Jolley: Five Minutes with R-CALF's Bill Bullard and the TPP

By **Chuck Jolley** March 01, 2016 | 11:24 am EST

The Trans Pacific Partnership has all the earmarks of being one of the most staggering marketing agreements since NAFTA. It certainly has a larger economic foot print than the European Union. It will change the economic rules of the road among at least a dozen countries bordering the Pacific basin and it has the quietly spoken potential to include several more nations.

Certainly being on the outside looking in would be financially awkward for American businesses. That the U.S. should be a major player in such a partnership is critical. The devil is always in the finer details, though, and whether or not the years of debate have crafted something in the best interests of all American businesses will be discussed for years.

The agreement seems to give preferential treatment to American agriculture and the early word from most ag associations was overwhelmingly positive. Tariffs would gradually diminish like a cancerous tumor under the twin attacks of chemo and irradiation. Markets with artificial gate ways would open up. Our fruits, grains and protein resources would soon begin to enjoy something akin to a twenty-first century version of the roaring twenties.

Urging immediate passage, National Cattlemen's Beef Association President Tracy Brunner said cattle producers cannot afford to wait any longer for passage of the agreement.

"The value exports add to U.S. beef is undeniable," said Brunner in a late February press release. "Asia and the Pacific Rim are extremely valuable markets for U.S. beef. We not only export steaks and ground beef, but this region demands high quality variety meats like beef tongue. Those products bring a premium in these markets and add value back to producers here at home."

Pressing hard, Brunner said, "Due to the preferential agreement between Australia and Japan, U.S. producers have lost over $100 million in sales to Japan this past year. The only way to level the playing field, stop the erosion of our market and rebuild market share is passage of TPP. Once TPP is passed the tariff rate on our beef into Japan will immediately reduce to 27.5 percent and continue to reduce to 9 percent over 16 years."

Not so fast, said Bill Bullard. Several weeks ago, R-CALF's chief honcho spoke at a meeting of the Cattle Producers of Washington and suggested that while everyone was admiring the TPP on its face value, the agreement might have feet of clay. He suggested that the benefits would go to the packers and leave cattle ranchers in a state that could be best described as 'chickenized.'

Not being at the CPW meeting, I contact Mr. Bullard and asked about his speech. He sent a copy which made for some interesting reading. Of course, I had a few questions afterwards and he answered them at length. Here is what he said:

Q. Just when I thought American agriculture was speaking with a united voice in support of the Trans Pacific Partnership, I heard about your presentation to the Cattle Producers of Washington. Going against large and influential groups like the NCBA and NAMI, you said the Partnership will be a colossal failure for the American cattle industry. Those groups pointed to the advantages of relaxed trade restrictions between the twelve participating countries. What are your concerns?

A. To conclude that the Trans Pacific Partnership free trade agreement (TPP) will benefit U.S. cattle producers, you must first believe the three trade myths espoused by multinational meatpackers and their allies: 1) Trade deficits don't matter; 2) Imports don't matter; and 3) Exports are all that matter. If you don't believe those myths, then a critical analysis of the TPP reveals that it will benefit multinational meatpackers at the expense of independent U.S. cattle producers. Here's why:

The U.S. already has free trade agreements with 6 of the 11 TPP countries. Two of the remaining countries (Brunei and Malaysia) do not impose tariffs on U.S. beef. Thus, the only countries where restrictions could be materially reduced are New Zealand, Vietnam and Japan. Like Australia, New Zealand is a net exporter of beef and not likely to begin purchasing significant volumes of U.S. beef. That leaves only Vietnam and Japan. Even without a free trade agreement, U.S. beef represents about one-third of Vietnam's beef import market, but because Vietnam's per capita income is exceedingly low, the country represents a niche market at best, with or without the TPP. So, Japan represents the only country among the 11 countries that may provide additional market access to U.S. beef if tariffs are reduced. But, let's discuss this later.

Importantly, the block of 11 TPP countries, not even including the U.S., collectively control the world's third-largest cattle herd, behind only India and Brazil. The TPP block including the U.S. collectively producers far more beef than it consumes and while its beef production continues to increase, beef consumption within the block is declining. Because the TPP block is comprised of four of the world's largest beef and cattle exporters (Australia, Canada, Mexico and New Zealand), and because the U.S. has already removed trade restrictions through free trade agreements with each of those countries except New Zealand, the U.S. is already saddled with a huge and growing trade deficit with the 11-country TPP block.

