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THE FUTURE OF THE AMERICAN CATTLE INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-NINTH CONGRESS

SECOND SESSION

MARCH 31, 1986

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MONDAY, MARCH 31, 1986

AFTERNOON SESSION

THE FUTURE OF THE AMERICAN CATTLE INDUSTRY

MONDAY, MARCH 31, 1986

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9 a.m., in the Hilton Hotel, Rapid City, SD, Hon. James Abdnor (chairman of the subcommittee) presiding.

Present: Senator Abdnor.

Also present: Robert J. Tosterud, deputy director.

OPENING STATEMENT OF SENATOR ABDNOR, CHAIRMAN

Senator ABDNOR. Good morning, I want to welcome you all to our fourth congressional hearing concerning the problems of the livestock industry. I truly appreciate seeing this list of witnesses that we have here today, and the distances that many of you have come. I know some of you had to leave yesterday and I know that being here after Easter is not an easy thing. I appreciate the fact that you made this great effort and are willing to take the time to come from far away. This is one of the broadest groups, I think, that we have had, Bob, ever, and out here in South Dakota. And I mean, this with Washington included. This is a very, very impressive witness list and that simply means that we have an awful lot to talk about.

I think everyone in the room probably is pretty well acquainted with Robert J. Tosterud, who I personally selected and stole from the Department of Agriculture a couple of years ago for help. He is a vital individual who has certainly had national notoriety for his expertise, and I feel awfully good having him with the Joint Economic Committee.

As many of you know, I am the ranking member of the Senate side of the Joint Economic Committee. We take full advantage of this committee, because it does allow us a lot of latitude for the kind of hearings that I feel are so necessary and sometimes are hard to bring about. We are here doing this again today.

I want to welcome you all to the hearing and I want to be brief in my opening statement. As I said, this is our fourth congressional hearing concerning the problems of the livestock industry. The testimony and the findings of the previous three hearings dealing with the growing spread between livestock and retail meat producers has been lifted to the Department of Justice and the Federal Trade Commission for their analysis and action.

It's interesting to note that following those hearings, livestock prices rose more than $10 per 100 weight, and the retail meat prices dropped significantly. Now, perhaps, as many of my cattle friends have said, cattle and meat prices are more responsive to congressional forces than to market forces. Unfortunately, cattle prices have slid back again and it is time to turn the heat back up. We'll be holding hearings once a week if it's necessary to get the cattle up to $70 a hundred if this has anything to do with it.

I will say this, this particular hearing came about because of requests we had from cattle friends that were more than happy to come here today. Some see the future of the American cattle industry as the last roundup for the traditional rancher cowboy. The challenges confronting this industry are many and have become complex. Tax shelters, cattle, beef, and cattle imports, the livestock futures market, the dairy buy-out provisions of the 1985 farm bill, the concentration in the fields, packing industries, the unresponsiveness of retail meat prices declining, red meat consumption, and I guess the list goes on, and on, and on. But our objective here today, and in the months ahead, is to identify, discuss, and understand those challenges to effectively address them and to derive recommendations to improve the economic condition of the livestock producer. So, I'm looking forward to hearing today's testimony and I expect the witnesses to challenge this committee and this particular idea with recommendations which need to be pursued.

I appreciate that we are here embarking upon a long, difficult, and controversial road. I want to say how grateful I am for the caliber of witnesses we have from States north, south, east to west, and the expertise of our group. I have three gentlemen who traveled all the way out from Washington who are going to make a great contribution to the hearing, and some have been wanting to talk to the joint committee for a long time.

And we have somebody here today from the Commodity Futures Trading Exchange, as well as the World Agriculture Outlook Board, USDA. I think you will all agree with me that we do have an impressive group and the sooner I quit talking, Bob, and get on with it, the better. So, I'm going to break our first panel into two groups, because of the number, and the limited space.

[Whereupon, Roger Husted, president, South Dakota Stockgrowers Association; Bill Gallagher, chairman, legislative committee, South Dakota Stockgrowers Association; Raymond Schnell, cattleman, Dickinson, ND; and Pat Vinton, vice president, Nebraska Stock Growers Association, were called to testify.]

Senator Abdnor. I want to welcome you to the hearing, gentlemen, and tell you how much we appreciate the efforts that you have made to get here and the statements you are going to be giving. We will start at my left and go from left to right.

STATEMENT OF ROGER HUSTED, PRESIDENT, SOUTH DAKOTA STOCKGROWERS ASSOCIATION

Mr. Husted. I'm Roger Husted, president of the South Dakota Stockgrowers Association and I'm happy to be here to testify at this Joint House-Senate Economic Committee for looking into problems and trends that disadvantage the livestock producer.

We hope we can shed some light on some of the problems South Dakota cattlemen have and indicate our ideas for solutions. All cattle producers and feeders are not all competing on the same level playing field. However, we all, as meat producers, want to produce a good product and be reasonably paid for our risk and effort. The fat cattle market in July and August 1985 was a disaster and I think the cow market in November and December 1985 was an absolute wreck.

There were calves that were bringing more than the mothers were and a lot of this, the cow market, was due to the drought in western South Dakota. The shortages of feed supply and also wheat was due to a very early winter that came in to our country and this caused a very heavy liquidation of mother cows and also, a cost of cows that was moved out of the area. And because of low cattle prices, lack of available credit through commercial channels, transportation costs for feed, crops in the field buried in snow with grazing not available until spring—the South Dakota cow-calf producer is cutting cow numbers.

South Dakota has ag economic problems. We are told that South Dakota may relocate 3,000 South Dakota agriculture operators and about 300 main street businesses in 1986 and 1987.

Cattle marketing and movement in western South Dakota show an increase in 1985 and 1986 compared with the same months in 1984 and 1985.

Last year, in 1985, the cattle movement started in July and continues because of lack of grazing, forced sales, and a discouraging market outlook to recover costs from a slumping live cattle market.

In the brand inspection in South Dakota, the increase in numbers from 1984 to 1985, there was about a 30-percent increase in western South Dakota, and I'm sure, also, in eastern South Dakota, which has no brand inspection. There would also be current liquidation. In our area, there is quite a liquidation yet, of cows, due to the serious financial condition of the ranching industry.

Total cow slaughter in the Nation during the first 6 weeks of 1986 was 6 percent above the same period in 1985. Beef cow slaughter increased 1 percent, while dairy cow slaughter was 13 percent larger than a year ago. Dairy cow slaughter was 42.5 percent of the total cow slaughter this year to date.

Cow slaughter early this year combined with a smaller cow herd, reflects an increased rate of beef cow herd liquidation. I think with the dairy program we will see a tremendous increase in the cow slaughter coming up, and I think the numbers come out today. I don't know if we have all heard them, but they sure affect the future markets.

During 1985, close to 8,000 feedlots went out of business in the 13 major feeding States. Practically all had one-time capacities of less than 1,000 head and most were located in the Corn Belt.

Many cattle owners do not depend on income from cattle for their living. Their production contributes more numbers than the live market can absorb at live prices that return cost of production.

We depend on supply and demand to price our cattle on the live market. Thirty percent of the cattle sold do not need to bring a profit to make their producer a living.

Senator ABDNOR. What was that statement? Is it 30 percent?

Mr. HUSTED. Thirty percent of the cattle numbers and the people that raise them. Cattle producers do not depend on them for their actual livelihood. They have other income and maybe it's a side line.

Senator ABDNOR. OK.

Mr. HUSTED. We would like to say a word about the September 23, 1985, declaration of disaster in 25 or more South Dakota countries. This disaster was triggered by grasshoppers and drought. The disaster declaration opened the way for ranchers to apply for 4 percent, 20-year operating loans through the SBA—Small Business Administration.

So far, the ranchers have been rejected by the California district office because their disaster is "economic," not "physical"; and they have been told the gross income limits of nonfeedlot operators has been changed from $500,000 to $100,000, and that figure must include stressed sales. Nonranching businessmen who apply may have up to $1 million on line 31, and that's gross income. We think the SBA program should be available to ranchers on the same basis as it is to any small business and we do not think the SBA should be forced to refer ranchers from SBA programs to FHA programs.

And another item is the two chain banks in the State are selling off branches and phasing down their agricultural operations. Our Federal land banks and PCA's voted to merge in the Omaha district. Our Federal credit system in the State is struggling to survive.

When most lenders, several years ago, started stressing cashflow, and coupled that with arbitrary asset reevaluation by Federal and State bank examiners, we learned that unless you can pretty much self-finance your operation, lenders are recommending or forcing the selling of cows in South Dakota.

The South Dakota Stockgrowers Association recommend financial institutions consider timing when forcing the sale of livestock, especially the cows, to allow the rancher to sell his livestock at the most financially beneficial time within a time period. This would have been a big advantage to ranchers in the past 6 months. And this spring is a real concern of ours because there is a lot of cows that are going on the market now that are being forced due to the financial crisis and to me, the timing looks very poor.

I guess we'll talk a little about the cattle futures. Since 1960 through 1985, the annual percentage increase of the Consumer Price Index has been 5 percent. And the annual percentage increase of the fed cattle market has been 9.16 percent.

One of the reasons given to the cattle industry for establishing the live cattle futures contract in 1965 was that the futures market would help stabilize the cash market and give producers a market that would trend away from wild up and down swings in the cash market.

In the first 5-year period from 1960 through 1964, before the trading of live cattle futures, the fed cattle market moved from the high to the low 23.6 percent. In the year 1985, by itself, the fed cattle market moved from the high to the low 21 percent.

We have attached to the joint prepared statement a chart showing monthly Omaha steer prices from 1950 through 1985. And a chart showing the annual change for fed cattle prices since 1960 at Omaha.

We ask that you analyze these data. We don't believe these data bear out the argument that the cattle futures market has brought stability to the cash cattle market. Do all people in the marketplace have the same chance in the futures market? Does the cow-calf man, backgrounder, and feedlot, all have the same opportunities? In the futures, are steers and heifers treated on the same basis, or is the heifer discriminated, as they are in the marketplace?

How can the cow-calf man sell a 450 pound calf on the futures market and still be competitive, and use the futures market? The average cow herd in South Dakota is under 100 head.

How can this cattleman have opportunities and still use the futures market? These are questions that should be answered, so that we are competing on equal ground.

We were told the futures market was introduced into the business some 10 years ago to help stabilize our market. We would like to see a study of market fluctuations for 10 years before the futures market and the last 10 years of the futures market.

The live futures market and how it actually operates needs a thorough study, because we believe there is speculative manipulation at times. The live futures market does affect the live market without changing supply or demand. The futures market effect on sending the live market signals that have nothing to do with supply or demand is a great concern to our members.

Retail spreads, and I guess we testified in Huron on this, but many of our members are concerned about the margins of retailers at times when there is an excess of fed cattle and depressed prices on fed cattle, but those low prices are not reflected at the retail level, and it is a big concern of our organization.

I'm going to skip over a little of my testimony and another item that I would like to talk about is the haying and grazing. One provision in the 1986 Mini Farm Bill Acreage Reduction Program just approved concerns us: The provision that allows wheat and feed grain producers to hay and graze set-aside acreage during at least 5 of the principal growing months in 1986.

This set-aside land will not be in a true conservation reserve if program participants are paid to seed it to grass, and then allowed to run cattle or they can hay the land. It is hard for cattlemen to compete with land put into crops under subsidy and now taken out of crops under subsidy.

We want no haying or grazing allowed on the set-aside land while the 10-year reserve contract payments are being made to transfer it from cropland to grass.

To do otherwise, is unfair subsidization, and distorts beef cattle markets as cattle are purchased to put on this pasture. The additional cattle depress beef prices. We plan to urge our State ASCS committee and State ASCS administration to put strong controls over haying and grazing on conservation reserve acreage in 1986 and on January 1, 1987, when the Secretary of Agriculture under the new law regains the last say on the Acreage Reduction Program, we hope you support us in not allowing this practice to continue to disrupt the cattle business unfairly as it has in the past.

On imports, and we have heard much on Governor Janklow's executive order ban on Canadian livestock that have been fed chloramphenical. This action is one of considerable importance to cattlemen. We are disappointed this had to be done by the Governor rather than the Federal Government. It is illegal to use the drug on our animals in the United States, yet, other countries are using it and importing to this country. It seems to us that we should all play by the same rules. We ask for a fair trade policy. The Feds should protect consumers from health hazards and producers from unfair importer competition.

The labeling of imported beef has been an issue in the beef industry for a long time.

Because of its implications on international policy and foreign trade, a Federal law calling for the labeling of imported beef has not been popular in Congress. However, it was popular in the South Dakota Legislature in the 1960's. South Dakota adopted a State law calling for imported beef to be labeled, even on restaurant menus.

The law was never enforced. Once imported beef reaches this country and is inspected, it is considered part of the domestic supply and loses its identity.

The newly enacted farm bill includes a promising provision regarding the labeling of imported beef.

The Comptroller General was instructed to evaluate the feasibility of requiring all imported meat, meat food products and other ag products to bear labels stating countries of origin.

The study may at least answer some questions regarding the issue, like the cost of enforcing such a regulation, where the meat products go and who uses them. It will undoubtedly address the issue of tariff and nontariff trade barriers, and will focus on meat inspection for imported beef.

We are following this labeling issue with a great deal of interest.

Congress, or the administration, will downsize the Extension Service Program in production agriculture from its 1986 budget. We have made the following recommendations to the State Director of the Cooperative Extension Service for our State's program priorities.

We are requesting emphasis on a coordinated program on cattle marketing.

Marketing live cattle for a profit to the cow-calf producer, the yearling operator, and the feedlot operator must be more than those three operations only being able to survive from each other's losses.

A cattle marketing extension program should be a resource without being a partisan for any one marketing tool. We believe extension should provide information and direction on live cattle futures, forward contracting, retained ownership, investor feeding, market fluctuations, imports, forced sales, and retail margins.

We believe our State Extension Program, other than 4–H, cannot be successful unless there is a direct tie between research and what producers need. We believe research should be advised by a panel of producers on a statewide basis and not dictated by Federal program grants. The Federal contribution to the extension programs in South Dakota is over $3.6 million and the Federal contribution to agricultural experiment station research is over $3.3 million. Federal money makes up about 36 percent of our $19.3 million extension and research budget. We think South Dakota would use a much higher percentage of these Federal moneys in the State extension and research budgets if they were not granted at the Federal level for projects that we don't need nearly as badly as we need help in marketing.

We are watching with interest, the proposed bill in the Senate that limits the loss that can be transferred from one business to another to $25,000. Profits are even harder to make when one has to compete against those who show a loss in the cattle business and charge that loss to other income for tax purposes.

Certainly no one intends to lose money in the cattle business, but the competition in taking risks is not equal, if the tax laws allow those who have large incomes to take less losses than those who make money the old-fashioned way. A lot of cattle are investor owned. This tax writeoff limitation could have a positive effect on the cattle industry.

We would like our industry profits and losses discipline and control cattlemen who make their living from producing and feeding cattle; not be at risk from those who can afford small gains from their investment because of other income.

We encourage investors to be involved in cattle feeding, however, we do not approve of their tax advantage on losses incurred in cattle feeding.

I think that pretty well sums it up. It's hard for us cattlemen to compete with somebody that is either feeding cattle to break even or even feeding them for a loss to show they can gain on their profits from other businesses.

Some Federal programs do cause all of us problems in our cattle marketing. I will point three items out, so you can advise Congress of problems we have that Congress controls. One is the Livestock Reporting Service. Faulty reporting by the USDA and misleading reporting of livestock on feed by the Crop and Livestock Reporting Service is creating lower prices and working to the detriment of the cattle industry.

We think Congress should discontinue the Federal Crop and Livestock Reporting Service. We don't want a price forecasting system controlled by Government jobs that operates in partners with a cheap food policy.

We encourage Congress to assist with sales programs that aid the cattle export market. With nutrition education and research, we hope that members of this committee will take steps so that all sides of any nutritional and food safety issue relating to beef are properly investigated and objectively publicized.

And I guess, last, I will touch on the farm crisis. Cattlemen see the so-called farm crisis as a matter of low prices, slumping demand by consumers, a drought in most of South Dakota and Government programs that are harmful to cattlemen. Cattlemen believe Congress can help us and our Nation by doing two things.

They are: One, reducing the national deficit and work toward a balanced budget. Two, work toward a strong trade policy and eliminate our negative trade balance.

Deficit spending causes high interest rates. And causing high interest rates is the No. 1 problem facing our industry today. Interest rates affect us two ways. By taking a bigger bite in our expenses, it also causes our cattle to sell cheaper because of the cost of high interest while they are in feedlots.

Drought in western South Dakota in 1985 has compounded the situation. Many producers had two choices. One, to sell their foundation breeding herds at greatly reduced prices for later replacement at a much higher cost, or two, purchase feed to get them through. Either choice increases interest payments.

Many of our people this year, due to the drought and the cattle market wreck, are experiencing interest payments above 25 percent of their gross income. Real interest rates must come down. The producers in business now can't absorb the losses already incurred by agriculture.

I would like to conclude this by saying that there tends to be a negative attitude in the business segment of agriculture, and that upsets us. It makes it much more difficult to work out of our critical financial situation. We all must remember the cattle industry starts with the cow-calf operation. They are the grassroots of the industry. In order to be successful, all segments must work together to prosper. We have come through some tough times. We see some positive things happening such as lower cattle numbers and implementing a national program for beef promotion and research.

I would like to close this with a thank you and I would be happy to answer any questions.

Senator ABDNOR. Thank you, Roger, and we'll ask you those questions when the other witnesses testify. I want to tell you that we'll make this prepared statement a part of the record so that the figures, facts, charts and so on will be in the record. That was an excellent statement and you pretty well laid the whole problem out. There wasn't much left out. You certainly have an excellent point. The last one struck me, though—what you said about the negative attitude in the business segment of agriculture.

I'm sick and tired of politicians going around and talking about this and never coming up with anything helpful or positive. It's better to complain than to try and do something. It's a hell of a lot easier, I'll tell you that, but I think there are some bright spots in the future, though Lord knows we have a long way to go. Some of the things we're talking about here look at least a little brighter today than maybe 6 months ago. I'm glad to hear you say those things and I want you to know that.

Mr. HUSTED. Thank you, Senator.

Senator ABDNOR. I think I believe there is a positive sight out there today and it is always darkest before the dawn. I really think there is going to be some light. You certainly have been through a lot and I don't know how much longer we have to go the other way. It has to turn around if we set our minds to it and get a few breaks, get ourselves all working together and get all the negatives out of it, start seeing if we can push for the positive and get our story told.

One thing about the cattle industry is that most of it talks the same way, unlike other farm groups which come in with different ideas. It makes my job in Washington difficult. Mr. Gallagher has something to add to this.

