as vertical integration and bankruptcies, support legislative changes in regulatory authority over the poultry industry.

The American Farm Bureau Federation, which is the largest farm organization in the United States with membership that includes farm operators and others in agriculture, speaks in part for poultry growers. The Assistant Director of the Bureau's National Affairs Division told us that the Bureau's 1983 program called for changing the act to (1) include poultry dealers in the definition of a packer in order to provide the same jurisdiction over the marketing of poultry as now exists for livestock and (2) give poultry growers the payment assurance protection now accorded livestock producers by the bonding, trust, and prompt payment requirements. The Assistant Director also said that protection for the livestock industry is much more extensive than for poultry, mainly because livestock growers are more organized and politically active.

The National Grange, one of the largest and oldest organizations of primarily farmers and other rural residents, also speaks in part for poultry growers. The Legislative Director of the National Grange told us that the Grange adopted a resolution at its annual meeting in November 1983 that calls for changing the P&S act to provide live poultry growers, who raise birds for live poultry processors, the same financial protection provided the livestock industry.

Officials of the National Broiler Council, the National Turkey Federation, and the Poultry and Egg Institute of America told us that their organizations are opposed to any revision to the act that would increase government regulation of the poultry industry. Accordingly, they would not favor legislation requiring bonding of poultry dealers or handlers or that would give P&SA authority to proceed administratively against poultry industry participants that violate the act. The President of the Broiler Council, which speaks for the processors, said that meatpacking and cattle are the act's main focus. Because the act's definition of a packer does not mention poultry integrators, the president questions whether P&SA should have jurisdiction over the poultry industry as it is structured today. He said that the Council believes the poultry industry should not be subject to the same regulations as the livestock industry because, in its view, the poultry industry is no different from other industries, such as the vegetable industry, which are not regulated to the extent the livestock industry is regulated.

According to the Council President, the growers' economic concerns are the industry's concerns. Speaking for the Council, he said that growers are generally being treated fairly by integrators and that growout contracts only reflect economic conditions of the integrators which also assume most of the risks. The Council President said that, in areas with several integrators, growers do switch from one integrator to another.

The Council President added that the Council would be hesitant to open the act for any revisions. He said that the Council would like to see poultry removed from the P&S act completely but is concerned that opening the act could add more regulation to the industry. The Council is opposed to giving P&SA greater authority over poultry operations because it views the poultry industry as not in need of regulation. The Council President said that he believes a bonding requirement for poultry integrators is not needed because it would only increase costs to the producers and ultimately to the consumers. Also, he believes that processors are paying growers promptly and any exceptions are within the terms of the contract between the grower and processor.

Another industry spokesperson, the President of the Poultry and Egg Institute of America, said that the Institute would also be opposed to opening the act for change because everyone with an interest would want to have a chance to do something with it. He added that there probably would be no difference in the poultry industry if there were no P&SA because the agency's authority over poultry is limited. However, the Institute would be opposed to any attempts to strengthen poultry coverage in the act.

The Executive Vice President of the National Turkey Federation, whose membership includes both growers and processors, told us that its members were satisfied with the contractual arrangements they have with each other. He said that there is no need for bonding, similar to that which the 1976 amendment provided for the livestock industry, to be applied to the turkey industry or for P&SA to have any additional regulatory authority over the poultry industry.

The Chief of P&SA's Poultry Branch told us that he believes that the agency should have the same regulatory authority over poultry as it has for livestock. The Administrator of P&SA told us that he believes that either the agency should have the same regulatory and enforcement authority over poultry as it has for livestock or the act should be amended to eliminate poultry entirely. USDA does not have any plans to solicit or seek legislation to change the P&S act to provide stronger poultry coverage. According to USDA officials, USDA believes that the initiative for legislation should originate at the grower level. The Assistant Secretary for Marketing and Inspection Services told us that this reflects the administration's position not to increase government regulation. He said that he does not have any knowledge of prior administrations' attempting to develop any legislative changes to the act.

According to the Chief of P&SA's Poultry Branch, a senator's office drafted proposed legislation in 1983 to amend the P&S act to require the prompt payment of live poultry growers by live poultry processors. The Chief said that the senator's plans were to introduce the proposed legislation during the latter part of the 1st session of the 98th Congress. However, the proposed legislation was not introduced because of timing and other considerations, including an outbreak of avian flu which has affected poultry in certain parts of the country.[2] In January 1984, the Chief told us that the senator's office had advised him that plans are to introduce the bill during the 2nd session of the 98th Congress.

AGENCY COMMENTS

USDA commented on a draft of this study. It said that the study adequately covers the subject matter addressed. (See app. I.)

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[2]The outbreak of avian flu in late 1983, which was continuing as of February 1984, has resulted in additional financial and other problems in the poultry industry. To contain and eradicate avian flu among poultry, over 10 million birds had been destroyed as of February 1984. A special federal-state task force has been established to carry out the eradication programs. As of February 1, 1984, $20 million had been paid to owners of the destroyed flocks and an additional $34 million had been authorized.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

MAR 16, 1984

Mr. J. Dexter Peach, Director
Resources, Community and Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

The Department has reviewed the General Accounting Office draft report entitled Regulation of the Poultry Industry under the Packers and Stockyards Act and has no substantive comments or recommended changes. The report is well written and adequately covers the subject matter addressed.

Officials of the Packers and Stockyards Administration have discussed a few suggestions for minor changes with the author of the report and these have been incorporated in the author's draft.

Sincerely,

C. W. McMillan

C. W. McMillan
Assistant Secretary
Marketing and Inspection Services

27472

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