

Testimony of
Ms. Sara Lilygren

August 23, 2002

Thank you, Sen. Durbin, for inviting the American Meat Institute to testify here today. AMI is the nation's oldest and largest organization representing meat packers and processors, whose business practices are governed nationally not only by the Sherman Act, the Clayton Act, the Robinson-Patman Act and the Uniform Commercial Code, but also by the Packers and Stockyards Act, a statute unique to our industry that clearly prohibits meat packers from engaging in unfair or deceptive business practices that disadvantage their livestock suppliers. To my knowledge, there is no other sector of the U.S. manufacturing or service economy in which the federal government plays such a watchdog role with respect to raw material suppliers.

And yet, ironically, as the meat and poultry industry operates with this additional, daily, government oversight of our business transactions with livestock producers, we are here today to discuss whether meat packers should receive additional scrutiny, enforcement or business restrictions in order to protect or benefit livestock producers.

Questions about the structure of the meat industry have been raised throughout AMI's 100-year existence. While some suggest our laws and enforcement of them are inadequate, I would suggest another theory: perhaps we haven't done a good job of pinpointing some of the real problems and coming up with constructive solutions that benefit everyone.

Let me try to characterize the environment in which my member companies operate today. AMI members include 250 of the nation's largest and smallest meat and poultry food manufacturers. Collectively, they produce 95 percent of the beef, pork, veal and lamb food products and 70 percent of the turkey food products in the U.S.

AMI's members have one common objective: to produce products consumers will buy. It is the consumer who determines the value of our products, which in turn determines the value of our raw materials. So we must start any discussion with the consumer. Market research tells us that U.S. consumers have diverse tastes and that 95 percent of them eat meat and poultry regularly, so there is room in the marketplace for many different meat and poultry products with many different attributes. We also know that there is a robust global appetite for U.S. meat and poultry products. We now export 9.3 percent of our beef products and 6.9 percent of our pork products, principally to Japan, Mexico and Canada. These exports have grown exponentially in the past decade, in large part because we produce what consumers abroad want to buy.

In fact, livestock producers have raised and spent hundreds of millions of dollars over the past decade through check off programs designed to build consumer demand for beef and pork. A large part of these efforts has been to send clear signals from the consuming public back to producers, so that producers can deliver the type of livestock that will yield the meat products

most in demand. These efforts have had many benefits, including improved communications throughout the meat chain among retailers, packers and producers. This, too, has led to vertical integration.

In order to create the foods people want to buy, AMI's members have done many things. They have increased their coordination with livestock producers so that the raw materials they purchase produce the foods consumers want to buy. They have increased their coordination with their retail and foodservice customers, sometimes changing management or operations in order to meet their customers' needs. This increased coordination has led to increased vertical integration, which has sometimes included complete or partial ownership of some of each packer's livestock

supply. Some positive outcomes of this increased coordination may be familiar to you:

Leaner Beef and Pork for Consumers. Retailers, meat packers and livestock producers heard loud and clear in the 1980s that consumers wanted leaner meats. Working together, these three sectors accomplished an average 27 percent fat reduction in a serving of beef and a 31 percent fat reduction in a serving of pork. Among the actions taken were: packers and retailers trimming fresh meats to ¼-inch of external fat; hog producers and pork packers working together to develop leaner hogs; cattlemen and meat packers petitioning USDA to create a new "Select" grade for leaner beef; and meat processors developing vast new offerings of low-fat hot dogs, luncheon meats, ham, sausage and bacon products.

Improved Risk Management Options for Producers. The volatility inherent to farming and ranching has been reduced for many livestock producers through the increased use of contracted sales with meat packers and many other creative risk management plans. The benefits to farmers were perhaps most vivid during the hog market crash of 1998, when spot market prices for an unanticipated over-supply of hogs dropped to as low as \$9 per cwt. Those hog farmers with contracts had locked into much higher prices for their hogs - generally \$35 and more per cwt. - and were protected from the low market prices. Packers with contracts, on the other hand, were obviously paying far over the market value for their hogs at the time. Both parties to the contract, however, benefited from the certainty provided by a steady, consistently priced, contracted supply of hogs.

Before I leave this topic of the benefits of coordination and even integration between manufacturers and their suppliers in the meat industry, I would just note that this is a trend throughout the manufacturing and service economy. It is driven largely by consumer demand for consistent product quality at the lowest possible price. The demand for low prices has led to fewer and larger retail chains in fields as diverse as home improvement products (Home Depot), video rentals (Blockbuster), food and consumer products (Wal-Mart) and fast food (McDonalds). In fact, these companies not only owe their success to these qualities and business practices, they advertise them to consumers. The consolidation at the retail level has driven consolidation at the manufacturer level - for tools, appliances, consumer goods and food products, among others. The demand for consistent product quality has led many firms to exert greater control over their supply chain. Just ask anyone who supplies products to Wal-Mart or McDonalds what that means: it means you must meet their standards or you can't sell to them. It

often means you must subject your products and plants to periodic customer audits. This is the way business is done today - and the meat industry should be no exception.

I note for the South Dakotans here today that the benefits of vertical integration are bringing benefits to this state. Just last week the Wall Street Journal published a fascinating story about ValCap, a venture partially funded by the federal government in which livestock feeders, corn growers and fuel producers are joining forces to help one another earn a living. Senators Daschle and Johnson have been proponents of this vertically integrated agriculture approach. And for those of you here from Iowa, you know that your state is the home to a number of leading vertically integrated manufacturers who dominate their fields. Winnebago and Maytag are two respected firms who've formed numerous vertical alliances in recent years with both suppliers and distributors. And Gateway computers, a dominant home computer manufacturer, has now formed vertical alliances to offer Internet access and other affiliated services and products to its customers. The son of a fourth generation Iowa cattle rancher founded Gateway, by the way. The spirit of entrepreneurship is alive and well throughout this country.

Against this backdrop I have described of businesses trying to compete for the consumer's dollar, I hope you can understand why the American Meat Institute strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global business community is doing, which is to form relationships with suppliers of raw materials in order to produce consistent quality, lowest priced products that consumers will buy. In our view, the proposed ban on packer ownership, control or feeding of livestock would do just that. Further, we will oppose any effort to restrict meat packers who comply with existing antitrust and fair business practice laws from sourcing their raw materials in any way. It is unfair to make it illegal for the meat industry to compete with the poultry industry or any other industry for the consumer's dollar. But let us not forget the ultimate consumer during this debate.

Over the last three decades, Americans have benefited from increasing meat industry efficiency that has made meat more affordable, abundant, convenient and varied. Each year, consumers spend less of their disposable income on meat and poultry. Today, that number stands at 1.9 percent, compared to 4.1 percent in 1970. This is a trend of which we are proud - and one that provides consumers a distinct benefit. We should not rush to undo the foundations of this success without understanding the ramifications for everyone involved.

If there is consensus that the livestock market is not working properly, then we advocate a thoughtful, reasoned, fact-based approach that will help all businesses - farms, ranches, processors and retailers -- pinpoint problems and develop targeted and effective solutions.

I would be happy to answer any questions.