STATEMENT OF BILL GALLAGHER, CHAIRMAN, LEGISLATIVE COMMITTEE, SOUTH DAKOTA STOCKGROWERS ASSOCIATION

Mr. GALLAGHER. Thank you, Senator. My name is Bill Gallagher, chairman, legislative committee, of the South Dakota Stockgrowers Association. I think we have gone through Roger's testimony, the testimony of the South Dakota Stockgrowers and what I want to do is just touch on a couple issues that we have discussed and most of you are aware that this discussion has been going on now for a number of weeks.

It's not to be a complex situation. We get into this area and that area and there is no feeling that we can say this is the No. 1 problem or this is the No. 2 problem. Everything seems to be tying together. We run into all these different areas.

Just a few points. When we talk about the futures, we see the futures trade moving in the $1 to $2 range, up or down. It's staying to break even or below costs of feeding with no chance for the feeder to lock in a profit, but along the speculation line with $1 or $2 movements, why we have a pretty good trade as far as speculation goes, but no chance for the bona fide feeder to get much use out of it.

Then, the packer, of course, has a great advantage to fill his needs with cattle that are being fed with no profit motive. A number of our packers are down. Competition is down there and another area that although not necessarily the No. 1 problem, but it ties to the rest of it.

Let's go to cattle numbers. Cattle numbers have seen to be used more as price fixtures or a market breaker than being really a benefit as far as being able to protect the flow of cattle.

All the old answers or problems solved by the smaller numbers doesn't hold true today. I can't quote the figures, but we'll get there, but we all know where the beef cow industry is today in numbers. We also know where the beef cow business is today, financially. Long-range projections on lower numbers seem to be in order, but the short-term bulk is called bearish and that seems to depress the market. We find it strange how the markets reaction is downward to a specific group of cattle that are just about ready to kill and so then, these cattle are held over and we're back to having too many overfed cattle.

On to the tax advantages, and the tax advantages place a hard part in the overall picture. We may have created a feeding situation where the only profit made from feeding the cattle is not profit made from feeding the cattle, but profit made from taxes being saved or taxes not paid. There was a recent study, I believe, out of USDA, but the recent study showing that while the Government collected $5 million from taxes in farm income, it lost the potential of $5.3 billion on farm income that is used on taxes lost.

The bottom line would be if agriculture paid no taxes whatsoever and we didn't even get a form. There would be no way to write off losses in agriculture. There would have been a net gain to the treasury of $3.8 billion. Another point that we have discussed and this probably will take up another area, but the accrual or the cash basis means of accounting. We have many pro and con ideas on this and the cow-calf industry, I don't think, has had those questions answered to them yet. And so I think that is an area that I would really like to see some looking into.

Senator ABDNOR. I know they were talking about knocking that out in the House.

Mr. GALLAGHER. Well, we have been told that accrual would be a wreck to our industry as far as the cow-calf deal goes, but when you're involved in the industry that we're in, you know how to define "wreck." I guess that is why I would like to have it expanded on a little bit because I think we have had a wreck and is the accrual or cash basis—maybe it does benefit the cow-calf segment, but maybe it benefits the investor or the shelter more than it does us. And I think that is what we would need to look at.

Senator ABDNOR. We would like to see that one way or the other. I mean, you like to have the option so you can do it either way.

Mr. GALLAGHER. I think what we have talked about, Senator, that we would like to dig into it a little deeper and find out the advantages and disadvantages that we have with cash, plus we would like to find out, is it more advantageous for a cow-calf man or cash or accrual, or is it more advantageous for tax shelter work.

Senator ABDNOR. The only thing I can say, is don't wait too long, because they're writing that tax program now and it's moving faster than I like to see it more.

Mr. GALLAGHER. A point has been made and it's a bookkeeping nightmare as far as accrual goes, but in some of the discussions, why very little cowboys tax work is done around the kitchen table now anyway, so I see it more as a bookkeeping thing and most everybody has an accountant, and so I think it needs to be looked at. I'm not saying one way or the other, but we're curious about it. It is a complex issue and I think we all agree that there is not one single issue—I guess, personally, I feel that this may be the last chance that we're going to get together and discuss this. It's been getting worse every year.

There are so many beef cow producers that have gone out of business. I think we're going to have to take a long hard look at these questions and hopefully we're going to be able to pose the questions. I guess we just have to say to you that we're going to do our best to pose the questions, but then as we go forward into this with the Joint Economic Committee, I guess we would offer our services to be ready any time to help. I thank you, Senator.

[The joint prepared statement of Messrs. Husted and Gallagher follows:]

JOINT PREPARED STATEMENT OF ROGER HUSTED AND BILL GALLAGHER

We would like to thank this Joint House/Senate Economic Committee for looking into problems and trends that disadvantage the livestock producer.

We hope we can shed some light on some of the problems South Dakota Cattlemen have and indicate our ideas for solutions.

PROBLEMS:

All cattle producers and feeders are not all competing on the same level playing field. However, we all, as meat producers, want to produce a good product and be reasonably paid for our risk and effort.

The fat cattle market in (July and August) 1985 was a disaster and the (November and December) 1985 cow market was an absolute wreck. Good aged foundation commercial cows sold for less than their calves taken off at the ring. Cattle production, last summer in South Dakota, was disrupted by drought and distress marketing reached an all time high. Winter came early. The fat market and the stock cow market are in a slump in February and March.

Feed supplies in Western South Dakota were used up before Winter officially came. Cattlemen who moved cattle they owned out of the drought area have not found that profitable.

Because of low cattle prices, lack of available credit through commercial channels, transportation costs for feed, crops in the field buried in snow with grazing not available until spring -- the South Dakota cow/calf producer is cutting cow numbers.

South Dakota has ag economic problems. We are told South Dakota may relocate 3000 South Dakota Agriculture operators and about 300 Main Street businesses in 1986-1987.

STRESS SELLING AND MOVEMENT

Cattle marketing and movement in Western South Dakota shows an increase in 1985-1986 compared with the same months in 1984-1985.

Last year (1985) cattle movement started in July and continues because of lack of grazing, forced sales, and a discouraging market outlook to recover costs from a slumping live cattle market.

MOVEMENT OF CATTLE IN SOUTH DAKOTA

BASED ON BRAND INSPECTION

FOR SEPTEMBER THROUGH FEBRUARY 1984 & SEPTEMBER THROUGH FEBRUARY 1985

	1984 HEAD			1985 HEAD	
	MARKETS	LOCAL		MARKETS	LOCAL
Sept.	37,990	21,526	Sept.	49,247	23,459
Oct.	63,883	42,996	Oct.	99,067	77,091
Nov.	192,753	85,485	Nov.	253,362	87,445
Dec.	166,727	44,046	Dec.	178,106	44,412
Jan.	81,579	25,035	Jan.	118,807	62,655
Feb.	104,966	28,899	Feb.	152,172	27,732
	647,898	247,987		850,761	322,794

Markets -- 202,863 Head Increase -- 31% Increase.
Local -- 74,807 Head Increase -- 30% Increase.
Total Increase in numbers for months illustrated -- 277,670 Head.

Total cow slaughter in the Nation during the first six weeks of 1986 was 6 percent above the same period in 1985. Beef cow slaughter increased 1 percent, while dairy cow slaughter was 13 percent larger than a year ago. Dairy cow slaughter was 42.5 percent of total cow slaughter this year to date.

Cow slaughter early this year, combined with a smaller cow herd, reflects an increased rate of beef cow herd liquidation.

During 1985, close to 8,000 feedlots went out of business in the 13 major feeding states. Practically all had one-time capacities of less than 1,000 head and most were located in the Corn Belt.

Many cattle owners do not depend on income from cattle for their living. Their production contributes more numbers than the live market can absorb at live prices that return cost of production. We depend on supply and demand to price our cattle on the live market. Thirty percent of the cattle sold do not need to bring a profit to make their producer a living.

DISASTER LOANS

We would like to say a word about the September 23, 1985 Declaration of Disaster in 25 or more South Dakota counties. This disaster was triggered by grasshoppers and drought. The Disaster Declaration opened the way for ranchers to apply for 4% twenty-year operating loans through the SBA. (Small Business Administration).

Ranchers who have applied for SBA loans so far have been rejected by the Sacremento, California District Office because their disaster is "economic", not "physical"; they have been told the gross income limits of non-feedlot operators has been changed from $500,000 to $100,000, and that figure must include stressed sales. Non-ranching businessmen who apply may have up to $1,000,000 on line 31 (Gross Income). We think the SBA program should be available to ranchers on the same basis as it is to any small business -- and -- we do not think the SBA should be forced to refer ranchers from SBA programs -- to FHA programs.

ARBITRARY ASSET REEVALUATION

Two chain banks in the state are selling off branches and phasing down their agricultural operations. Our Federal Land Banks and PCA's voted to merge in the Omaha District. Our Federal Credit System in the state is struggling to survive.

When most lenders, several years ago, started stressing cash flow, and coupled that with arbitrary asset re-evaluation by federal and state bank examiners, we learned that unless you can pretty much self-finance your operation, lenders are recommending or forcing the selling of cows in South Dakota.

The South Dakota Stockgrowers Association recommend financial institutions consider timing when forcing the sale of livestock - allowing the rancher to sell his livestock at the most financially beneficial time within a time period. This would have been a big advantage to ranchers in the past six months.

CATTLE FUTURES

Since 1960 through 1985 the annual percentage increase of the Consumers Price Index has been 5%. And the annual percentage increase of the fat cattle market has been 9.16%.

One of the reasons given to the cattle industry for establishing the live cattle futures contract in 1965 was that the futures market would help stabilize the cash market and give producers a market that would trend away from wild up and down swings in the cash market.

In the first five year period from 1960-64 before the trading of live cattle futures -- the fed cattle market moved from the high to the low 23.6%.

In the year 1985 by itself, the fed cattle market moved from the high to the low 21%.

We are attaching along with this testimony a chart showing monthly Omaha steer prices from 1950 through 1985.

And a chart showing the annual change for fed cattle prices since 1960 at Omaha.

We ask that you analyze this data. We don't believe this data bears out the argument that the cattle futures market has brought stability to the cash cattle market.

Do all people in the market place have the same chance in the Future's Market? Does the cow-calf man, backgrounder, and feedlot all have the same opportunities? In the Futures, are steers and heifers treated on the same basis, or is the heifer discriminated, as they are in the market place?

How can the cow-calf man sell a 450 lb. calf on the Future's Market and still be competitive, and use the Future's Market?

The average cow herd in South Dakota is under 100 head.

How can this cattleman have opportunities and still use the Future's Market? These are questions that should be answered, so that we are competing on equal ground.

We were told the Future's Market was introduced into the business some 10 years ago to help stabilize our market. We would like to see a study of market fluctuations for ten years before the future market -- and -- the last ten years of the Future's Market.

The live future's market and how it actually operates needs a thorough study; because we believe there is speculative manipulation at times. The live future's market does effect -- the live market without changing supply or demand. The Future's Market effect on sending the live market signals that have nothing to do with supply -- or -- demand is a great concern to our members.

RETAIL SPREADS

We think the cattle business from farm and ranch production to retail in stores, restuarants and fast food operators is too spread out and too big and too competitive at the consumer buying level to say that any one price spread problem, if addressed by legislation, will ensure a fair return for every working cattleman.

Many of our organization's cattle producers are often concerned about margins of the retailers at times when there is an excess of fat cattle and depressed prices on fat cattle, but these low prices are not reflected at the retail level.

LAND MANAGEMENT

The management of federal multiple use land in our state has problems.

The National Grasslands began 49 years ago with the passage of the Bankhead-Jones Farm Tenant Act of 1937 with the purpose of administering these lands to provide economic stability to the area and to promote sound grassland agricultural practices.

The two consistent elements in this situation are the land and the ranchers. Ranchers are the only direct pay-for-use partners in this arrangement. They often represent more than one generation of stewardship of the land. They have remained on the land because they are skilled in grassland utilization through management and they are committed.

The government agency side of the equation, has become what could be called a circus of personnel, research projects, planning, making and changing policies and the unconscionable waste of money.

The evolution of the relationship between the ranchers and the government experienced a major turning point in the 1960's and early 1970's with the movement toward environmentalism.

Keep in mind that during the entire history of the Bankhead-Jones Farm Tenant Act, the purpose and committment of the rancher has remained the same -- the advantageous utilization of range and grass. The only way this can be accomplished is through flexible management that includes conservation practices.

Ranchers, in general, have always cooperated with practical shifts in land management on the public lands. They are willing to participate in a dialogue to reach an understanding on short and long term grazing plans.

Ranchers have grown weary of being treated as an illegal child by a host of bureaucrats and technicrats who have swarmed into the picture with the passage of the Endangered Species Act of 1973.

If we examine the ledger, we find the rancher fighting for his economic survival, trying to combine management skills with the elements of nature to at least hold hiw own. If they had operated like the federal agencies, they would not be there.

The government agency side of the ledger reveals hundreds of thousands of acres of grassland laid waste by prairie dogs, millions of dollars spent on prairie dog control, study after study that is never heard of again once the funding disappears, ever-changing personnel with performance demands placed on the ranch operation that may have no greater purpose than to allow an employee to fill out a report. The list could go on and on, but the bottom line is that the assortment of government agencies involved have a miserable and expensive track record. So miserable, in fact, that the Farm Bureau took them to court.

It must be recognized there are numerous capable employees of land management agencies who are to be commended, but they are, sadly enough, limited in the good they can do by the policies they are forced to administer if they are to keep their jobs. Employees are often transferred to a new duty location before they can learn what our problems are - say nothing of working out solutions.

We are convinced a cleaning rod needs to be run through the bureaucratic tube that runs from Congress to the grass roots. The fact of the matter is that by the time Congressional intent works its way down to the citizen level, the bureaucratic machinery has turned well meaning laws to garbage.

If there ever was a time that action needs to be taken it is now in these severe economic times for Agriculture. Here are some suggestions for what can be done immediately:

1. Remove from grassland management policies all practices that are deemed experimental that require ranchers to alter operations in such a way that costs in labor or capital are increased.
2. Establish prairie dog control policies that recognize private land owner good neighbor values and federal land managers meet the same requirements as citizens have to meet in managing federal property.
3. Require federal policies to recognize state law on weed and pest control.
4. Fully support the annual court directed Farm Bureau Prairie Dog/Agency meeting as a part of policy development for management.
5. Management programs should be based on carefully developed plans that are fully understood and agreed to by ranchers and are on a ten year time frame.

HAYING AND GRAZING

One provision in the 1986 Mini Farm Bill Acreage Reduction Program just approved concerns us: The provision that allows wheat and feed grain producers to hay and graze set-aside acreage during at least five of the principal growing months in 1986.

This set-aside land will not be in a true Conservation Reserve if program participants are paid to seed it to grass, and then allowed to run cattle or they can hay the land. It is hard for cattlemen to compete with land put into crops under subsidy and now taken out of crops under subsidy.

We want no haying or grazing allowed on the set-aside land while the ten year [illegible] payments are being made to transfer it from cropland to grass.

To do otherwise is unfair subsidization, and distorts beef cattle markets as cattle are purchased to put on this pasture. The additional cattle depress beef prices. We plan to urge our State ASCS Committee and State ASCS Administration to put strong controls over haying and grazing on conservation reserve acreage in 1986 -- and on January 1, 1987, when the Secretary of Agriculture under the new law regains the last say on the Acreage Reduction Program -- we hope you support us in not allowing this practice to continue to disrupt the cattle business unfairly as it has in the past.

IMPORTS

You have heard much on Governor Janklow's Executive Order ban on Canadian livestock that have been fed Chloramphemical. This action is one of considerable importance to cattlemen. We are disappointed this had to be done by the Governor rather than the Federal Government. It is illegal to use the drug on our animals in the United States, yet, other countries are using it and importing to this country. It seems to us we should all play by the same rules. We ask for a "fair trade policy". The Feds should protect consumers from health hazards and producers from unfair importer competition.

The labeling of imported beef has been an issue in the beef industry for a long time.

Because of it's implications on international policy and foreign trade, a federal law calling for the labeling of imported beef has not been popular in Congress.

However, it was popular in the South Dakota Legislature in the 1960's. South Dakota adopted a state law calling for imported beef to be labeled, even on restuarant menus.

The law was never enforced. Once imported beef reaches this country and is inspected, it is considered part of the domestic supply and loses its identity.

The newly enacted Farm Bill includes a promising provision regarding the labeling of imported beef.

The Comptroller General was instructed to evaluate the feasibility of requiring ALL imported meat, meat food products and other ag produdts to bear labels stating countries of origin.

The study may at least answer some questions regarding the issue, like the cost of enforcing such a regulation, where the meat products go and who uses them. It will undoubtedly address the issue of tariff and non-tariff trade barriers, and will focus on meat inspection for imported beef.

We are following this labeling issue with a great deal of interest.

EXTENSION SERVICE

Congress -- or the Administration will downsize the Extension Service Programs in Production Agriculture from its 1986 budget. We have made the following recommendations to the State Director of the Cooperative Extension Service for our state's program priorities.

We are requesting emphasis on a coordinated program on Cattle Marketing.

Marketing live cattle for a profit to the cow-calf producer, the yearling operator, and the feedlot operator must be more than those three operations only being able to survive from each other's losses.

A Cattle Marketing Extension Program should be a resource without being a partisian for any one marketing tool. We believe Extension should provide information and direction on: Live Cattle Futures, Forward Contracting, Retained Ownership, Investor Feeding, Market Fluctuations, Imports, Forced Sales, and Retail Margins.

We believe our State Extension Program -- other than 4-H -- cannot be successful -- unless there is a direct tie between Research and what producers need. We believe Research should be advised by a panel of producers on a state wide basis -- not dictated by Federal Program Grants. The Federal contribution to the Extension Programs in South Dakota is over 3.6 million -- and the Federal contribution to Agricultural Experiment Station Research is over 3.3 million. (Federal money makes up about 36% of our 19.3 million Extension and Research budget). We think South Dakota would use a much higher percentage of these federal monies in the State Extension and Research budgets if they were not granted at the federal level for projects we don't need nearly as badly as we need help in Marketing.

TAX SHELTERS

We are watching with interest the proposed bill in the Senate that limits the loss that can be transferred from one business to another to $25,000. Profits are even harder to make when one has to compete against those who show a loss in the cattle business and charge that loss to other income for tax purposes. Certainly no one intends to lose money in the cattle business, but the competition in taking risks is not equal, if the tax laws allow those who have large incomes to take less losses than those who make money the old fashioned way. A lot of cattle are investor owned. This tax write-off limitation could have a positive effect on the cattle industry. We would like our industry profits and losses discipline and control cattlemen who make their living from producing and feeding cattle; not be at risk from those who can afford small gains from their investment because of other income.

We encourage investors to be involved in cattle feeding; however, we do not approve of their tax advantage on losses incurred in cattle feeding.

SOLUTIONS THROUGH BUDGET ADJUSTMENT

Some federal programs do cause all of us problems in our cattle marketing. I will point three items out, so you can advise Congress of problems we have that Congress controls:

LIVESTOCK REPORTING SERVICE: Faulty reporting by the USDA and mis-leading reporting of livestock on feed by the Crop and Livestock Reporting Service is creating lower prices and working to the detriment of the cattle industry.