During the past 25 years, the U.S. purchased \$36.3 billion more beef, cattle, beef variety meats and processed beef than we sold to those 11 countries. In 2015 alone, we imported a record \$8.3 billion from those countries and those imports dwarfed our meager \$3.3 billion in exports, leaving us with a deficit of \$4.9 billion with the TPP block. The U.S. would have to nearly quadruple the value of its exports to Japan just for the U.S. to balance its lopsided trade with the 11 TPP countries. That isn't going to happen.

Additionally, the huge beef trade deficit we currently have would likely be worse and will likely become worse as soon as the five TPP countries that are presently banned from exporting beef to the U.S. –

because their food safety systems have not yet been certified as equivalent to ours – are given the go ahead to begin shipping raw beef and processed beef to the United States. Peru and Vietnam are two of those five countries temporarily ineligible to export to the U.S. and their combined herd size of nearly 11 million cattle is equivalent to Canada. Canada, with a mere 12 million cattle, routinely exports well over $1 billion more in beef and cattle to the U.S. than the U.S. exports to Canada. Our beef and cattle trade deficit with Canada alone was $1.6 billion in 2015.

From the live cattle industry's perspective, it would be difficult for the U.S. to pick a worse group of countries to join with in a free trade agreement. The unrelenting trade deficit with the 20 countries we already have free trade agreements with, which deficit is now $44.5 billion accumulated over the past 25 years, is severely weakening the U.S. live cattle industry. Industry analysts are already pointing to the increased imports we had in 2015 as justification for the 2015 cattle price collapse. This will only get worse under the TPP.

What the beef industry is hiding from the cattle industry is that steadily rising imports facilitated by the free trade agreements we already have with 20 countries are overwhelming any increases in exports and are causing domestic cattle prices to fall. This is allowing imports to systematically supplant domestic beef production and shrink the domestic cattle industry, just as overwhelming imports already decimated our domestic commercial sheep industry. The USDA reported in 2012 that 18 percent of all the available beef in our domestic market is now derived from beef imports and imported cattle slaughtered in the United States, and that percentage is trending upward. The TPP will help fuel this unfavorable trend.

R-CALF USA acknowledges that Japan is an important export market. It is currently our largest export market without a free trade agreement. But, we had an even larger share of Japan's market in 2003 than we have today. Our share was reduced not because of tariffs; but rather, because we refused to do what Japan asked us to do – we refused to test the cattle from which our exported beef was derived for BSE. Had we followed the golden rule: Do what your customers ask – our larger share of the Japanese market would not have been captured by Australia. Because we once imported more beef to Japan without a free trade agreement, we can do so again if we focus on safety and quality. Japan will remain an important market with our without the TPP.

Q. In a letter to Lisa R. Barton, Secretary to the Commission, U.S. International Trade Commission, you wrote, "Under the TPP's product-specific rules of origin, the origin of beef is wherever the animal was slaughtered. This renders the origins of cattle irrelevant. It relegates U.S. cattle producers to nothing more than an undifferentiated global supply chain for meatpackers." In effect, you're saying the Partnership is reducing American beef from a well-recognized international 'brand' to just another agricultural commodity. Isn't this a disadvantage to U.S. based packers as well as cattle ranchers?

A. My contention is that the TPP adopts the anticompetitive mantra of the National Cattlemen's Beef Association (NCBA) who argued in federal district court that "beef is beef, whether the cattle were born in Montana, Manitoba, or Mazatlán." I explained to the U.S. International Trade Commission that by declaring the origins of cattle irrelevant, the TPP allows multinational meatpackers to steal the reputation of the U.S. cattle producer and put it on beef from animals born and raised anywhere in the world, in the form of a “Product of the USA” label. I said this will extinguish competition between U.S. cattle producers and their foreign cattle-producing competitors and for all of this, the U.S. cattle producer will receive nothing in return.

Your observation that this practice may relegate United States-labeled beef to “just another agricultural commodity” is interesting, but that is not what we think will happen. This is because the TPP is not gifting our domestic cattle industry’s well-established reputations to other TPP countries, but rather, it is gifting their reputations to multinational meatpackers. Consider that Brazilian-owned JBS has both major beef packing and major cattle feeding operations around the world, including in at least three TPP countries: United States, Canada and Australia. This means JBS is positioned to transfer the best genetics, the best feeding and managerial practices, and the best technology from the United States and to anywhere in the world. Thus, the TPP grants JBS a license to take its highest quality cattle from Canada, Australia, and even Brazil and put the U.S. cattle producers’ reputation on the resulting beef in the form of a USA label and all JBS has to do is slaughter the animals in the United States.