We think Congress should discontinue the Federal Crop and Livestock Reporting Service. We don't want a price forcasting system controlled by Government jobs that operates in partners with a cheap food policy.

MARKETING: We encourage Congress to assist with sales programs that aid the cattle export market.

NUTRITION EDUCATION AND RESEARCH: We hope members of this Committee, will take steps so that all sides of any nutritional and food safety issue relating to beef are properly investigated and objectively publicized.

FARM CRISIS

Cattlemen see the so-called Farm Crisis as a matter of low prices, slumping demand by consumers, a drought in most of South Dakota and government programs that are harmful to cattlemen.

Cattlemen believe Congress can help us -- and our nation -- by doing two things. They are:

1. Reduce the national deficit and work toward a balanced budget.
2. Work toward a strong trade policy and eliminate our negative trade balance.

Deficit spending causing high interest rates is the number one problem facing our industry today. Interest affects us two ways. By taking a bigger bite in our expenses, it also causes our cattle to sell cheaper because of the cost of high interest while they are in feedlots. Drought in western South Dakota in 1985 has compounded the situation. Many producers had two choices: (1) Sell their foundation breeding herds at greatly reduced prices for later replacement at a much higher cost, or (2) Purchase feed to get them through. Either choice increases interest payments. Many of our people this year, due to the drought and the cattle market wreck are experiencing interest payments above 25% of their gross income. Real interest rates must come down. The producers in business now can't absorb the losses already incurred by Agriculture.

CONCLUSION:

There tends to be a negative attitude in the business segment of agriculture, and that upsets us. It makes it much more difficult to work out of our critical financial situation. We all must remember the cattle industry starts with the cow/calf operation. They are the grassroots of the industry. In order to be successful, all segments must work together to prosper. We have come through some tough times. We see some positive things happening such as lower cattle numbers and implementing a National Program for Beef Promotion and Research.

FED CATTLE PRICES: ANNUAL CHANGE

	Annual Change (Percentage)	Annual High vs. Avg. (Percentage)	Annual Low vs. Avg. (Percentage)	CPI (Percentage)
1960-64	± 7.8	+ 9.8	-13.8	+1.2
1965-69	± 6.8	+ 8.6	- 7.4	+3.4
1970-74	±10.6	+10.2	- 9.6	+6.1
1975-79	±16.0	+ 9.8	-12.6	+8.1
1980-84	± 2.8	+ 8.2	- 6.6	+7.5
1985	±11.0	+10.0	-11.0	+3.8

OMAHA CHOICE ..EER PRICES
900-1100 Lbs.

JANUARY 20,1986

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YR. AVG.
1950	26.67	25.35	25.91	26.58	28.38	29.20	29.80	29.52	30.31	29.84	30.88	31.85	28.88
1951	33.63	35.34	35.34	35.78	35.12	34.58	34.67	35.13	35.95	35.17	34.95	33.86	34.92
1952	33.95	33.65	33.46	33.12	32.80	31.50	32.10	32.25	32.06	31.77	31.41	29.52	32.37
1953	25.19	23.10	21.61	20.94	21.55	20.99	24.18	24.28	24.79	24.08	23.71	22.69	22.77
1954	23.25	22.74	22.74	23.22	23.16	22.78	22.72	23.11	24.06	23.98	24.91	25.35	23.45
1955	25.85	24.51	24.57	23.37	21.87	21.55	21.78	21.81	22.35	21.45	20.14	19.60	22.16
1956	19.57	18.22	18.78	19.42	19.69	20.00	21.87	25.12	26.08	24.82	22.64	20.42	20.99
1957	20.05	19.35	21.03	22.05	22.63	22.65	24.44	24.94	23.94	23.86	24.15	25.17	22.61
1958	25.69	26.12	28.22	27.99	27.71	26.87	25.94	25.23	25.86	25.69	25.97	26.34	26.39
1959	26.83	26.53	27.65	28.86	28.28	27.36	27.33	27.16	27.05	26.05	25.24	24.98	26.93
1960	25.63	25.64	26.94	27.20	26.33	25.12	24.57	24.17	23.92	23.99	25.08	25.66	25.18
1961	26.02	25.13	14.73	24.09	22.64	21.80	21.89	23.55	23.54	23.82	24.58	25.29	23.78
1962	25.36	25.45	25.89	26.20	25.01	24.56	25.68	27.39	28.66	28.11	28.76	27.81	26.45
1963	26.09	24.03	22.53	22.71	21.87	22.11	24.39	24.18	23.85	23.65	22.71	21.35	23.21
1964	22.04	20.65	20.91	20.44	19.93	21.40	22.95	24.52	24.95	23.91	23.51	22.81	22.21
1965	22.90	22.43	23.08	24.35	25.88	26.86	26.30	26.42	26.37	25.54	25.17	25.43	25.12
1966	25.68	27.11	28.12	26.87	25.78	25.06	25.25	25.79	25.70	24.82	23.96	23.65	25.69
1967	24.64	24.03	23.78	23.80	24.64	25.46	26.34	26.92	26.92	26.02	25.55	25.60	25.27
1968	25.57	26.19	26.63	26.42	26.29	26.39	27.39	27.63	27.48	27.07	27.46	28.06	26.83
1969	27.82	27.63	29.00	30.41	33.18	33.99	31.56	30.40	28.77	27.72	27.67	27.98	29.66
1970	28.23	29.30	30.97	30.64	29.52	30.29	31.12	30.14	29.31	28.67	27.21	26.71	29.33
1971	29.11	32.23	31.81	32.44	32.88	32.39	32.44	33.24	32.62	32.34	33.58	34.40	32.42
1972	35.74	36.19	35.13	34.53	35.66	37.88	38.21	35.66	34.85	34.85	33.56	36.79	35.83
1973	40.65	43.54	45.65	45.03	45.74	46.76	47.66	52.94	45.12	41.92	40.14	39.36	44.54
1974	47.14	46.38	42.85	41.53	40.52	37.98	43.72	46.62	41.38	39.64	37.72	37.20	41.89
1975	36.34	34.74	36.08	42.80	49.48	51.82	50.21	46.80	48.91	47.90	45.23	45.01	44.61
1976	41.18	38.80	36.14	43.12	40.62	40.52	37.92	37.02	36.97	37.88	39.15	39.96	39.11
1977	38.38	37.98	37.28	40.08	41.98	40.24	40.94	40.11	40.35	42.29	41.83	43.13	40.38
1978	43.62	45.02	48.66	52.52	57.28	55.38	54.59	52.40	54.26	54.93	53.82	54.54	52.25
1979	60.35	64.88	71.04	75.00	73.99	68.53	67.06	62.74	67.84	65.81	67.00	67.78	67.67
1980	66.32	67.44	66.80	63.07	64.58	66.29	70.47	73.31	69.69	67.18	65.05	64.29	67.04
1981	63.08	61.50	61.40	64.92	66.86	68.26	67.86	66.37	65.37	61.45	59.81	59.24	63.84
1982	60.75	63.54	65.80	69.11	72.10	70.18	66.18	65.14	61.25	58.78	58.91	58.92	64.22
1983	59.33	61.20	64.03	67.70	67.51	65.90	62.22	61.27	59.19	59.58	59.41	62.85	62.52
1984	67.08	67.07	68.60	67.86	65.89	64.28	65.79	64.36	62.68	60.85	64.29	65.32	65.34
1985	[illegible]5	62.80	59.28	58.72	57.58	56.64	5[illegible]	51.94	51.29	58.02	63.30	62.94	58[illegible]

Taken from "Livestock and Poultry Outlook and Situation"

US

Senator ABDNOR. Thank you, Bill Gallagher. We'll get into a number of the tax reform proposals. There is nothing very hard and fast on the Senate side. The House has passed its version, but if it gets to moving rapidly, maybe it wouldn't be a bad idea if the association had a feel for what they see in the tax reforms and the effects it would have on them. Tax hearings, of course, will be held in the Finance Committee. Too many times you come up with things after the hearings because it takes awhile to get the feel of it, but at least this committee might make a sounding board for some in Washington. It might get their attention.

We do have tax experts on the committee as well as experts in other economic areas. We will watch it and if we see in the days ahead that something needs to be done, we will get attention drawn to it. Legislative interest will be created and proposals for the cattle industry prepared. Keep us informed.

Mr. Schnell, you have been very patient. You have come a long way and we appreciate the fact that you're here, so go right ahead.

STATEMENT OF RAYMOND SCHNELL, CATTLEMAN, DICKINSON, ND

Mr. SCHNELL. I am Raymond Schnell and I'm from Dickinson, ND. I have been in the cattle business all of my life and this includes cow-calf operator, and I have been in the marketing end of it. I fed quite a few cattle. I'm doing order buying and I have done backgrounding during all this time. I have always been in optimist about the cattle business, but in looking back on the events and the cattle industry since 1980, I'm losing that sense of optimism. I'm a firm believer in the free enterprise system, but this has also been a difficult thing to rationalize with things that have developed in the past 15 years.

Someone said the other day, that what we need to do in the cattle business especially, is a specially designed computer that will find answers to all of the statements that just do not add up.

This hearing, I presume, is an attempt to find some of those answers. I want to extend my thanks to Senator Abdnor and all of those who have had a part in trying to find answers and solutions to the unprecedented problems in the livestock and cattle industry of today. I would like to be able to provide gold-plated solutions to some of the many problems that plague our industry. I'm afraid there are no easy answers and each and every one of our problems is very involved with other industries, with government, with social conditions, with financial situations, and a host of combinations of all of these circumstances.

Since I don't have an easy solution, I would like to attempt to give my analysis of some of the causes of the situations as I feel they are in regard to the issues that I have been exposed to in my part of the cattle business.

Whenever things go wrong, everyone looks for the party responsible; that is, the one to blame. I don't believe that there is any single source of all our troubles. I don't feel we can solve our problems by pointing an accusing finger at other parties of the meat and food industry. Those of us in the production end of the meat business cannot afford to alienate the packer, the retailer, or the consumer. We need them all and we had better work as well with them as we can, but I do have suggestions for changes that would help the production end of the beef business.

To say the cattle market has been erratic and unpredictable is an understatement. We wonder how almost every market forecaster could be so wrong in their predictions for 1985, and so far in 1986, we wonder why the market does not seem to follow the trend that we saw in the last year.

There used to be some spotters that an industry could rely on, but not so lately. If you look at the charts in the handout, particularly the second to the last page, the bottom draft, it shows a real up-and-down affair in our cattle business. Just in 1985 we saw a top of around 69-cent cattle and a bottom of 48½- or 49-cent cattle. This is completely opposite of what we used to see in the cattle business. Our high market this year—this past year was in January and November. Normally, our high market is April to June and our low market is in October and November.

This looks as though we are running into the same pattern again this year and it is just impossible to figure out. Ed Houvicek, who is one of the most optimistic of the economists in the predicting business today, took a bunch of figures and I think they were mostly of Texas cattle, that is, cattle fed in the Texas feeding area for 11 years, and in his sampling, it came out that all of the cattle fed over those 11 years, everyone lost an average of $37 a head.

It used to be that when the feeder lost money, the cow-calf man made money and vice versa. These last many years, both have lost money. There are some practices in our industry, I think, that are contributing to losses. There is no one simple answer. Again, but let me elaborate on some areas where I feel changes would improve the price structure and up the marketing system. Take a look at the consumer first, and what their wants are.

The consumer, according to recent surveys, wants lean beef that is cheaper. Well, I guess any of us as consumers on whatever we are consuming, would like to see that happen. We have not satisfied that consumer in either case. The reasons behind not providing the consumer with leaner and cheaper beef are a part of our problems in the cattle business. Let me talk a little about the retailer.

Where does the retailer fit into this picture, and I'm not happy with how the retailer decides how much his margin will be in relation to his cost to the beef.

The charts indicate my concerns very well. If you will look at the charts as I go along, then we'll get into those. I agree that the retailer in our free enterprise system can and should be able to determine his own margin of profit. Many years ago when we should have approved it in dusting beef, I did not want anyone telling me that I did not deserve the profit that I got. But it is very frustrating to be losing $50 to $100 a head with the cattle market. That is 15 to 20 percent lower than anticipated and yet, to find very little change in the supermarket prices.

I think the charts indicate that very well. In the first 3 months on the chart, that is, December, January, and February, cattle prices went down 10½ percent. Retail beef prices went down less than 1½ of 1 percent. When we got—and then both the beef market and the retail market went down and prices went down. We then got to September and choice steer prices were down 18 to 19 percent and beef—retail beef prices were down 3 percent. The retailer says that he can't change his prices every day just like the beef market changes, and I agree with that, that would not work right.

But these charts indicate that for 3 months the price of beef went down 10 percent. In a 3-month period, and the retail price didn't go down hardly at all, but it looks like maybe they need 3 months of leap time for prices to come down.

Let's take a look at September on the same chart. When the price of cattle choice steers went up, what happened to the price of retail beef, it went up the same month. they didn't have to wait 3 months for the price of beef to come up. This hurts the industry double, and not only in the price itself, but if we would have lower prices at the retail store, when we have lower prices on the live cattle market, we would sell more beef. We would get rid of that surplus and get ourselves back in shape again to probably have a little better price.

This would get us over a bad situation and that was so evident in the last year and exactly the same thing is happening so far in the 3 months of this year. The retailer did not help. The retailer was a part of the problem and maybe it is still there, and I guess it is still a free enterprise system, but they could be a little more responsive to the problems in the production end of the meat industry.

Senator ABDNOR. Your judgment is that it would have been a reasonable time to show the change in the increase of the market prices as it reflects back to the consumer?

Mr. SCHNELL. I would think that a month would be the most that would be needed to reflect a certain amount of change in the livestock cattle market.

Senator ABDNOR. Do you fellows agree with that? Finish, and then we'll go ahead and talk about it.

Mr. SCHNELL. Thank you. Let's take a look at the packer end of it. I have no problem with the margin of profit with the packer and in the charts that I have handed out. Incidentally, in those charts, the first shows the retail—the correlation between beef prices and live and retail prices from 1970 through 1985—very revealing. They sure didn't hurt themselves any.

The second one shows the relationship between live cattle prices, dress beef prices and the retail price. And it has surely indicated that the dress beef prices follow close in harmony with the live cattle prices, so I have no quarrel with the packer in regard to his margin of profit. What about the fact in the lean problem that the consumer is so concerned about. Packers are the ones that decide fat beef or lean beef. You know, research, for many years has been very definite in saying that 100 days of feed—concentrated feed—is all that is needed to get the best in taste, flavor, and tenderness of beef.

There is no reason to feed them longer than that for those three most important factors. Buying practices of the packers have almost entirely lost that effect. You have cattle that you know are ready to be slaughtered in 110 days. You call the packer buyer and the packer buyers look at them and he says, well, feed them for 2 more weeks or feed them for 3 more weeks and then they will be just right.

What happens then. It raises the cost of feeding because that last week or 2 weeks, or 3 weeks at the most, are the most expensive part and it's almost double when they are feeder cattle or lighter feeder cattle. It increases the amount of fat in the carcass by a large amount because that last gain is mostly fat, but it also increases addressing percentage and that makes the buyer look good when he brings the cattle to be slaughtered then they dress out at 63 percent instead of 62 percent and he gets a better grade from the packing plant and everybody is happy except that they are hurting the industry. Feeders are blamed, very often, for having too much fat on the cattle. They say they are holding the cattle and that they should have sold them earlier. They were holding for a better price. Well, there is some of this. There is no doubt about it, but not always it's the feeder's fault. Some days you just can't sell fat cattle at any price.

Within the last 8 weeks, for example, it was down in the Kansas area, and where the U.S. major packers had an influence on the market. They had a lot of contract cattle out and they just practically quit buying and called in their contract cattle. Well, you know what happened, the chart shows what happened to that cattle market in those 8 weeks. It went down about $3 or $4 a hundred.

This is the effect that some of these new practices and marketing can have on them. Sometimes we think they are favorable such as the futures—the large feedlots, the options, the contracting cattle and so on, but also, it can be very harmful in this case and it surely was.

My personal experience in regard to trying to sell cattle here in South Dakota, we expected they should be ready. They were larger cattle when they went in and they should be ready when 110 days are up. We put them on the show list which was the 21st day of January of this year. Slaughter prices at that time were 59.37 cents and that is the average of slaughter cattle or slaughter steers sold and we couldn't find anybody interested. We kept trying to sell those cattle and we were not that fussy on price. We wanted to sell the cattle because when I went into the feeding business, I made one vow—solemn vow that I would sell the cow when they were ready. I would not hold cattle beyond that time. Finally, we got them sold 3 weeks later.

I said the price on January 21 was 59.37 cents. Three weeks later we sold the steers for 52 cents. Of course, there was $2 of freight involved in it. I lost $103 a head. If I would have been able to sell those cattle at the time when they were ready, when we thought they were ready, I would have lost less than half of that, so when they say that the feeder is the one responsible for over fattening, they are wrong, and that is again, identified by the fact that packers do not pay premium for yield grade one and two cattle but they sure as the devil discount four and five grade cattle. So there needs to be some work there.

The Government's role in our industry is almost a disaster. The beef industry is probably the most regulated and inspected industry in the United States today, at least in the food industry. We have 8,000 inspectors looking at our meat and every aspect of it before it gets to the consumer. Yet, who gets the bad publicity, the beef industry does. Have you ever heard of dirty conditions in the fish industry? You have never heard of them and the reason is that there are no inspectors for the fish industry. They don't have inspections. Little or no Government inspection in the fish industry and yet, we, the most severely regulated industry, catch all the flack.

Our Government has been very severe on the meat industry and we have not been treated fairly. There have been and still are some governments whose goal is to discredit meat and the eating of red meat.

This has been evidence in the publicity regarding a number of researcher projects. The actual results were neutral or in some cases, even beneficial to meat's role in diet. But after the USDA publicity and specialists were through with their rewriting, red meat was the bad guy. These are not just isolated cases. There is a lot of them that have been quite common with recent further research on many of the projects. And what seemed to put meat in a bad position in our diets indicated that there seemed to be a concerted effort to discredit red meat.

Now, findings on the same issues are quite favorable to including red meat in all diets. Some of our own Government ties were the worst offenders in these cases. Federal farm policy has not been kind, nor has it been fair to the cattle industry.

Farm programs have financed over ag businesses and you have heard that two times already this morning. Financed in competition about the beef producers and an example is the dairy program. Over the last 2 years, which upset the cow market and this new Dairy Buy-Out Program looks to be worst yet in upsetting market ing patterns.

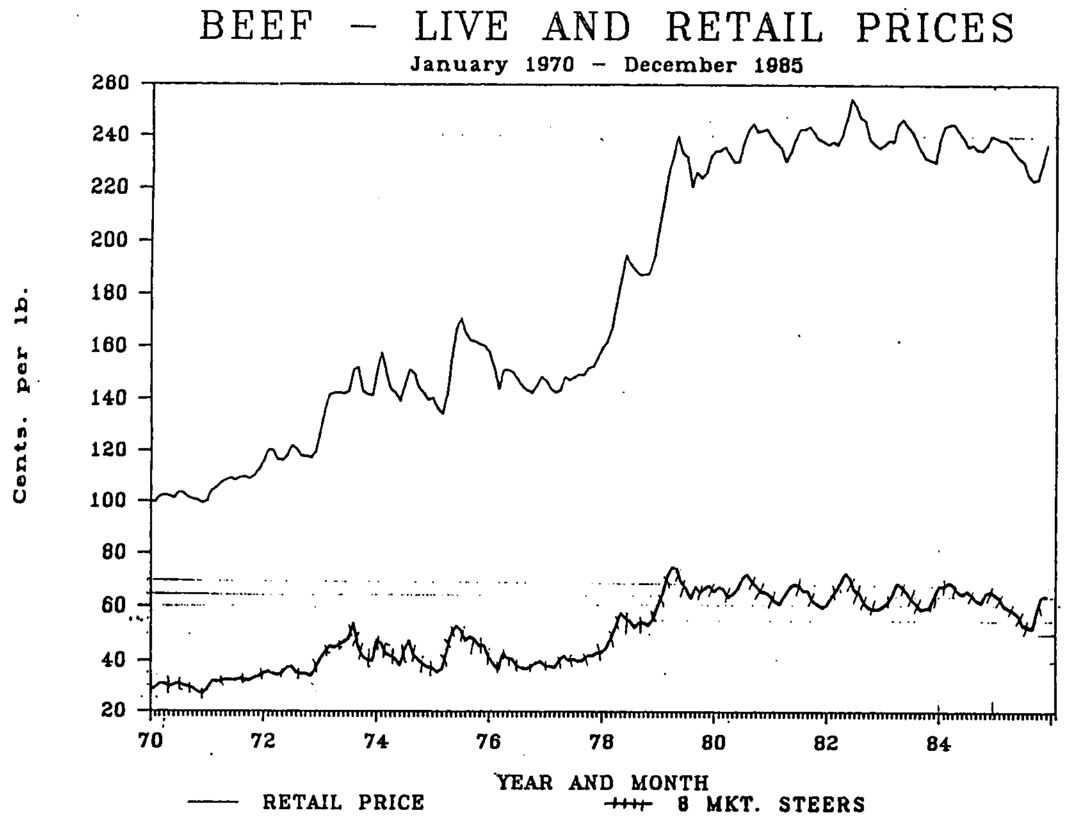
The futures market today, as I understand it, is down a great deal and today we were looking for some improvement in all the marketing factors. Well, I think the dairy buy out and the report of how many have taken advantage of it is the cause of it.

Also, grazing diverted acreages and you heard some about that and your tax laws. They have created unrealistic situations in our business especially in the feeding and the figure that Roger Husted used at 30 percent of the cattle sold doesn't have to make a profit because they obtain a profit from tax breaks and so on. That is very deplorable and no industry should have to fight that. Our Government was very unfeeling in it's manipulation or nonmanipulation of interest rates. The extremely high rates of the early 1980's hurt a lot of industries, but especially agriculture, because of the large amount of dollars netted. Of course, the purpose was to control inflation. I submit that when the prime rate is over 12 percent, then that is the largest factor in inflation is the interest rate itself and it does not help any industry in the United States to have inflationary interest rates.

In December 1980, I paid 23½ percent interest to feed cattle. Many feeders are in the same situation with 2 points over the prime rate. There is no way to justify that in my estimation and I say that the Federal Reserve could have changed this at that time, but did not.

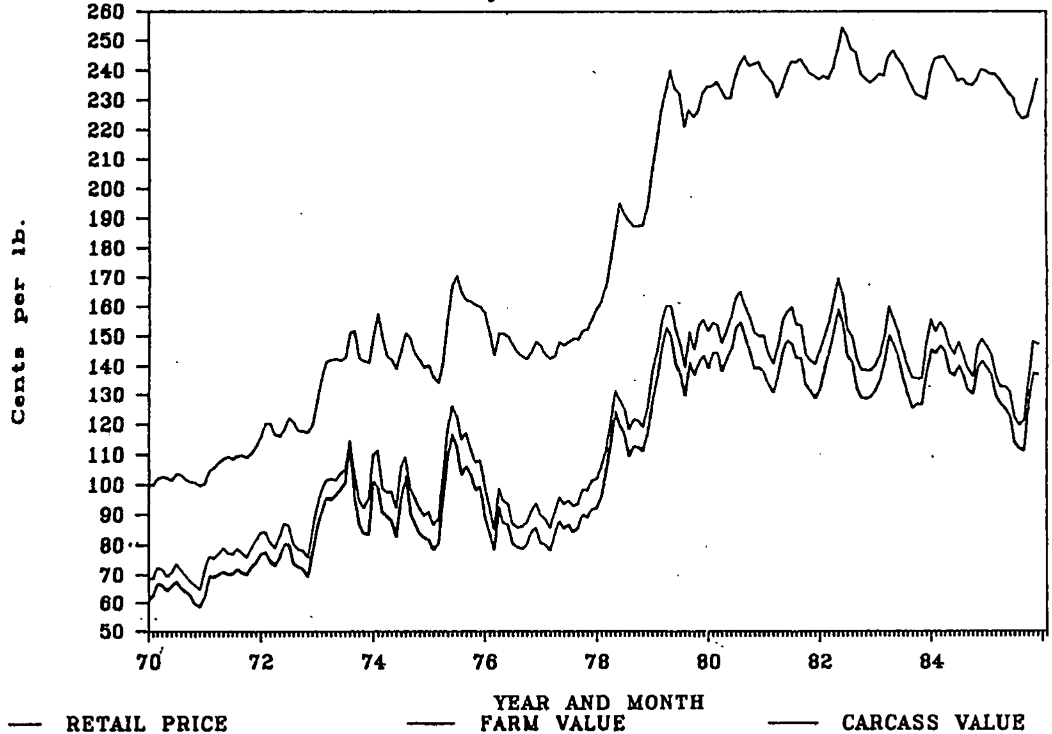
Senator, there are many problems in the cattle industry that need a lot of attention and need work on. I would hope that we could keep it more of a free enterprise system instead of being tied to all kinds of Government programs that in the past have not been that good to us. I know the people were working very hard to help livestock and all of agriculture, but if there were some way that we could make it with our own help, I'm sure that we would prefer it. It would be better on the Treasury and I think it would be more successful to the United States itself. Thank you.

[The charts referred to in Mr. Schnell's statement follow:]

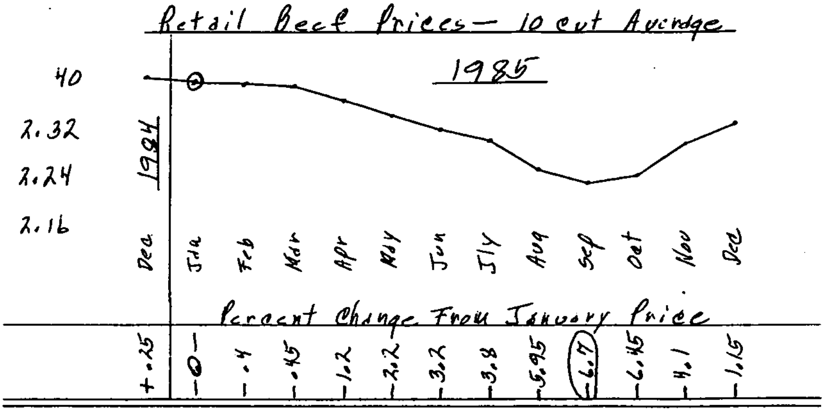

BEEF - LIVE AND RETAIL PRICES
January 1970 - December 1985
Cents. per lb.
280
240
220
200
180
160
140
120
100
80
60
40
20
70
72
74
76
78
80
82
84
YEAR AND MONTH
RETAIL PRICE
8 MKT. STEERS

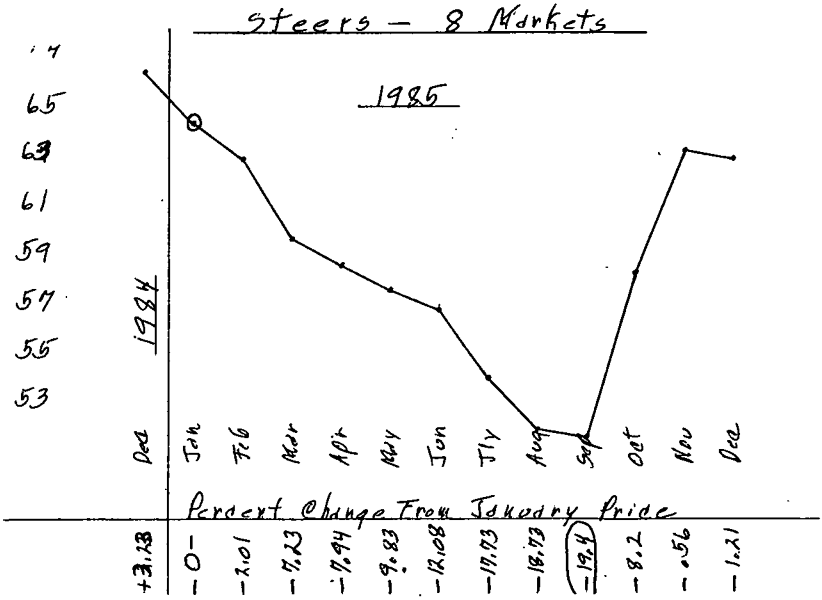
BEEF – FARM, CARCASS, AND RETAIL VALUE

January 1970 – December 1985



USDA-ERS Data



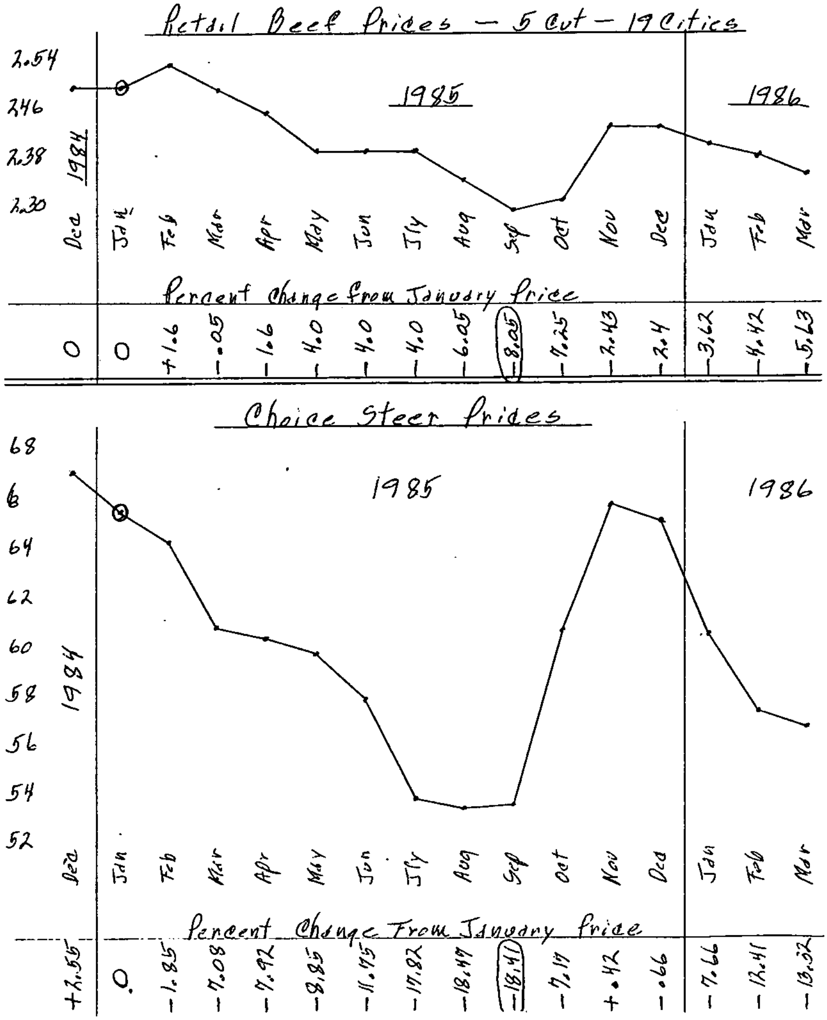


USDA - ERS Price Spreads

Beef, Choice yield Grade 3

Year	Retail price	Gross carcass value	Carcass by-prod. allow-ance	Net carcass value	Gross farm value	Farm by-prod. allow-ance	Net farm value	Farm-retail spread Total	Carcass retail	Farm carcass	Farmers' share	8-mkt steers
						Cents/lb.					Percent	$/cwt
1984												
Dec	240.3	152.2	2.7	149.5	159.4	16.9	142.5	97.8	90.8	7.0	59	66.42
Annual	239.6	150.6	3.0	147.6	158.6	18.6	140.0	99.6	92.0	7.6	58	66.09
1985												
Jan	239.7	149.6	2.6	147.0	155.9	16.1	139.8	99.9	92.7	7.2	58	64.95
Feb	238.7	146.7	2.4	144.3	152.8	15.6	137.2	101.5	94.4	7.1	57	63.65
Mar	238.6	139.2	2.2	137.0	144.6	14.9	129.7	108.9	101.6	7.3	54	60.26
1st qtr.	239.0	145.2	2.4	142.8	151.1	15.5	135.6	103.4	96.2	7.2	57	62.95
Apr	236.8	135.0	2.1	132.9	142.8	15.8	127.0	109.8	103.9	5.9	54	59.52
May	234.4	134.8	1.8	133.0	140.6	15.2	125.4	109.0	101.4	7.6	53	58.57
June	232.0	132.9	1.7	131.2	137.1	14.2	122.9	109.1	100.8	8.3	53	57.11
2nd qtr.	234.4	134.2	1.8	132.4	140.2	15.1	125.1	109.3	102.0	7.3	53	58.40
luly	230.6	124.0	1.4	122.6	128.3	14.3	114.0	116.6	108.0	8.6	49	53.44
ug	225.5	121.2	1.4	119.8	126.7	14.7	112.0	113.5	105.7	7.8	50	52.79
ept	223.6	122.7	1.3	121.4	125.6	14.5	111.1	112.5	102.2	10.3	50	52.35
3rd qtr.	226.6	122.6	1.3	121.3	126.9	14.5	112.4	114.2	105.3	8.9	50	52.86
Oct	224.2	137.5	1.5	136.0	143.1	15.5	127.6	96.6	88.2	8.4	57	59.63
Nov	229.9	150.6	1.8	148.8	155.0	16.9	138.1	91.8	81.1	10.7	60	64.59
Dec	236.9	149.3	1.6	147.7	154.0	16.6	137.4	99.5	89.2	10.3	58	64.17
4th qtr.	230.3	145.8	1.6	144.2	150.7	16.3	134.4	95.9	86.1	9.8	58	62.80
Annual	232.6	137.0	1.8	135.2	142.2	15.4	126.8	105.8	97.4	8.4	55	59.25

Cattle-Fax Data



Cattle-Fax Data

	Retail Beef Prices	Choice Steer Prices
December '84	2.49	67.14
January '85	2.49	65.47
Feb	2.53	64.26
Mar	2.48	60.84
Apr	2.45	60.29
May	2.39	59.68
Jun	2.39	57.78
Jly	2.39	53.80
Aug	2.34	53.38
Sep	2.29	53.42
Oct	2.31	60.78
Nov	2.43	65.85
Dec	2.43	65.04
January 86	2.40	60.46
Feb	2.36	57.35
Mar	2.35	56.75 *

* 3 weeks only

Senator ABDNOR. Mr. Schnell, I can't express my thanks enough to tell you how much we appreciate your coming down and giving us that story, and your charts are very, very, very revealing. I hope we can followup in Washington and get this message across. I'm hoping we'll find some help. It is up to us to do a good job. Our next witness in the first panel is a guy that, I know, got up at 5 o'clock this morning to drive here. It's amazing he stayed awake during all this. We thank you, Mr. Vinton, for coming from Nebraska.

STATEMENT OF PAT VINTON, VICE PRESIDENT, NEBRASKA STOCK GROWERS ASSOCIATION

Mr. VINTON. Thank you, Senator. My name is Pat Vinton and I'm vice president of the Nebraska Stock Growers Association made up of over 2,000 cattle producers and feeders. Our office is in Alliance, NE, and I live in Gordon, NE, and own and manage a cow-calf-yearling operation.

I appreciate the opportunity to be here with you today. We appreciated you bringing the hearing out to our part of the country. I was listening to the other panel members and I was wondering how we started out on our left and I ended up being what was left.

The topics that this hearing is addressing do bear on the future of the American cattle industry and we will address them one by one. I would like to start by saying that we also appreciated the opportunity to be represented at the hearing of this committee last September in Huron. At that time, the spread between the price of fat cattle and beef at retail was at an all-time high and we feel the publicity generated at that hearing substantially helped to reverse the negative psychology that had been demoralizing the market.

We do want to note that the spread is now approaching those levels of early last fall and our market is once again lower than market fundamentals warrant. We are not as lacking in currentness in feedlots as we were then, but if something isn't done we will drift into another disaster.

Now, to address the topics of this hearing. First of all, I'll address the tax shelter cattle investment, and I do have copies of the prepared statement a large portion of which I rewrote, on the way up here this morning, so if you want corrected copies——

Senator ABDNOR. We would like to have it any way you want it for the record.

Mr. VINTON. Thank you, Senator. In Nebraska, we have been discussing the corporate ownership of land and cattle as a result of the recent constitutional amendment which banned corporate ownership of ag land and livestock. As we discussed the tax shelter investment in cattle, I think it is important to make a distinction between investor-owned cattle and tax shelter cattle. For my purpose, I will define investor-owned cattle as those cattle which are owned for the purpose of making a real economic profit by breeding, grazing, or feeding those cattle. Tax shelter cattle investors are unconcerned with the profit and cattle ownership. Their motivation is to lower the Federal tax bill by deferring income or using strategies to convert ordinary income into capital gains income.

I'm only too happy to compete with investor cattle, but I can't compete with tax shelters. I never could and never will be able to as a bona fide rancher.

The tax deferral strategy utilized prepaid feed and deducting those feed costs in the prior to the sale of those cattle has had a negative effect for years by causing numbers to be placed on feed in the November and December periods which resulted in a large bunch marketing on in the spring. Feed is prepaid and the cattle are purchased and then marketed with hedges on the futures market, so there is almost no risk to the owner.

He is well satisfied he had the cattle to break even to insure that the tax trade entity is successful.