For beef variety meats and processed beef, the advantages flowing to the multinational meatpackers is even more evident. For example, it is highly doubtful that tongues, livers, hearts, tripe and processed beef from cattle born and raised in Canada, Mexico, Australia or Brazil could even be differentiated from those same products produced exclusively from U.S. cattle. This demonstrates that there is intrinsic value embodied in the USA label itself (precisely because it is associated with the good reputation of the U.S. cattle producer) and under the TPP, that label is improperly gifted to multinational meatpackers at the expense of the U.S. cattle industry.

Q. From your Washington presentation: "Packers are shifting unprecedented volumes of cattle from the cash market to their captive supply holdings, particularly formula contracts." It was a concern also expressed by *Cattle Buyer's Weekly* Publisher Steve Kay in December during my annual 'Five Minutes with' wrap up with him. He said, "The cash market has disappeared in Texas (3.8% cash and grid so far this year) and is disappearing in Kansas (11.4%). Yet Texas still sets prices for some people, sometimes on less than 300 head sold. This is unacceptable." Talk to me about who wins and who loses and the potential size of those wins and losses if the trend continues.

A. The ongoing loss of the price-discovering cash market is not a natural phenomenon. It is part of a well-planned and highly perfected strategy by the multinational meatpackers to “chickenize” the cattle industry – to capture control of the live cattle supply chain away from independent cattle producers just as they did in the poultry and hog industries. As I wrote in the 2013 South Dakota Law Review Article on this subject, the live cattle supply chain is the multinational meatpackers “Last Frontier.”

As has already occurred in the poultry and hog industries, if the multinational meatpackers succeed in destroying the price-discovering cash market where slaughter-ready cattle are sold to the meatpacker, then the meatpacker will control the terms of production, terms of marketing, and will largely dictate the price of all fed cattle. When this happens, cow/calf producers and yearling operators will receive their “product specification requirements” directly from the packer-aligned feeders (without a cash market, all feeders will have to have marketing agreements with a specific packer).

The purpose of the product specification requirements will be to ensure that producers begin raising a consistent quality product (note I did not say a high quality product) that maximizes the meatpackers’ profits and meets the meatpackers’ perceptions of humane treatment and sustainability. Such specifications will likely include the genetics that must be used, the type of electronic ear tags, recordkeeping, third-party verifications, feed, feed additives and vaccines that must be employed by producers in the production process.

Seed-stock producers that are not producing packer-preferred genetics will be among the first to disappear, just as did most of our nation’s registered hog breeders. If producers do not want to participate in this packer-led, command-and-control industry, they will have to market their cattle to feeders that do not sell to the four largest multinational meatpackers that control about 85 percent of the fed cattle market. That means their marketing options are limited to just a 15 percent market share. This chickenization model has served the packers extremely well in the poultry and hog industries. In fact, it allowed the packers to eliminate 9 out of every 10 hog producers in just the past 30 years. Competition is disappearing alarmingly fast in the U.S. feeding industry. In just the past 20 years, the number of U.S. feedlots declined 76 percent, which means that competition has already been severely reduced because there are now nearly 85,000 fewer buyers competing for the 34 million calves produced each year by U.S. cow/calf producers.

It would be extremely naïve for producers to think that beef packers JBS, Cargill and Tyson, which already control the supply chains of beef’s competing proteins, pork and poultry, are not working aggressively to capture the cattle supply chain. It would be equally naïve for producers to believe that the NCBA will stop the packers from chickenizing the cattle industry, particularly since the NCBA formally represents the interests of JBS, Cargill and Tyson.

In 2010 we encouraged the USDA Packers and Stockyards Administration to finalize rules that would stop the erosion of our price-discovering cash market. Those rules were known as the GIPSA rules but our effort was soundly defeated by the NCBA and their meatpacker members who convinced Congress to prohibit USDA from using any funds to finalize the rules. Below is an excerpt from a fact sheet we delivered in 2010 to the USDA and the U.S. Department of Justice to explain how the packers were destroying our cash market. It is even more applicable today now that the volume of our national cash market has shrunk below 22 percent (it was somewhat below 40 percent when this excerpt was written).

The Packers’ Winning Strategy for Controlling Livestock Supply Chains

Step 1: Packers created an economic risk for feeders called ‘market access risk.’ Market access risk is the risk that feeders will not have timely access to a market outlet when their livestock are ready for slaughter. Packers created market access risk through consolidations that put control over market outlets into the hands of only a few. In effect, packers have become gatekeepers, deciding who does and who does not have timely access to the market.