A more recent strategy involves setting up a corporation to own the cattle which allowed them to repay the feed and defer that income and then in the following year, they sell the stock of the corporation including the cattle to go with the stock and allowing them to take capital gains on that deferred income. This allows for a tax gain of over $35 per head tax profit and not an earned or economic profit. Again, the cattle and the feed are prepaid and help to break even to assure the tax benefits. No genuine agricultural American can compete with this tax motivated investor.

All we ask is a level playing field where the players follow the same rules. It's these same inequities in the tax shelter that cause this. It is a sad commentary when States pass laws to attempt to compensate for inequitable Federal tax laws. The only segment of our industry that supports tax sheltered investment in cattle are custom or commercial feeding sectors and purebred and livestock sector, and even they are divided on the issue.

Cattle imports is an issue that really gets the attention of our members. When our market is already down and I hear of cattle from Canada further depressing the market they get mad. And the consequences of this foreign competition are not evenly felt. Those nearest the markets that receive imported cattle suffer by far the greatest consequences and anything that could be done to spread out the effect of imported cattle on local markets would be beneficial. In the meanwhile, the Beef Import Act of 1964 has served the industry quite well and any effort to ease stress from imports should be approached in such a way as not to jeopardize that law.

As American beef producers, we do strive to produce a truly superior product and it is generally recognized, and internationally, as just that. However, we ag producers and consumers have grave concerns about some of the beef imported into this country.

Many countries do not have the same high standards of inspection or the rigid guidelines of the USDA and the Food and Drug Administration that are not licensed in the United States. And they may have lax, if any, withdrawal periods for those substances. Consequently, it is possible to import beef which could contain harmful residues or lack the processing inspection guidelines that ensure this country's beef consumers of a product which is among the safest and most wholesome anywhere.

Therefore, with the consumer's right to a safe and wholesome good supply, we, the cattle producers of this Nation, urge Congress to investigate the safety and wholesomeness of imported beef. We demand for the safety of the consuming public that immediate bar of imported beef from those countries whose requirements are less than ours and such ban would last until they verified meeting our standards.

Unlike most consumer products, beef has an ingredient in some processed food or is a product sold in grocery stores or restaurants and is not subject to labeling stating the country of origin.

This puts the beef industry in a very precarious position which we are at risk of having our product liable. If unwholesome or residue latent beef is detected and you cannot trace the origin of that product, then it is identified as the American beef producer. It shouldn't be here in the first place if it doesn't meet the standard of production.

Partially due to the lack of labeling, we are unable to combat advertising such as recently appeared in the New York Times urging people to stop eating fast food hamburgers in order to save Central America rain forests; that beef represents a fraction of 1 percent of the beef consumed in this country but are very inaccurate, which the entire industry suffers from. This threatens our industry as we continue to lose consumers and there is very little we can do to combat it. Only Congress has the authorities to address these two issues of safety and labeling.

We urge your immediate action. The futures trading is another emotional issue among our people and many feel the futures serve them poorly. Feeder cattle contracts are thinly traded and not much used as a hedging tool by producers. As a consequence, they feel the futures contract uses them far more than they can effectively use it. Most ag economists say the futures are here to stay and constantly chastise producers for not more fully understanding the process of using it more extensively. We would like to see these economists join the cattle industry in pushing for disclosure rules on the Chicago Mercantile Livestock Exchange contracts at least as stringent as those imposed on grain traders by their exchanges.

As to Government farm programs, only recently have cattle organizations become involved in them.

Cattlemen have never asked for price support programs, but generally felt they shouldn't get involved in the designing of programs for other commodities that do have supports. After the PIK Program and the two dairy programs, cattlemen have come to realize they must get involved in general farm legislation, if only in self-defense. Our general position is that one commodity should not solve its problems on the back of another, but that is easier said than done.

The Feed Grain Program this year probably more than any in the past almost compels participation.

The so-called safety net is too badly needed in these uncertain times to ignore. We do see this sincere effort to protect farmers resulting in continuing surpluses of feed grain that in turn translates eventually into surpluses of meat; and cattle producers of which have no safety net. We aren't about to ask for supports either, however, we do ask for understanding of the fact that farm legislation must eventually think of agriculture as an interdependent unit and stop trying to solve the various problems of parts at the expense of other parts and eventually the whole.

These are complex problems and ones that cannot be addressed with simple, short-term solutions.

There are, however, immediate problems pressing down on cattlemen. The main ones being too low a price for cattle and two high interest on debt. Even the problem of lost equity would be better dealt with if interest weren't so high.

Ironically, the primary reason given for interest staying high in the ag sector is the necessity for lending institutions to take over land, at a loss, and increase their reserves against these losses by holding up interest rates to the survivors. This chain of events suggest that there may be few survivors.

One side note was that there was mentioned earlier on the panel the disaster loan programs and they have been questionable benefit in our area. We found out recently that the family-size farm is limited to an operation of 150 head and so most people can't qualify simply on that basis or what seems to be an arbitrary method.

We would like to close by saying that the underlying concept of the Landowner Protection Act cosponsored by Senator Abdnor has real merit for coping with the dilemma facing debt burdened ranchers. Officials in the Farm Credit System have said that this bill would cause landowners to purposely take bankruptcy to avail themselves of its provisions. We feel that if the very cash-flow statements the system requires of its borrowers were reviewed they would prove that without some such program the borrower is already on the road to bankruptcy and the bank that made the loan was a party to the upcoming wreck.

Thank you for the opportunity to testify at your hearing.

[The prepared statement of Mr. Vinton follows:]

PREPARED STATEMENT OF PAT VINTON

My name is Pat Vinton and I am vice president of the Nebraska Stock Growers Association, an organization made up of over 2,000 cattle producers and feeders. Our office is in Alliance, Nebraska, and I live in Gordon, Nebraska, and own and manage a cow-calf-yearling operation.

We appreciate Senator Abdnor bringing this hearing out to our part of the country. The topics this hearing is addressing do bear on the "Future of the American Cattle Industry" and we will address them one by one. There are some other things only indirectly tied into the suggested topic that we want to touch on also.

I would like to start by saying that we also appreciated the opportunity to be represented at the hearing of this committee last September in Huron. At that time the spread between the price of fat cattle and beef at retail was at an all time high and we feel the publicity generated at that hearing substantially helped to reverse the negative psychology that had been demoralizing the market. We do want to note that the spread is now approaching those levels of early last fall and our market is once again lower than market fundamentals warrant. We are not as lacking in currentness in feedlots as we were then, but if something isn't done we will drift into another disaster.

Now, to address the topics of this hearing.

We in Nebraska have been discussing the issue of investor owned cattle at great length as we agonize over the constitutional amendment passed in 1982 prohibiting corporate ownership of land and involvement in farming and livestock enterprises. Of course individuals can still invest in cattle and it would be illegal to keep them from so doing. As a result most of the discussion on this subject is centered on corporate investors. It would appear that the underlying issue is one of taxation and tax shelters. One could generalize that custom cattle feeders and elements of the purebred cattle business strongly support tax sheltered investment in cattle. Many farmer-feeders come down against such investor involvement and our organization has found that cow-calf-yearling operators are quite divided on the issue. One could make the point that part of the cause of the run up in land prices was the result of competition from investors looking for tax shelters. The reality now in Nebraska is that our ag land is worth only 45% what it was at its peak in 1981 and as a consequence many of our members have some extreme credit problems. Those who have had to sell their base cow herd to service a debt payment in recent years are faced with the necessity to find outside cattle to run on their grass to provide income to meet their next payment. A philosophical argument about investor capitol interests them little. They are aware that cattle numbers are down, that their neighbors are hurting like themselves and that they would like to find people with the money to place cattle on their grass whatever their origin.

Cattle imports is an issue that really gets the attention of our members. When our market is already down and they hear of cattle from Canada further depressing the market they get mad. And the consequences of this foreign competition are not evely felt. Those nearest the markets that receive imported cattle suffer by far the greatest consequences and anything that could be done to spread out the effect of imported cattle on local markets would be beneficial. In the meanwhile the Beef Import Law of 1964 has served the industry quite well and any effort to ease stress from imports should be approached in such a way as not to jeopardize that law.

Futures trading is another very emotional issue among our people. Many feel that the futures serve them poorly. The Feeder Cattle contracts are fairly thinly traded and not much used as a hedging tool by producers. As a consequence they feel the futures contract uses them far more than they can effectively use it. Most ag economists say the futures are here to stay and constantly chastise producers for not more fully understanding the process of using it more extensively. We would like to see these economists join the cattle industry in pushing for disclosure rules on the Chicago Mercantile Livestock Exchange contracts at least as stringent as those imposed on grain traders by their exchanges.

As to government farm programs, only recently have cattle organizations become involved in them. Cattlemen have never asked for price support programs, but generally felt they shouldn't get involved in the designing of programs for other commodities that do have supports. After the PIK program and the two dairy programs, cattlemen have come to realize they must get involved in general farm legislation, if only in self defense. Our general positon is that one commodity should not solve its problems on the back of another, but that is easier said than done. After decades of farm programs for the major crops it has become difficult for farmers to afford to produce alternative crops for which there is no program. The feed grain program this year probably more than any in the past almost compells participation. The so called safety net is too badly needed in these uncertain times to ignore. We do see this sincere effort to protect farmers resulting in continuing surpluses of feed grain that in turn translates eventually into surpluses of meat, and cattle producers of which have no safety net. We aren't about to ask for supports either, however we do ask for understanding of the fact that farm legislation must eventually think of agriculture as an interdependent unit and stop trying to solve the various problems of parts at the expense of other parts and eventually the whole.

These are complex problems and ones that cannot be addressed with simple, short term solutions. There are, however, immediate problems pressing down on cattlemen. The main ones being too low a price for cattle and too high interest on debt. Even the problem of lost equity would be better dealt with if interest weren't so high. Ironically, the primary reason given for interest staying high in the ag sector is the necessity for lending institutions to take over land, at a loss, and increase their reserves against these losses by holding up interest rates to the survivors. This chain of events suggests that there may be very few survivors.

We would like to close by saying that the underlying concept of the Landowner Protection Act co-sponsored by Senator Abdnor has real merit for coping with the dilema facing debt burdened ranchers. Officials in the Farm Credit System have said that this bill would cause land owners to purposely take bankruptcy to avail themselves of its provisions. We feel that if the very cash flow statements the system requires of its borrowers were reviewed they would prove that without some such program the borrower is already on the road to bankruptcy and the bank that made the loan was a party to the upcoming wreck.

Thank you for the opportunity to participate in this hearing.

# # # # #

Senator ABDNOR. Thank you. And thank you to all of you. I would like to ask some questions and I won't take much time, because we have quite a list here. We are going to take whatever time is necessary because all of the comments were exceptionally fine and very needed.

I want to go, first of all, to Roger Husted. Roger, I do think that the dairy buy out is not a helpful thing at all, but there are some things in that farm bill that may help a little. The conservation reserve is supposed to be great. At least it might put an end to this blowing up of the land. I have always said that if we did that plus the tax loss bill we might start improving the agriculture picture. I know we're going to when we talk about the unplanted acres. That is something else, again, and it has caused a big uproar there.

We were fighting there among ourselves. The Southern States were pushing, and so we have to. I might say that Senator Zorinsky was outspoken in saying what was going to happen but it seems like from that line on it's out. That was pretty much hard to hold. We particularly are trying to get out some of the crops that were breaking on the planted acres with crops that are not subsidized under those conditions. We may get into that before the day is out.

I do want to—and almost all of you have mentioned the tax loss advantage that is going on, and I tell you that I think it came to a head when I saw an ad in the Wall Street Journal where they were advertising to save $3 for every $1 invested at some livestock yard down in Texas.

You know that is one of my bills that I have been on for a long time, and I'm very grateful to have the stock growers and cattlemen in the different States behind me, because that is the kind of suppoort it is going to take if we are going to try and get into this. I wish the American Cattlemen's Association was more interested in it than they were, but we're on the subject of tax reform and I look for something to pass this year. Right now, the House did nothing with this.

I thought that the gentleman over in—Congressman Hamilton of Indiana was trying to get it in the House, but it didn't succeed. I don't think he is a member of the committee. I don't think that was part of the problem and it's not in the Senate version right now. I have gone over and sat down with this panel and Senator Packwood as to close the loopholes, but it is not what I want and I think much of what has been proposed has slowly fallen by the wayside, and as you know, there is a lot of heat about the tax and bond that has gone down the tube by the committee and they hadn't got into the excise tax.

He wants to put a 20-percent minimum of tax which might be all right, but I think this is the subject by itself that needs attention and it is very apparent to me. I don't think it's going to come out of the committee, I will say that. Senator Packwood is trying hard, but there is not enough State laws for everyone that is for it. We have a lot of people who are against it and the fact that it's quite a thing for some of the States. They certainly like it.

I came out in our debate a year ago in the budget bill when I put a sense of Congress which is all I could put in under the bill at the time, or the budget, because the budget resolution is not the place to write tax laws. They are strict about that and that comes out of the Finance Committee, but I got the expressions on the part of Congress. Something should be done, which I will be reminding Congress or the Members of, but even there, I have plenty of opposition and some is at least expected, but a lot of people take advantage of the loophole and we have to work on it. I probably will have to go outside the committee and try it on the floor. As a matter of fact, Mr. Tosterud doesn't know it, but when I go back I'm going to try and pull Brooks Meyer like he did and get up each day and make comments about tax law and farming, so they don't forget it is around.

I was sitting here looking, Mr. Tosterud, that Nebraska is here, Colorado is here on the program, Iowa, North Dakota, Wisconsin, Arizona, South Dakota, and that makes up—it must be 14 Senators in that group and if we started with that group, that could be a big help when the time comes. And if everybody is helping and we could add some other States, that is what it is going to take to make this thing go. I hate to see a tax reform measure go without this being a part of it, but I'm not kidding myself, it's not going to be easy. It's going to take a lot of help. And some of the figures you were using get worse than that.

As more money goes out paying guys for—I mean, they take more credit off for not having to pay taxes for their losses than we have people paying into it and the agricultural field. And people are aware of it down there, but I have not made that progress so far in the Finance Committee, so I will say one thing, that we need all the help we can get on that, because I think it is a very important part. Mr. Husted, the question I want to ask, in the cattle industry, Is there a lowering of the interest rate? After all, the interest is down and it looks like it's going to go another half a point. Is that showing up?

Mr. HUSTED. Not in my area, no. I would say that the banks in our area have not come down. I asked my banker and he said that maybe, but you have to be aware that you have a lot of nonperforming loans that we have to cover, so in other words, I'm looking up the list for bankruptcies.

Senator ABDNOR. Mr. Gallagher.

Mr. GALLAGHER. That is totally agreeable. That is what we are hearing, Jim, and it's not going to come down. We have got to pick the ticket up for the nonperforming loans.

Senator ABDNOR. Mr. Schnell.

Mr. SCHNELL. Senator, this thing has really bothered me. I started making loans on cattle in 1946 and I had loans ever since. Every time I asked the banker why he has to charge me 2 or 3 percent more than he charges a guy that buys a Caterpillar to go into the road construction business, or some such thing, well, he says, agriculture is a risky business so we have to put 1 percent or so aside as a reserve.

Well, it seems to me that was 40 years ago that I started borrowing the money and paying the 1 percent for the reserve. I have yet to find out where that reserve is. As soon as something goes wrong then they are doing what they are doing right now and yes, our interest rates have come down, but not so much to the farmer and rancher as to the business man up and down main street, by about 2 percent or 3 percent.

So, we are still paying even though we paid for 40 years for reserve to carry us over this present time. They don't have it and they put it in their pocket or in their buildings and so here we are building the reserve again and paying for the catastrophe in the livestock business the second time.

Senator ABDNOR. Mr. Vinton.

Mr. VINTON. I just checked with our local bank a couple weeks ago and their average cost of money was 7½ percent and the average return on their investment was right at 12 percent, so they have quite a spread there and there are banks that have, depending on the condition of the bank, the spreads are wider in our area. The average interest rate would run anywhere from 12½ to 13 percent.

Senator ABDNOR. You're talking about you were paying 22 or 23 percent?

Mr. VINTON. Twenty-three and one-half percent.

Senator ABDNOR. Was the spread as much than as it was today? I mean, after all, prime was up to 21 or 22 percent.

Mr. VINTON. Twenty-one and a half.

Mr. SCHNELL. Generally the long-term loans at that time were around 17 or 18 percent.

Just those of us that finally were able to get more money so we could get deeper in the cattle business and lose their shirt a little faster went on that basis of 2 points over prime. A lot of the cattle feeding was done that way. Prime got up to 21½ percent and I paid 23½ percent.

Senator ABDNOR. Is there a reason why it shouldn't be 9 to 11, or 9½ to 11½, instead of the 13 and 14? Times are tougher now.

Mr. HUSTED. Could I say one thing. When you say—I'm talking about the last year. I'm not talking about 2 or 3 years down the line, and I would like to add the average cost to our area is 12 to 15 percent.

Senator ABDNOR. That is quite a spread when you think what interest means to the operation.

Mr. HUSTED. I don't think the banks in our area have come down.

Senator ABDNOR. You used to say 1 percent in Washington is $2 billion in income. I got that figure from Mr. Tosterud and that's why I'm asking. That is a big—2 percent, $4 billion, that is a big part of farm programs in the past.

So, it is important and it is real troublesome for Members of Congress. I get alot of letters from people chewing me out when you talk about buy downs from this program and that buy—that cashflow is zero and they say that all you're doing there is making me pay more up on this end, so it gets to be a troublesome question, but I think there is one thing I really believe that today, Members of Congress are more conscious of the problem of agriculture and livestock than I have ever seem them before.

I mean, they don't poo-poo it as much as they used to, but there is a movement on credit that is, something is going to happen some day in the near future and there is a lot of proposals floating around, but again, I don't think it should be just something for the desperate ones because we have a lot of people who still have their head above water that might survive if we can possibly give them a break until the thing gets turned around, and that is the thing that bothers me.

You mentioned the bill that had my name on it with Senator Nickles. I guess his district and my district, and the farm banks that are probably the two most banks that cause us problems in the United States and we're finding that many of our operators—agricultural operators have kept their payments current and their interest current and are on the verge of being foreclosed on and it's a shocking thing, and all we're trying to point out is that those banks could conceivably restructure a borrower's loan so they won't lose any more money in the farm credit banks than they would if they foreclosed and turned around for a lesser price and lower interest. They could give the same credit benefit to a farmer or rancher. They ought to do it and I don't know why it takes legislation to do that, but we're working on that and it's almost impossible for me to believe that we have to do that kind of thing, but these are the things that very much are alive in Congress and maybe if we keep working together with all the States and all the cattle programs and agriculture programs in trying to work together on something instead of going off in 10 different directions, than we might get something done.

I guess I better move on to the next panel here.

[Whereupon, Tom Spencer, Pueblo, CO; Jim Courtney, Montana; Jim Strain, chief executive officer, American Cowmen's Association; Marie Fisher, South Dakota WIFE, were called upon to testify.]

Senator ABDNOR. Our first witness is Tom Spencer from Pueblo, CO. Welcome. If you want a better Senator than Senator Armstrong we can get you one out of Texas. We sure have him on our side and he's a good man.

Mr. SPENCER. Thank you, Senator, and I appreciate the reference to Senator Armstrong. We think he is all right in our books too.

Senator ABDNOR. He is a tremendous fellow. He's very deep and very, very factual. I have never run into a man who knows his information better than he does.

STATEMENT OF TOM F. SPENCER, COW-CALF RANCHER, PUEBLO, CO

Mr. SPENCER. Thank you. My name is Tom F. Spencer of Pueblo, CO and I'm a cow-calf rancher of yearlings although I feed cattle in commercial feedlots in Colorado and Kansas and other States as well. I do no farming and the cattle operations are my only income source. I appreciate the opportunity to express my views and I would like to commend you for holding this hearing. I suppose some of the testimony you will be hearing will be repetitious in light of what has already been said here, but I think the problems that we keep going over are just indicative and probably amplify the magnitude of the problem.

I'm a past president of the Colorado Cattlemen's Association and past board member of the National Cattlemen's Association. The views here that I express today are my own. The conditions in the production end of the livestock industry today are so bad that many are lacking the incentive and economic ability to continue in searching for the solutions.

More questions are posed than there are answers. The costs for producing cattle are at record high levels while recent retail price trades have been at record levels. Agriculture is trying to survive in one of the gravest times in history while some packers and retailers are enjoying record earnings.

During 1985 I have had my own production of cattle plus others that were purchased on feed and in that entire year and the first 3 months of 1986, there were less than 5 to 6 weeks that any cattle being fed made any money. Research and analysis of the mortgage system reveals the following conditions and practices that contribute to price depression and collectively result in low prices for producers.

One, commodity futures trading of cattle; two, use of formula buying based on prices quoted on very few actual bids; three, delivery of fat cattle to the discretion of the buyer; four, inadequate enforcement of the P&S Act or the lack of regulations to assure competition in the banking industry; and five, the short sided politically motivated action by the Government to maintain the chief policy for this Nation and effective efforts to improve prices to livestock producers. And feeders must consider a defensive measure against the above mentioned factor, to refer back to each one.

The futures and time, does not permit me here to state all the things that are wrong with the future and I think enough has been written about that, that we shouldn't take even time to address it and I will refer to them a little later as to what is happening this morning.

More permanent is the buying practices by packers and processors when packers are allowed to feed a part of their needed inventory and their supply, they can draw from the market place periodically and put pressure on prices and having supplies bought in advance also provides the ability to keep prices down.

Furthermore, packers base their prices on an extremely low number of actual trades reported. Two to three weeks ago the beef market broke $3 to $4 a hundred and this break was based on only about 14 leads of recorded cattle to a major reporting service. I have been told that only 2 to 2½ percent of sales are determining our markets and a better reporting system is sorely needed. The delivery of cattle to the discretion of the buyer.

Buying practices by the packers to stand off and receive delivery of fat cattle is probably the most useful tool to keep prices to their own advantage. When packers are allowed to feed cattle with no restraint as to numbers and are further allowed to regulate delivery to their advantage, there lies the greatest area for improvement that this committee should address.

I agree with Raymond Schnell on his advocacy of the free enterprise system. I have been supporting it all my life in the cattle business, but I hope that he wouldn't take offense to me in disagreeing with him about alienation of the packers retailer.

I don't have any problems at this time with taking on a little hard ball game with the packers and the retailer. I think that the beef is a very popular item and it's a good profit center for both the packer and the retailer and if either one doesn't handle the product then someone else will.

I'm tired of pussyfooting around and being defensive about the industry that is in the area of unsafe products and animals rights, activities, and making the retailer mad. I can't imagine our forefathers and what they went through to have times and also being cautious of addressing these problems. It would have been interesting to have been around when President Theodore Roosevelt, known in his history, as the trust buster, took on the Nation's railroads with the full support of our National Cattlemen's Association. I only wish that our leaders in Government and the cattle organization had the same courage today. It has not been many years ago that the P&S effectively barred the major packers then known as the Big-4 from owning ranches and participating in ownership terminal markets and also, participating in the production of livestock. Why isn't there support to look into possible monopolistic practices today.

I would submit to this committee that there is lots more room for unfair trade practices today then 40 to 50 years ago when Swift and Wilson had a few occasions because that certainly would have been a small impact on the cattle business.

The P&S Act was intended to prevent cooperation between packers and beef buyers. And present expanding, feeding and ownership and forward contracting of cattle by the packers seems to fly in the face of this act and indeed seems to flaunt it.

A possible solution would be to limit packers to ownership of a small percentage of their total capacity and to disallow them on putting off taking cattle after 3 working days. While it is not my political philosophy to ask for laws or regulations I think at this point, it is past the time for stringent enforcement of the P&S Act. When we have four firms killing over 51 percent of the steer and heifer slaughter, there is plenty of room for unfair trade practices.

Senator ABDNOR. What did you say?

Mr. SPENCER. The figures. And these are P&S figures. Four firms are slaughtering 51 percent of the steer and heifer slaughter and those are 1984 and 1985 heifer figures.

Continual action by the Federal Government and farm legislation over the last 50 years has been consistently to detriment to the producers of the raw product. The PIK Program, while being a short-term relief for some was the beginning of the breaking point for many cattlemen. In 1985, the farm bill, in my view, will not only be another burden on the tax payer, but a certain provision in the bill will again adversely affect the cattlemen. Just this morning, the June futures are down. The limit is due to the release of the figures on the first dispersement of the dairy cattle.

I have those figures, but I suppose I won't take time to give them, because we'll all be reading about them in the paper probably tonight, but it just shows again, the influence of whatever nature that can affect the futures. I'm sure that the people—the packers, are out. Those are forward contracts that are out right this very minute attempting to forward contract some cattle this morning.

But this action to the CMA very vividly reflecting the problem regarding the future. Enough will be said here today about our problems. And hopefully, sometime soon more can be said about the success of these deliberations.

I earnestly want to thank you, Senator Abdnor for providing the opportunity to express the views and I hope that something positive can be shown out of this deliberation.

Senator ABDNOR. Thank you for the information you have provided us. Our next witness is Jim Courtney from Montana.

I mentioned some Senators that have been of help to us in everything we do and Senator Baucus happens to be a member of the Finance Committee and I have to do a better job of cranking things up because this is not a political issue. This is one that has a lot of merit or benefit for the livestock industry as well as agriculture as a whole, so we'll be going on, but I'm pleased to have your information.

STATEMENT OF JIM COURTNEY, MONTANA STOCKGROWERS ASSOCIATION

Mr. COURTNEY. Thank you. I don't have any prepared testimony. It was a little short noticed. I am pinch-hitting for the Montana Stockgrowers Association, and we'll try to submit some testimony before your deadline with some statistics and figures.

But I would like to say that I really appreciate this opportunity and I appreciate you being here, Senator, and with your interest, it seems to me that Roger Husted about said it all and I have to really concur with him, Mr. Gallagher, and other members in their concerns. I'll hit on a few of our problems that we have in Montana and concerns, and try not to take too much time.

Senator ABDNOR. Go ahead.

Mr. COURTNEY. This drought has been very severe in the last 7 or 8 years and it's affected our numbers so much especially the eastern half of Montana, the cattle are gone. And I don't know how these folks are going to restock. I guess that really is a problem that is concerning a lot of us. Where are they getting the financing to restock.

In this period, we have had a whole change of rules in the credit system, you know, they look to the banking system today. Like the State A Basketball Tournament was here and half the time one team had the advantage. Why, if at the second half they only let one side shoot the free throw to even up and that's where we get in the ranching business. They have changed the rules pretty much.

Well, I would say it has to start with the economist. They come out with these theories and calculations on land values so that the lending institutions have devalued the property and it has really affected the ability for those people to operate, because you don't have any net worth left and I think this is really serious.

Over this past winter it was mentioned earlier that the cows have gone to market because of the winter and no feed and it is devastating when you look back here 2 months ago and the cows that are forced to be liquidated at $350 per head, which are sold by the pound a month later that were worth $450 and then all of a sudden they are up to $550 in 2 months.

But they were forced to liquidate and this is devastating. These people can't get back into business. And really, I guess, that is where one of our biggest concerns are.

Senator ABDNOR. Do you have thoughts on it. What could be done?

Mr. COURTNEY. Well, there is a proposal that is circulating in the country and I mislaid it this morning, and I'll send you a copy, and we'll be in Washington with the National Cattlemen's Association, and this is going to be presented to their board on proposals on different credit relief here somewhere to try and maintain the business.

Senator ABDNOR. That's the point we're——

Mr. COURTNEY. We'll get you a copy, and I just received it in the mail, but any way, there has to be credit relief to the producer's level.

We have not received it. As I mentioned before, the Farm Credit System has had to bail out and it wasn't passed down to the local banks and they don't want agriculture anymore. And we really have a problem and I really don't know whether Congress had addressed it or not, but somewhere, somebody has to address it or there is nobody left out here.

Senator ABDNOR. I think the mood is getting better for that. It can be something that is going to be perpetuated, the people who are almost beyond help, but there are a lot of those that could be helped. What you're talking about are the adverse weather conditions and the price. What a time to hit the people who are so far in debt, do you think you could revive them enough to keep them going until they can get on a cash-flow later?

Mr. COURTNEY. I think there is a possibility of a good percentage of them that could be saved if the interest is paid on time.

Senator ABDNOR. That's what we're talking about.

Mr. COURTNEY. I'll give you an example of confusion. We have had the disaster programs, the FHA thing, and very few of the ranchers could qualify to get a disaster loan. Maybe you could borrow it from the bank if you could borrow it from the bank, if you qualify, and if a disaster is a disaster. I don't care who he is. This is really disturbing and this feed thing, thank God for eastern South Dakota. Our feed supply is still being hauled into Montana and up in that country yet, and it is really expensive.

Senator ABDNOR. That mention of the bill that said they should take the feed to the disaster areas, was that a help up in Montana?

Mr. COURTNEY. Well, the grain—you're talking about the grain?

Senator ABDNOR. Yes.

Mr. COURTNEY. Yes, but it came late. We just got it, see.

Senator ABDNOR. Sorry about that.

Mr. COURTNEY. Yes; so, this credit is really the problem and restocking and another thing, that imports of the Canadian cows into the Northwest is a definite concern.

I visited with some person in the State of Washington the other day and I tried to find the right source to get statistics and to the number of cows, or fat cattle that come down into the Northwest area at certain times that really break a market during the week and we have that happen here. We have those cows come in here and get slaughtered, and they're during the drought or depressed time. Our markets are never allowed to pick up and stay stable. We keep having this little chat all the time and I think it's really critical and you can't ship anything into Canada, you know.

Senator ABDNOR. Is it greater right now than it was? I mean, it's something that has been going on?

Mr. COURTNEY. It's been going on for some time.

Senator ABDNOR. I have heard a lot of complaints and I'm wondering if the numbers are increasing?

Mr. COURTNEY. I'm trying to get ahold of them and I couldn't get ahold of the right people, but we'll get them to you. There is a lot of concern on the cost when they come down into that area.

Senator ABDNOR. They have been coming to South Dakota.

Mr. COURTNEY. You bet they come here. The tax advantage thing. I would like to concur with the other gentlemen that it is something that concerns us and the futures. There is a lot of confusion. You know, it depends on what business you're in, which end of it. On the cow-calf operator it is devastating to us and we have a lot of disagreement among our own people, you know, and it depends on what line you're in, but you have to raise that calf. There isn't any way that you can cut that cost on him and only to a certain point. The people that need the cattle have a little more advantage where they don't have to buy them if they can't lock it in and work it out, but there is—the bankers don't understand it well enough.

I think that definitely it hurts us. Why should this report this morning affect the ag futures? I mean, what happened today are that the numbers today that come out. Why should it be down the road next fall? It affects the whole thing across the board and that is really disturbing.

I guess I'll just kind of shut it off there and our main concern is again, sir, are the interest rates that are going to have to be down in line a little in the single digit figure if we are going to be able to operate and the imports are definitely a concern.

And you mentioned a little earlier here about whether the industry is doing enough of what the health and public relations part and I think there is a lot of room for the livestock industry to work on public relations. We have been beat around by the press and it is real difficult to get our stories into the press. It's very difficult.

And some of these Dear Abby stories, they are devastating to us and after the accusations have been made you're kind of dead. But this is an effort that is definitely going to what I'm hearing to be a topic for the National Cattlemen's Association this next year. I know the State organizations are going to work harder on public relations to get our word across that the image of the cattle industry out to the people, rather than we're the bad guys. With that, I would like to thank you, Senator Abdnor.

Senator ABDNOR. Thank you, Jim. I appreciate you coming all the way down. I put my name on a resolution some time back and I referred to ag and that is the last, simply saying be it resolved that the Americans are encouraged to consume beef and beef products and be that as a simple thing to pass, but it doesn't seem to move. Mr. Tosterud just handed me some of the adverse information that we keep getting from the animal reform group. I don't need my friends is really a case for animals. I mean, it's humorous out here, but you would be surprised how it might be resolved back East and the great American meat out.

All I'm saying, is that it isn't decreasing and if anything, it's getting worse and I do think, personally, that the cattle industry has been too slow about responding to this. I realize it's hard to get people who are in a losing business to contribute into a fund that does this, but sometimes it is the only answer, because I don't think it is going to come out in Washington. They ask that it shouldn't come out on this, but we can't afford it. That's all we don't need right now with all the other problems we have.

Jim, it's nice to have you back.

Mr. STRAIN. It's nice to be here, as always, Senator. I appreciate it.

STATEMENT OF JIM STRAIN, CHIEF EXECUTIVE OFFICER, AMERICAN COWMEN'S ASSOCIATION

Mr. STRAIN. My name is Jim Strain with the American Cowmen's Association. We have a little office here in town and I personally am involved with the cow-calf business down in Mellette and Jackson Counties, SD.

I have basically one primary thought here, Senator, that I would like to talk on. With your permission, if I could go to the blackboard after I have read a statement here and use illustrations that goes with the expression that pictures are worth a lot of words.

I think that the free enterprise system, of course, that we all know, strives on the concept of competition.

The supply-demand concept is predicated on an orderly reduction in pricing as supply exceeds demand until the two, supply and demand, converge and price stability returns; conversely, and orderly increasing of price as the opposite situation develops.

In beef marketing at some price level for all cuts, price resistance sets in and begins to impede product movement, the entity, which controls the delivery of the finished product to the consumer, is able to reduce movement simply by pricing at or above this level. Supply, on the other hand, is programmed to come on line in a constant manner and short term it is impractical to attempt to stabilize price by reducing supply to conform to the reduced outflow of product.

In a situation where price is not lowered to develop demand, the volume of the final deliverer of product may suffer, but its profit margin may not, in that the volume moved is lessened because of price, but as input costs are lowered, the margin widens and overall margin could thus be maintained even on lower volume.

The futures market offers opportunities for a profit not from moving volume, but by restricting volume, which in turn causes a backlogging of supply and eventually lower prices as a result of the backlog. By taking a short position on the futures market, a profit center is developed that makes reduced product movement advantageous and shifts marketing from a situation that demands a high volume movement of product in order to profit to the unnatural opposite. Similar possibilities exist in an up market situation.

Through the futures, we have put in place a mechanism that could conceivably make erratic, wide-swinging, and disorderly markets profitable when the opposite is the desired, and I would like to expand on that in front of the blackboard.

I have plenty of wind to speak with here and I'm short on a few other things, so we'll go ahead on that subject. Here is a little something for you to follow along with. This is going to require a little bit of——

Senator ABDNOR. Can you all hear him?

Mr. STRAIN. I'm going to take a 1,200 pound heifer here and I'm going to price him a couple different ways. The first thing, I'm going to price him at 70 cents and that makes that steer bring $840. I'm next going to take $840 and I'm going to divide 500 pounds into that $840, because that is how much retail meat this steer is going to yield. This is not carcass weight, this is retail weight.

Now, I'm going to divide this into that and come up with a dollar amount of $1.68 per retail pound. Now, I'm going to take that same steer weighing 1,200 pounds and mark him down to 60 cents and that equals $720 and divide it by 500 pounds and that comes out to $1.44 per retail pound. Now, I take that same steer and I'm not like in the direction of the market here, and times him times 50 cents and that is probably—we're kind of in that category, and that makes that steer bring $600. I will divide that $600 by the 500 pounds again, and I'm going to come up with a $1.20 per retail pound.

I'm also going to put a couple other figures up here while I'm on the subject of figures. I'm going to take 100,000 cattle, because that is about how many choice fed cattle we killed in this country on a 5-day basis, and sometimes we kill a few on Saturday if the packing house is making money, and sometimes we don't.

Now, I'm going to take and assume that these are not all 1,200 pound cattle, and some are lighter, so that yield at retail, I'm going to put in at 450 pounds, and that is going to give the conservative side of the argument. Now, that makes for 45 million retail pounds that come on line every day in this country. That is a pretty big pile of meat if you have all that in front of Black Hills Packing Co. over here across the creek.

Now, we're talking about variations here of 24 cents at $1.20, $1.44, $1.68. This makes changes in the retail market of 24 cents.

OK. Let's go down here and let's put that 24 cents on there and we times it times the 45 million pounds a day. So, every 10-cent live variation and every 24-cent pound variation equals $10,800,000 a day.

The meat business is a pretty fair country business when you put it on a national scale. So that gives you some idea. Now, we're going to talk about the futures market a little bit. I guess the contracts are still 40,000 pounds. I want you to remember those figures. I'm going to take 40,000 pounds contract and change the price of its $10 a hundred or 10 cents a pound, whatever, and that amounts to $4,000. Then, I'm going to take 1,000 of those contracts, and some of you volume traders, I'm going to times that times the $4,000 and that is going to give me $4 million.

Now, I guess that anybody would have to concede that at some point in time figures like that can start attracting people's interest because you know people in our capitalistic enterprise system are concerned with profits and that is natural.

I want to read you a statement that a fellow by the name of Chuck Leavitt, who is a livestock commodity analyst with Shearson Lehman, used to be Shearson Lehman Bros., that came off of the Knight Ridder news wire, and I read it in an article that the Western Livestock Journal did on Mr. Leavitt's statement last summer. This is back about the time that, because of Senator Abdnor's efforts on focusing attention on the price spread, this was getting some play in the press.

This is Mr. Leavitt's statement:

> The consumer should not be blamed for low retail beef demand, at least part of the blame goes to retailers who don't feature beef when supplies are large. The USDA cattle on feed report numbers have been telling the retailers that supplies will tighten toward the end of summer and into fall. That's when prices should rise. Fearing the high visibility of price changes, retailers don't want to drop prices now, just to raise them a few months down the road. So sluggish demand may mean worsening cash cattle markets.