Step 2: Packers offered to solve the market access risk problem by guaranteeing timely market access in return for producers' willingness to sign marketing contracts that promise delivery of livestock at some future point in time.

This would appear to be a win-win situation – producers secure timely market access and packers are better able to schedule their procurement needs. But, this is the beginning and end of the mutually beneficial aspect of the plan.

Step 3: When livestock volumes shift from the cash market to the contract market, packers continue using the cash market to discover the base price for *all* contracts. Thus, price discovery for the entire industry continues to take place in the market where market access risk abounds. As the price discovery market becomes thinner, less competitive, and more susceptible to manipulation, the packers' pricing strategy lowers the aggregate price for all livestock, including the price for cattle involved in branded programs and other alternative marketing programs.

Step 4: Packers exploit the ever-thinning cash market, which they can do because they are so few in number, simply by shunning the cash market for extended periods of time, say a week or longer, which is sufficient to lower livestock prices. The effect of market access risk and the attendant pricing strategy is an eventual lowering of the price of all livestock below the feeders' cost of production, resulting in the mass exodus of livestock producers.

Step 5: Packers lead the few remaining feeders to believe the cash market is an outdated, antiquated market and they actually convince feeders to berate the cash market in favor of alternative contracting methods. This effectively distracts attention from the packers' anticompetitive pricing strategies and it encourage producers to seek a new so-called solution to the new problem associated with the mass exodus of feeders: Packers begin offering livestock producers not just a marketing contract, but a full-fledged production contract where the packer, and not the livestock producer, determines the terms of production and terms of marketing; and, because competition is severely reduced, the packer gains even more control over the pricing of all livestock.

This simple, five-step plan is not conjecture. This <u>is</u> the highly effective strategy packers used to reduce the number of hog producers from 667,000 in 1980 to fewer than 65,000 today. The cattle industry is now in the fourth-step of this five-step process. In just the past four years, the volume of cattle sold in the cash market was reduced 20 percent. Today, fewer than 40 percent of the cattle set the base price for all the cattle sold to packers, including the 60 percent sold under alternative marketing agreements. The warning sirens could not be sounding any louder!

Q. You're concerned about a weakening of health and safety standards created by TPP. What are some of the dissimilarities that you fear? Won't the various federal rules and regulations imposed on imported meat prevent those possibilities?

A. First, the federal rules and regulations that were once imposed on imported meat to prevent the introduction of tainted food, diseases or pests have been systematically weakened since the 1995 Uruguay Round Agreement. It is clear to us that the reason our standards were weakened was because they were too high for developing countries, which did not have adequate infrastructure or resources, to meet and, therefore, they could not gain greater access our market.

For example, until 1995 we required foreign slaughter plants to have food safety systems that were “at least equal” to U.S. systems. But no longer. The new standard is a “close enough” standard referred to as an equivalency standard – now their safety standards need only be equivalent to ours. We also conducted monthly inspections of foreign packing plants up until 1999, but that too was deemed to be an impediment to more imports from developing countries. Now the U.S. only performs periodic inspections of foreign plants, which increases risk. We also once required countries to prove that they had eradicated dangerous livestock diseases from within their borders before we allowed the importation of fresh meat or livestock. But now, we assume a greater risk by carving our regions within disease-affected countries and allowing those regions to export to the United States.

The TPP exacerbates our already weakened health and safety standards by imposing very prescriptive requirements the U.S. must follow when rejecting foreign meat the U.S. deems substandard. For example, we interpret the TPP to impose an affirmative duty on the U.S. to accept a weaker food safety standard of an exporter if the exporter adopts a measure that has the same effect of the United States food safety measure *even if it does not achieve the same level of protection* as the U.S. measure.

Further, and among our greatest concerns is that even if the U.S. Congress disagreed with the World Trade Organization (WTO) on the specific level of health and safety mitigations needed before accepting imports from a particular country, a non-judicial and unaccountable panel of foreign jurists could usurp Congress under the TPP’s dispute settlement procedures by imposing financial sanctions against the U.S. for its failure to accept the WTO’s recommendations. The TPP, therefore, requires the U.S. to cede a wide swath of sovereignty to a foreign tribunal and we find this unacceptable.

Q. Let's talk about the world market and America's leadership in supplying 'high quality beef.' You have acknowledged that our technology, genetics and managerial skills are being exported around the world, reducing our marketplace advantage. JBS, a Brazilian company, is now the world's largest supplier of beef and the largest packer presence in the U.S. guaranteeing the transfer will accelerate. Isn't trying to stop it a battle that's already lost?