That was published on June 17.

This turned out to be devastatingly accurate. You have the figures up here, now I want you to remember what Mr. Leavitt said. Keep it in your mind. I want you to remember also, that the position of the retailer has always been that they don't like to raise and lower prices at retail in a yo-yo-like fashion. They like to enter in here at this level, whatever that happens to be, and they say there are times when we have no margin; we're trading even. There are times when we have a fair margin. There are times when we have a pretty good margin and times when we have a lot of margin, but flip the coin over and they will tell you there are times that they have a slight loss, a fair loss, and sometimes a big loss, but they say that they are better off not to fool with that price, but to try and get the profit margin through a constant pricing. I used to believe that. They also said that you cowboys and people that raise this stuff are better off because the consumer will accept all price reductions as justifiable. She's entitled to them, but conversely she resists all price increases as they are supplied and she calls it inflation.

Well, inflation has been a dead issue in the United States for 4 years and ever since tall Paul Volcker deregulated interest rates, the second most powerful man in the United States. And sometimes you wonder if they have the receipt for that.

Remember what I'm saying and remember the figures. OK. This is all easily documented, no problem. I sure used to buy that chain store argument about not fluctuating the prices, but that is when the market used to change $2 in a year. Now, we have seen that baby change $20 a hundred in 6 months. I don't buy that anymore. I'm glad that Mr. Spencer is here, because I don't care about those chain stores anymore than they care about me, and I'm willing to talk about them a little bit and that seems to be an unpopular position to take among a lot of livestock people.

I have hung around Rome while the fire was going and people are fiddling there. We're out of fiddling time and we better come to realize and not look outside for the answers because a lot of the answers rest within our industry. I don't think there is any shortage of brains in the cattle business. I don't think there is any shortage of gifted and talented people in the cattle business. I think there is a little shortage of leadership, maybe, and maybe that gets people pointed in the right direction.

Now, here you can see all the figures and the Senator has a copy in front of him. Many of you are familiar with what I put up here. Now, from now on you have to start using your imagination because I have to set up a hypothetical situation and the reason I'm compelled to do this is because I want to go into a situation that requires a controlled pricing system—a noncompetitive situation.

We don't have that in the meat business and I tell you how come I know. Because the people that retail the meat say we don't have it. And that is not all I'm going on, because a couple of agencies of the Federal Government, the Justice Department, and the Federal Trade Commission came along and said they were right.

This has to be a figment of our imagination. I have to hypothesize so I want a controlled marketing situation because that is dramatizing the thing. I'm saying, here, so I will become a part of that. I even have the retail outlets in the United States. There is another old guy, 50 years old, like I am, only he likes to fish and he has the other half. So, I want you to know that he wants to quit. He's done pretty well. He has a three-bedroom home in the suburbs and the kids are all through college and he wants to go fishing.

So, I go to him and I make a deal. He says, I got 300 stores scattered up and down the east coast. A few in the Midwest and so forth. I'll take $25 billion for them. This sounds like a good deal. Do you want to go fishing?

Anyhow, so I write the check out and I don't make it to my name, but I got it all licked up and no competition. I have a controlled situation and I like that. I'm not going to abuse it, but make a buck or two. Everyone is entitled to make a buck. So, we go into that situation. Can you people remember these figures? Do they mean anything to any of you? Are they now startling? It's a big money deal, this cattle business, a big hummer.

Senator Abdnor deals with the volume that the cattle business contributes to. The overall economy and it's quite an impressive picture. So I will set out here what I want you to remember about the future. I wish we had a bigger blackboard, but we don't, so we'll make use of this.

I'm going to take, and I have this beef moving. I have a beef guy working for me and this guy is a meat specialist in handling the meat for all the stores in the United States. The guy sells it and he's really good to the business. He really knows how to price everything. So, there is a reasonable margin in that sort of business that is important. He's my meat guy.

This meat guy who is good has a brother-in-law that is a commodity broker and this guy has been calling him and badgering him, and this is a hypothetical. And this is a figment of my imagination, but this commodity guy has been calling and says, listen, you have to try this. Why don't you try these catalytic set ups in a deal here on $10,000. That should make you 35 percent return a year. Sounds pretty good doesn't it? Well, this guy is a busy man and he has the responsibility, the guy says, and if you trade this my way, we'll set you up in saddles and spreads and we'll lay this one and buy and sell. He has options and has all kinds of deals and probably only certainly is not the return this guy gets, but probably that the broker will wind up with 35 to 40 percent of the money the first year and that's a bad deal.

But anyhow, the guy is in charge of the meat dolage and he comes to the boss and says, listen, the beef deal has been going good. He says, we're moving a lot of product and he says, it's getting hard to buy in this country and we have to chase price to get, you know, get price and he says, how is the rest of the stuff going? Well, he says, kind of slow. Seems to be a preference for beef. Let's get it leveled out, he says.

So, this guy knew how to do it. This meat man, he's been around, he says. I'll tell you what I'll do. I'll raise the price 10 percent of all this beef, you know, when you price anything up 10 percent you start restricting useage, don't you. I think economists like Mr. Tosterud call it price ration. Bob, isn't that right?

Mr. TOSTERUD. Yes.

Mr. STRAIN. I would love to have a Cadillac car instead of that 1982 Chevrolet with 163,000 miles on it and they have one down here. The demand is here and the supply is here in Rapid City. There is only one thing that inhibits me from buying that and that is the price, and that's true of a lot of things.

You can price anything to where the useage begins to fall off, so the guy is trying to equalize and gets support backed up and wants to get it sold so he raises 10 cents, or 10 percent, rather.

This drops a little of this beef business to the porker or the poulter. He's equalizing the situation and that's really a make sense deal, isn't it.

All right. So you say, well golly, he's losing on his beef sales. He's not necessarily losing on his beef sales because as he reduced the poultry because of the price changing and the supply begins to build and as the supply builds, backlog starts to fall into place, right? I'm saying that the way this beef is priced or anything else particularly beef, because beef is programmed to come on on a constant basis. You don't start feeding the cattle less and don't start interrupting the pregnancy on your cow. You don't start trading the yearlings back and forth along the fence to walk a little meat off them.

So, if you impede the flow through prices you can build a backlog anytime you want to. Now, there is only one protection that the production end of this business has. And that is a lot of competition out there. Well, there isn't any, in my situation, because I have it all. I run the show.

But there is competition out there, we are told, that the question in my mind is, How competitive is the system out there?

Now, this guy doesn't necessarily let his beef counter over all margins. It's not necessarily that beef counter can still be making money, progressing, moving less volume, but his margin is better because his input is reduced. He can sell and still keep the whole thing on an even kilt. That is an enjoyable situation to be in. There is only one thing to stop something from happening and that is plenty of competition. Now, I am not a fair employed person, I really am not. And I don't like to see bogymen behind trees. I like to see everything working like the textbook says it works, but I have reservations about their abilities.

Last summer, there was a stretch of what appeared to be a non-competitive situation that this business of ours had ever seen. I have documentation written by competent people from various segments of the livestock media that wrote on it and wrote on it well. And economists chartered it and they had never seen anything like that before. It made me angry. And thousands of our people wonder how competitive our system was and I think we had the right to ask a lot of those questions. A lot of which were asked before Senator Abdnor in Washington, DC, and here in South Dakota. And we saw adjustments, there is no question about it.

But I think that anytime anybody puts themselves into a position where those uninterrupted wide margins quote, "can go on for so long, particularly when the National Cattlemen's Association observed that problem in April and wrote a letter to 100 of the largest retail chains in the United States and the 10 largest purveyors in the United States, and said, 'please help us out, we're hurting.' " And they never heard them, because it went on and it went on and it went on, but they finally heard some of the things that took place in one of Senator Abdnor's hearings in Washington, because it got tossed to the Federal Trade Commission and tossed to the justice system and I think that kind of got someone's attention.

Well, I don't say that the system is uncompetitive. I'm saying that it looks like maybe it could be and I'm saying that cattle people if they're smart, will get out there and they will guarantee that there is some competition out there and that is a tall order to take on an individual basis, but it doesn't have to be undertaken on an individual basis.

It could be undertaken on some joint venture-type basis. I'm going to tell you what the statistics indicate that the cattle business loss was last year: $1.4 billion was supposedly drained equity. Drained equity was drained out of an already wrung out cattle business. I don't think we could afford to lose that and I further don't believe that the consumer got the benefit of that.

She may have received the benefit of some of it, but I don't think much. And I think when you take a look at the earnings of the entities that handle and process this stuff, I think that will confirm what I'm saying and I think if you take a look at what the average prices were throughout the year, that that is going to kind of confirm what I'm saying here today.

I think that maybe if we have a system that lacks enough competition to assure ourselves a good situation in the market place and I think we have it within our hands outside of Government pretty much to solve that problem. I think it is just going to take a realignment of some of our thought processes and so forth to get this business brought home to ourselves.

Now, let's go back to this guy who had the brother-in-law. When he decided to do this, hike the price 10 percent, he knows in his own mind, what is going to happen. He is going to reduce the outflow of the national chain—this hypothetical national chain that doesn't exist.

When he does that, he also has been around long enough to know they're not going to interrupt the feed on those cattle. So, he knows before long, that he is going to be able to pick them the way he wants to. He is going to stampede them like the Indians stampeded the buffalo. He's going to get the job done.

Well, he calls his brother-in-law, he's been putting him off, and he says, well, I think I'll trade the cattle futures, you know, there is too good a deal to pass up. The guy says, well, what do you want to do. He says, well, I want to shorten it a thousand. Well, the guy says, listen, they have limits on these things and you can only sell 400 of them. Well, how about my wife. We'll sign a card for her and she can get in. I have a brother-in-law and I think he would want to get in on that. So, the guy falls in.

So, there is limitations on what you can do. There are smart people out there that know how to go around the limitations when big bucks are involved. He can do everything he wants to do in a noncompetitive situation. In a competitive situation something breaks and somebody gets in his road, but that never happened last summer.

I will tell you what the flood was running out of. It wasn't on the packing house floor, it was on the floor between myself, ourselves, and our bankers. She was boot top deep and we're white because of it.

Well, so much for that. There was a lot of good articles written about this subject. I'm kind of a chauvinist, but I think the best writing was done by a couple of gals—you will like what I'm going to say next, but there is a gal by the name of Pat Staton, and she's with the Western Livestock Journal, that wrote extremely well on this subject and I visited a little with her. I helped her a little bit with what I could supply on this story and I suggested, back before Senator Abdnor's committee last summer, that if these changes were concerned about this price going up in the fall, why didn't they go to the board and secure the supply. That is why this thing was put in place, to guarantee price and guarantee price.

August 1, you could have bought the ag futures for in the low fifties and bought the ags for around 52 or 53 and you could have bought the Decembers for, I think, in and around 56. They could have guaranteed themselves prices and supply and so, Pat Staton, on visiting with her about that, she says, well, I'm going to ask him. She told me that she called the five biggest retail chains in the United States and asked them if they used the futures and four of them wouldn't talk to her. Safeway answered and said we were considering a shot to the futures.

And that's what they told her. Another person that wrote extremely well on this is, I think, one of the top press people in the livestock media, and that's Carol Wilson with the Western Livestock Market Digest and it's headquartered in New Mexico.

They went at it in a scientific way. They established what the credits were and called the meat board in Chicago and said, if a carcass weighed so much and I cut it up, I would get how much cut out of it. And they told this group that went out and conducted this survey—they went to a couple chains and checked this out and they found out what they were getting for the carcass. It would really blow your mind. It is a great business, I think, and I don't see why we should stay out of it.

I think it would help our end of it in more ways than one and I'm glad that Mel Potter and his group are here today, because I don't want to influence upon that, but they have an idea that it is time—that time has come as far as the cattle business is concerned.

Mr. Spencer talked abut foreign prices of the cattle. I think that if I had my way, they could shut that Chicago Mercantile down tonight right in the middle of today and I wouldn't care.

Go ahead and settle out what trade is done, finished, illiminated. They say you need it to spread risk, and to minimize peace and I say just the opposite. The truth, I think, it's made for a volatile market. We have people throwing cattle in a market today and owning cattle not to make money but through that ownership, but to break markets.

I was up at Powell, WY, personal story, through the Miller feedlot back in 1979 and they were feeding cattle for a big cattle feeder here in the United States. And we got to talking about the United States, and what that guy made down at Sioux City, IA, and Omaha and they were big numbers. It was 12,000 or 15,000. Now, those markets can't handle that today. Their volume is as this guy says. And I know all about that, because we shipped 4,000 fat cattle out of here to Sioux City and Omaha.

He said, you know, that nomally the flow of cattle out of this is to the west coast, Washington.

That's where the cattle should go normally. He said what the price relationship was and he said $1.50. He would have been $1.50 better off on 4,000 cattle that probably weighed 11 if he went with them West, but he sent them East. For what reason? Because he wanted to break the market. Why would anybody in the cattle business want to break the market. I'll tell you why. Because he had a short position on that board that probably made the 12,000 or 14,000 look like a short pair. He would lose $1 here and pick up $10 here. That's a business that I know happened.

Everybody in the business now, that I didn't know, the cattle came to Powell until I went out there. Just the other day, a couple days ago, packers got bullets and saw the supply tightening so they felt they could force the beef market and they went out and got in front of it, got inventory, and got 3 or 4 days ahead, so it's rumor and I don't know this, but usually where the rumors come at you from different directions there is substance to it, and said that this one particular packer, in a big way, went in and sold a lot of those up front cattle on the board and then they dipped off in meat 2 or 3 cents under what it had been going for.

Break in the market? Why, because they had all of this and they probably oversubscribed. They protected what they had bought and probably a little too high. They oversold it, which put them in a profit situation and their main competitor is an organization that doesn't use the futures and doesn't allow the executives to train them. So, this hurts the competitor and weakens them to stricken themselves in a business that is relatively noncompetitive in the big areas.

There is an edge of the cattle business that says that we can't function without the futures market because capital would leave. I don't believe that. They say that without that ability to lay off risk then leave. I think that if you can eliminate the futures, that we would stabilize particularly if we get competition at retail, I think we stabilize.

I think we get away from the peaks. It's not a lack of capital that plagues the business today, but it's lack of profit. Wherever there is profit, capital will follow. That is the free enterprise system. It's plain and simple.

The forward pricing that Mr. Spencer talked about, I think is the most noncompetitive thing in the world if we eliminated the futures tonight, because the packers can't afford to carry that for long periods of time. They have no idea what the beef market is going to be without the cattle, so without that, eliminates the business.

Like he pointed out to you, very noncompetitive, and the P&S could top it tomorrow. I think they have got the authority and discretion to stop. At 1 point, a $4 billion loss is a lot of people.

I'm going to shut it off, because I have taken more time than I should have and I hope you learned something from that, but I don't think I'm shooting from the hip. I think that if you scratch, and scratch deep enough, that you could substantiate most all of what I said. I'm not afraid to go on record of saying it.

Senator ABDNOR. You are on record.

Mr. STRAIN. I meant to shut if off.

Senator ABDNOR. I appreciate that. I'm not a judge of theory or substance of what you have here, but it is certainly worth noting and having on record. We certainly have a lot of interested people here from the Futures Commission and some of the other areas so I think it's good to get it out on the table. It's a fine contribution, but we have to be moving along.

Mr. STRAIN. Could I take another couple minutes?

Senator ABDNOR. We have to move on.

Mr. STRAIN. I want to talk about the cattle imports—the European imports or the EEC. They have a mountain of beef over there and they subsidize the exports of that beef at approximately $1,500 per metric ton or 45 to 50 cents per pound. This subsidized export effort is disturbing the movement of beef by traditional exporters to their traditional markets. Large amounts of this beef is reported to be finding its way to Canada which pressures their market and the safety valve for their producers is the United States.

So as that comes to the eastern border it has a tendency not to draw out of the central and western part to the markets, but it has to come here. They have a further disadvantage and I think this is one of the big problems is the floating exchange rates.

You take Australia and New Zealand and they are enjoying a 38-percent advantage right now. I don't think that is fair for our producers and we're the shoe on the other foot. I don't think it is fair for the producer. I think that maybe some kind of tariff should be looked at as Jim Courtney looked at cattle that come from the Northwestern part of the United States. There again, you have the exchange differential and the cattle being fattened on barley. That is subsidized $20 a ton by the Government. It is not fair trade.

Senator ABDNOR. The subsidy—they're all giving the subsidy to Canada?

Mr. STRAIN. Any place that they can get the meat. It goes out of there. Subsidized per metric ton.

I think one of the real tragedies in the system today as far as the imports are concerned is the meat that comes out of Central America. Those people are extremely poor down there. Most of the diets are protein deficient and I think it is totally unconscionable for the meat to exit that country and come here to the United States where we'll have several million acres of grass that won't have a hoof on it this year. That's the problem, but the currency thing is one of the biggest problems.

The 50 cent dollars, investment credit, depreciation periods, and capital gains on breeding that everyone has talked about, I want to cite a personal situation there. I was out in Colorado with the president of our association and he was visiting with a friend of his who is a levelheaded guy from—inclined to shoot from the hip and we went to the farm to look at cattle and we drove by the largest buildings I have ever seen in my life and the friend of his said, do you know what is in those buildings? There is 3,000 dairy cows in there—Holstein dairy cows, that used to be a little operation here—one-man operation, and the guy that had the 125 head raised alfalfa, raised corn and did it like normal northern Colorado people did it.

An investor tax lawyer figured that out and he says there is one group of investors that own that farm and that apparently, were helping for capital appreciation or maybe through the irrigation there is an extra right. There is another group that owned the facility that obviously were interested in investment credit and depreciation, and a third group that owned the cows that were no doubt, trying to roll ordinary income into capital gains and get the advantage that way, but the fact of the matter is, I would assume that every dollar in there was 50 cent dollar that would have gone to the Treasury. That is what I would call overcapitalizing in our industry that is already plagued with too much production and it's tax incentives and also, safety net programs like with the dairy program that encourage this. And I think that has to be looked at. I don't have a solution or excuse about their impact on beef, because the average life of a dairy cow, because they are fed a concentrated diet is 4½ years, so you might say that 700 cows are coming out of the facility to be slaughtered.

So, what you have are dairy producers in eastern South Dakota, Minnesota, Wisconsin, who work with the dollar or dollars in trying to compete. It's so unlevel that it is pathetic and it can be addressed.

I think I have taken enough time and I really appreciate the interest that you have shown. I really think that your efforts have done as much for us as anything that has been done by anybody in Washington and I really appreciate it.

Senator ABDNOR. Thank you, Jim. If I can get action out of the good things I hear, that needs to be done. But we'll keep working and again, as I say, I need a lot of your help down there in trying to generate the support that we need to put in the place. What you gave is a lot to think about and I'm glad we have it all on here.