A. My purpose in acknowledging the global transference of our superior cattle production capabilities is not to try and stop it; but rather, to point out that we can no longer measure the potential impact of trade policies using the 20-year-old argument that we export high quality beef and import a lower quality, lean grinding product. If we don’t acknowledge, for example, that about 40 percent of Australia’s total beef supply is now grain-fed beef, or that most of the beef consumed in Argentina is now grain-fed, our cattle prices will be continually pressured by rising imports and we will not meet our expectations for increasing market shares in foreign countries. The fact is that higher quality beef is being produced around the world and we need trade policies that reflect the fact that this higher quality beef is now being produced in lower production-cost countries.

Given that global quality is increasing, more than ever before we need a national trade policy that enables us to strengthen and maximize our domestic supply chain – that means our domestic live cattle industry. The TPP does just the opposite by rendering U.S. cattle irrelevant by allowing packers to put a USA label on beef derived exclusively from Canadian, Mexican, Brazilian or Australian cattle, or cattle from anywhere else in the world.

Q. Clarify something for me. You've said " Over half a million U.S. cattle operations have exited our industry since 1980; our U.S. cattle herd is now the smallest in 70 years; and our production output is the lowest in more than two decades, since just before NAFTA." It's a statement that seems to place the blame on those declining numbers on trade agreements such as NAFTA. Certainly the U.S. cattle industry is enduring a decades long decline. What are the reasons, as you see it, behind it?

A. There are two important indices with which to measure the competitiveness and well-being of the U.S. cattle industry. The first is the cattle cycle and the second is the spread between the price that producers receive for their cattle and the price that consumers pay for beef. Historically, each of the cattle cycles included 3 to 4 years of liquidation and 6-7 years of herd expansion. The size of our cattle herd was a record 132 million head in 1975, after which our industry experienced its last normal (4-year) liquidation phase. It then rebuilt for only 4 years and after 1982 we experienced an unprecedented 8-year liquidation, but this was followed by a normal 6-year herd rebuilding. That rebuilding ended in 1996 and from that point through 2014 our industry experienced an unprecedented 18-year liquidation.

Thus, our unprecedented liquidation started within two years of NAFTA's implementation. In 1996, worldwide imports of cattle, beef, beef variety meats and processed beef amounted only to about $2.5 billion. By 2015, after the implementation of NAFTA-style free trade agreements with 20 countries, those imports rose to $9.1 billion and our exports could not keep pace, rising only to $6.2 billion in 2015. The persistent and growing trade deficit fueled by free trade agreements that grant more and more countries unlimited access to the U.S. market is a major contributor to the substantial contraction of our U.S. cattle industry.

But the free trade agreements that ignore the ultra-sensitive relationship between cattle prices and increased cattle and beef supplies are not the only cause of the cattle industry's contraction. In fact, it is the combination of the free trade agreements that promote more imports than exports combined with the unprecedented contraction and consolidation of the U.S. feeding and packing industries that created the perfect storm that is decimating our industry.

An analysis of the spread between cattle prices and consumers beef prices reveals that our industry was likely creating new efficiencies during the 80s. Though the level of packer concentration was rising, it remained relatively low in the first part of the decade and the cost of bringing the raw product (live cattle) to the consumer (in the form of consumable beef) remained relatively constant. This is how you measure efficiency – by determining if the cost of bringing the raw product to the consumer remains unchanged or is reduced. However, beginning in the early 90s, when concentration levels were reaching unprecedented levels, the cost of bringing live cattle to the consumer was increasing year-by-year.

From 2000 to today, the cost is a runaway and it is now costing more than ever before in history to convert raw cattle into consumable beef. That tells us that the efficiencies created by the economies of scale achieved through industry concentration during the 80s had actually peaked at the end of that decade. From the early 90s onward, we have entered a whole new era – an era marked by the exercise of unprecedented monopsony market power (monopoly-type market power directed backward through the supply chain rather than forward to the consumer).

As a result of the unprecedented concentration and consolidation that has occurred in our industry, the largest of meatpackers are now able to exploit producers on one end of the supply chain and consumers on the other. One of the popular ways that meatpackers accomplish this exploitation is to import cheaper cattle and cheaper beef under our 20 free trade agreements and then sell those cheaper products to unsuspecting consumers for the same price as if they were produced by U.S. farmer and ranchers. Unfortunately, they can continue doing this because they are not required to differentiate the meat based on its country of origin. The TPP will make this inappropriate practice permanent.