[The prepared statement of Mr. Strain follows:]

PREPARED STATEMENT OF JIM STRAIN

1200 lbs. x 70¢ = $840
$840 ÷ 500 lbs. = $1.68 per retail pound

1200 lbs. x 60¢ = $720
$720 ÷ 500 lbs. = $1.44 per retail pound

1200 lbs. x 50¢ = $600
$600 ÷ 500 lbs. = $1.20 per retail pound

The supply/demand concept is predicated on an orderly reduction in pricing as supply exceeds demand until the two (supply and demand) converge and price stability returns; conversely, an orderly increasing of price as the opposite situation develops.

In beef marketing at some price level for all cuts, price resistance sets in and begins to impede product movement, the entity, which controls the delivery of the finished product to the consumer, is able to reduce movement simply by pricing at or above this level. Supply, on the other hand, is programmed to come on line in a constant manner and short term it is impractical to attempt to stabilize price by reducing supply to conform to the reduced outflow of product.

In a situation where price is not lowered to develop demand the volume of the final deliverer of product may suffer but its profit margin may not, in that the volume moved is lessened because of price, but as input costs are lowered the margin widens and overall margin could thus be maintained even on lower volume.

The futures market offers opportunities for a profit not from moving volume but by restricting volume (which in turn causes a backlogging of supply and eventually lower prices as a result of the backlog). By taking a short position on the futures market, a profit center is developed that makes reduced product movement advantageous and shifts marketing from a situation that demands a high volume movement of product in order to profit to the unnatural opposite. Similar possibilities exist in an up market situation.

Through the futures we have put in place a mechanism that could conceivably make erratic, wide-swinging, and disorderly markets profitable when the opposite is the desired.

100,000 Fed cattle processed per day-5 days per week
x 450 lbs. retail per animal

100,000 x 450 = 45 million pounds retail

Each $.24 variation in retail price = $10,800,000.

Chuck Leavitt-Shearson-Lehman-Knight Ridder

"The consumer should not be blamed for low retail beef demand, at least part of the blame goes to retailers who don't feature beef when supplies are large. The U.S.D.A. cattle on feed report numbers have been telling the retailers that supplies will tighten toward the end of summer and into fall. That's when prices should rise. Fearing the high visibility of price changes, retailers don't want to drop prices now, just to raise them a few months down the road. So sluggish demand may mean worsening cash cattle markets." June 17

40,000 lbs. contract x $10 move = $4,000 x 1000 contract equals $4,000,000

CATTLE IMPORTS European Economic Community (EEC) beef exports are subsidized by approximately $1500 per metric ton or 45 to 50¢ per pound. This subsidized export effort is disturbing the movement of beef by traditional exporters to their traditional markets. Large amounts of this beef is reported to be finding its way to Canada which pressures their market and the safety valve for their producers is the U.S.

Alberta has shipped thousands of fed cattle to the Pacific northwest which have been fattened on barley that is subsidized at $20 per ton by the Canadian government.

Imports of Central American countries where the populations are very poor and their diets (protein deficient) is unconscionable .

The recent real problem that has disadvantaged the United States beef producer is the exchange rate between the various currencies, the Canadian dollar is presently very cheap and last fall Australia and New Zealand were enjoying a 38% advantage. Tariffs are a possibility to protect ourselves as well as others who in the future may have the same problem that we are now having.

INVESTOR OWNED CATTLE (Fifty cent dollars, investment credit, depreciation periods, and capital gains on breeding stock) Over-capitalization which causes production (which is not needed) and is further encouraged by safety net federal programs.(Colorado dairy operation)
(Dairy cow life 4.25 years)

TAXES (Refer to page 5 of our introduction to A.C.A.)
Nine percent minimum interest rates -unrealistic on long-term owner financing.
Situations where persons repossessing ag-real properties are facing tax liabilities to the IRS.

Senator ABDNOR. Marie, you have been a good listener.

STATEMENT OF MARIE FISHER, SPOKESWOMAN, SOUTH DAKOTA WIFE (WOMEN INVOLVED IN FARM ECONOMICS)

Ms. FISHER. Thank you, Senator. I would like to start by thanking you for putting this together and giving us time to stand up for meat. I understand, according to Ralph Murphy, at Agricultural Days, is trying to get us to eat red meat. Ralph Murphy gave us that in Winner a few days ago and I got so much more from him when I was in Sioux Falls.

Senator ABDNOR. Well, good, we need someone else telling the story.

Ms. FISHER. I'm getting this stuff out and around the country.

Senator ABDNOR. I'm sure he wouldn't mind.

Ms. FISHER. The WIFE members were interested when I called them about it.

Thank you for letting me testify here. My name is Marie Fisher. I am spokeswoman for the South Dakota WIFE [Women Involved in Farm Economics] and, because I have had plenty of personal experience as to how stress can affect the body, I am also a peer listener for our support group which was organized earlier this year.

I have found that people who are under stress are having pains, like chest pains with no medical reason that the doctor can find. It is stress caused and can get very severe until the people realize that it is caused by stress. By meeting as a group, we are able to help each other.

Until the economy turns around so farmers and ranchers are again able to pay their bills, the stress will remain.

On our farm, which is operated by my son, though I am still very involved, he has a cow-calf operation, hog finishing operation, and grain farm, raising mostly wheat, milo, and barley.

April 1985 he penciled it out and found that he could not sell his 750 pound yearlings at a profit so he took them to a feedlot in Nebraska to be finished.

He ended up losing another $52 per head. They were never contracted because he could not contract in a profit. He has not penciled it out yet, how much he has in his present crop of yearlings, which weigh about 700 pounds now, but he is sure that at today's prices, he will again, be losing money on them. Unless he can contract them in for a profit if he finishes them, the yearlings will be sold soon at a loss.

Also, we did not lose a single calf last year, yet no profit. Because he knew that he would be short of hay this winter, my son bought a bunch of alfalfa last spring much cheaper than he could have bought it last fall. We did not cut most of our hay because there was nothing there due to the drought.

According to the book, "United States Agriculture in a Global Economy, 1985 Yearbook of Agriculture," it states, "In 1984 five of the major markets accounted for nearly 80 percent of the imports of beef and veal. The United States was the leading importer taking one-third of the total followed by U.S.S.R. 20 percent, E.C. 11.3 percent, Japan 8.4 percent, and Canada 4.7 percent. The United States also imported 38 percent of the pork. The United

States share of the export market for beef and veal is 4.6 percent and pork 4.5 percent." These figures tell me that the American farmers and ranchers do not produce near enough red meat for the American consumer.

On the 6 o'clock news, March 28, 1986, they stated that the Federal Government is going to purchase red meat to counteract the dairy cow buy-out program. This means that we will have that much excess meat hanging over our heads and keeping the prices down. In 1983, National WIFE adopted a resolution stating that any time there is a dairy herd reduction, there should be a reduction in the amount of red meat imported into the United States from foreign sources.

I feel that at the present time, we must cut imports. American farmers and ranchers can not keep competing at the present conditions because every time they cut production to increase prices, our Government permits that much more meat to be imported.

National WIFE adopted a resolution in 1984 insisting that there be the same strict standards imposed on imported beef as those on United States beef and that inspection procedures be no less strict, also that imported beef be withheld from the market until it can be tested and found clean and insists that the country of origin shall be restricted to the use of pesticides and animal drugs allowed in the United States and also, supports the labeling of all imported meat as to point of origin and type of meat throughout the entire food distribution process.

When I buy a product, I want to know if it is American produced or imported. I attended the Governor's Agriculture Conference in Sioux Falls last week. Governor Janklow, in his introductory speech, stated that in all of 1981, the United States imported 150,000 live Canadian hogs, but in just November, 1985, we imported 2,500,000 live hogs for a 2000 percent increase in just 4 years. Certainly, this has to be hurting not only the hog industry but also the cattle industry in the United States.

Jan Mauritz, president of Pacific Northwest Grain Export Association in Portland, OR, stated in his speech that the longshoremen, working most of the time get about $60,000 a year.

A percentage of our exports have to go on American ships because of cargo preference laws. Imports are not subject to cargo preference laws so it is much cheaper to import than export. I believe that if our exports are subject to cargo preference, then it is only fair that our imports also be subject to cargo preference laws.

JoAnn Smith, past president of the National Cattlemen's Association, in her speech, stated, "We are part of our own problem. We do not, in the beef industry, have a good image." Headline in a major publication the other day said to its constituent readers: "Don't make the same mistake as the beef industry." All of the above, ladies and gentlemen, is true. The other side of that is that we are, for in the first time in many years, we are in a position to do something about our destiny very quickly. We can take control She went on to state that we must merchandise our product and deliver to the consumer, the kind of meat the consumer wants.

We are all changing. The perception is that if they get more of what they want, that is the product they are going to buy. The consumer is concerned about health. The consumer wants beef. Include nutritional information. We are living in a world of perception, so sell that perception. We need uniformity in our product.

The poultry producers were, in 1960, in a stagnant market and knew they had to do something, which is where we are today. It is up to you and me to change the beef industry. Make sure that the beef checkoff fund addresses marketing and merchandising.

In closing my testimony, I would like to state that I believe the American farmers and ranchers can compete if our Government would change the laws that are handicapping us, like cargo preference, and treat us at least as good as foreign producers and countries. We produce the best and most abundant food supply in the world so our consumers pay less than 17 percent of their money for food. The least of about any nation in the world. Thank you.

Senator ABDNOR. Thank you.

Ms. FISHER. I have another little bit that is not part of the testimony that I found out since the dairy program buy out and there are several people in my area who, I think, and I'm not sure on this, but I think they wanted to get into the dairy buy out and did not. So, now they are going to increase production so there again, I think that instead of a buy out and so forth, that if you just follow the WIFE policy and have controls as to the amount of production, like our policy says. I believe that is the only way to go.

Senator ABDNOR. I just want to say one thing about that, Marie. It sure helps if the dairy people would all get together on one policy. This fight just keeps going on when the bill of legislation was up and being drafted.

You would think the dairy people were going on one thing and the next thing I hear they are all falling apart internally and I don't know. You would think that area business people would come together on a consensus of the programs. Unfortunately, we have the situation in the South. The dairy people do have a much better market than we do up here in the North and sometimes I think if we could just sell concentrated milk, if they would let us, which is illegal, but it involves a law that was drafted a long time ago, so we could compete out of milk.

I just don't know. It would be an interesting thing, because they don't rely on the price supports.

Up here, they are dependent on that and that creates a dispute, but it's interesting to hear your comments on that.

Ms. FISHER. I did testify for your committee in Brookings a little over a year ago on the tax shelter farming.

Senator ABDNOR. Yes.

Ms. FISHER. When this bill came up on the State legislature, I called a friend of mine and I found out, that as of that time, the guy I was testifying about and another corporation, are not making their land payments this year to the people they bought it from, plus the one I testified about has not paid any taxes, so the tax payers in Chipawa County, NE, have their taxes raised by about 25-percent this year.

Senator ABDNOR. Thank you.

Ms. FISHER. And also, I contacted Ralph Murphy, or Ralph Murphy contacted me Friday evening and gave me the name of the party who had called him about these Canadian imports. He has a friend who works for the trucking firm that was contracted or asked to bring Canadian cattle to Nebraska. That's 10,000 cattle per month. And that is all hearsay, so for—I don't have proof of that statement.

Senator ABDNOR. Let us know if you hear more facts from the statement?

Ms. FISHER. He is supposed to be looking it up and I tried to get him to, but he had the flu and couldn't get hold of the guy either.

Mr. STRAIN. I would like to make a brief comment.

Senator ABDNOR. We have to move on.

Mr. STRAIN. This 9 percent minimum that the IRS requires, this charge interest, I think that is a little bit outdated. We're, you know, leveled out here and we have a lot of old people that are repossessing land and so forth that aren't going to be able to operate land. We have to get a new group lined up to go. It's young people that should be reducing substantially. There isn't a question that that needs to be done and I think the climate is right to get it done.

Senator ABDNOR. Yor're right, Jim, that is a real sore spot down in Washington with that 9 percent and if we have that back the interest rates would be higher.

Mr. STRAIN. I would like to have you bear with me now. There is another situation on the repossessed ag properties where the chattel lender has been making substantial loans to an individual and to settle the debt. The landowner deeds it to the lender. That is, to the IRA and he's looking at that as having constituted a sale and what this guy is in effect doing, is winding up plumb broke, but winding up with a big tax liability, the IRA.

And I have heard reports of that and I don't have them documented, but there is something out in the country that needs looking at and I wish I could give you more specifics.

Senator ABDNOR. That's being discussed in Washington. As a matter of fact, I have my name on legislation dealing with that.

Mr. STRAIN. It's a problem. He is 61 years old and he is broke just as flat as you can get and has to start to walk out and make a living and he still has a son in high school and this guy is left with $20,000 in taxes.

Senator ABDNOR. I might, for what it is worth, my legislation just got adopted the other day. We have student loans—the eligibility loans, if somebody has a certain income, we have young people from the farms and agricultural businesses whose folks went through this very thing and decided they were not eligible for the loan because of the actual income for that year even though there is nothing left for the fellow that is closed out. The kid couldn't be eligible, but we have that changed at least for the student, but that is even worse for the people who are being closed out, so I appreciate you bringing that to our attention.

Thank you all. We have some very interesting witnesses and I hope everyone can hear our next group.

[Whereupon, Mel Potter, Marana, AZ; David Hales, market analyst, Cactus Commodities, Boulder, CO; Phil Harris, University of Wisconsin, Madison, WI, were called to testify.]

Senator ABDNOR. Mel, thank you for coming from Arizona. It's all yours.

STATEMENT OF MEL POTTER, CATTLEMAN, MARANA, AZ

Mr. POTTER. Well, I want to thank you, Senator Abdnor, for asking me up here and also, I want to thank you for all the work you have been doing for American agriculture, because I think we all realize they can stand all the help they can get.

I guess I will just introduce myself. I'm Mel Potter and I live in Wisconsin and Arizona and I'm in the cattle business in both places. And what supports my habit is the cranberry business, and I guess the only reason that it is still able to support the cattle business is because of Ocean Spray, which is a grower-owned co-op, and what Ocean Spray has done for the cranberry industry. I will eliminate as much of the middleman as possible.

Senator ABDNOR. So we all understand, Ocean Spray, this cooperative, how big an area is it?

Mr. POTTER. There are 1,000 cranberry growers in the United States of which approximately 800 of them own Ocean Spray.

It's in five States where cranberries are produced. Massachusetts and Wisconsin are the two largest producing States. New Jersey is the next and then Oregon and Washington. About 800 of the cranberry producers in the United States own and operate through management, Ocean Spray, and it has enabled the cranberry business to be just as good as the cattle business is bad.

I want to emphasize that. So, what I have come here to say, and I'm going to try and be as brief as possible.

Senator ABDNOR. Fine.

Mr. POTTER. So that I know you're running behind time here.

Senator ABDNOR. Not at all. You go right ahead.

Mr. POTTER. It's pretty well known that it takes $800 to produce a thousand pound steer, roughly, and some can do it cheaper, and some it takes a little more. When you look at the last 10 years we have seen 1 week in the last 10 years with fat cattle bringing about 80 cents and that is 1 week when the whole cattle industry has broken even. All the rest of the time somebody in the cattle industry has been losing money on those animals.

Under what is slaughtered today under Federal inspection, which is generally, I think, around 125,000 head, which, I think, Jim, is using 100, which is easier figuring, but let's say there is 125,000 head slaughtered under Federal inspection. Somebody in the cattle industry on today's cattle market is going to lose in excess of $25 million tomorrow, because of what is happening today in the futures. And another thing, it will probably be $27 or $28 million and it got as high as $37 million last year.

I'm just kind of confirming all these cattle people that have talked before me and have gone over all the many problems that we have in the cattle business.

There is just so many of them that it's hard to keep up with them all, but today, under what is killed, under Federal slaughter, somebody is making money and the cattle industry is losing $25 million. Somebody is making $37.5 million on that same product.

So, there is somebody in the beef business that is making a lot of money and this is figured, and I will tell you how I'm figuring all this, on today's cattle market, and it changes so fast that none of us can keep up with it, which is ridiculous but we're looking at about $200 million plus a head loss to the cattle industry, and on today's cattle market from the time that animal leaves the feedlot there is approximately $300 profit being made on that animal through the system that sells that animal.

Now, all I have been saying all the time along is that I don't think we can wait for the Government to help us. I don't think we can wait for the retailers to help us. I don't think we can wait for the wholesalers to help us. I don't think we can wait for the packers to help us. I don't think we can wait for the bankers to help us. We have to help ourselves and the way to do that is to get in the part of the business that is making the money.

Now, none of us want to go out and put on a white coat and operate a retail market out here, but if enough of us get together and invest money in a large corporation, which hopefully could be a co-op for, and this is for two main reasons. It needs to be a co-op. First, the tax situation. All the profits of a co-op can be returned to the stockholders without paying the tax at the corporate level. It gives you the advantage of having just the big subchapter S. The second thing is that because of the monopoly situation and the laws to that effect, but we can, as an industry, invest in a large corporation co-op and take control of marketing our own product. Make this money that is being made of our own product and send it back to the producer, so he can continue to do the thing that he knows how to do best and is able to do best and enjoys doing best.

And I guess, basically, what has happened so far, I wrote a letter back in June that I sent out about 3,000 of them and there was a permanent use response to it way more than I had ever anticipated. There is a lot of people out in the country that are willing to do something like this.

Everybody called me and writing me and asking me how to go about considering this and finally we had a meeting in Denver—the end of August, and at that meeting there was some of the largest feedlot operators in the United States there.

There was a varied opinion there and some of them though it was too big of an undertaking and some of them thought that we needed to do it some other way, and some of them were definitely behind it. After that meeting, nothing really came of it. I went back and was invited to go to the Iowa Cattlemen's Board in Ames, IA, and they also had some people from the NCA there. I went to that meeting and spent about 30 minutes kind of outlining my ideas on how to go about putting together this type of a co-op where we could control our own product and market it.

After I got done, there was another gentleman there that got up that I had never met until that day and how he got there, was that he was a father-in-law or excuse me, a son-in-law of one of the feeders on that board of directors. When that man had got my letter, I think he sent it back to this gentleman who works for one of the largest consulting firms in the United States and he asked him to take a look at this letter and see if—and I think he said—see if guy isn't completely nuts and anyway, he made some preliminary investigations into what I was saying in that letter and at that meeting, backed up everything I said, only he had the facts and figures to back up what he was saying.

And I feel like the whole group felt a lot more comfortable getting those from this gentleman and when he got done, the NCA people got up, or asked him, and I think his anwers to the NCA says it all.

They asked him, do you think that something like this, as radical or as controversial as this would be needed to be done. And he looked at him and he said, I don't think you have choice unless you have enjoyed what has happened to you in the last 10 years, because if you have not enjoyed that, you certainly aren't going to enjoy what is going to happen in the next 10 years, because it's going to be the same exact thing and I think that says it all right there in a nut shell.

Unless we take control of our own destiny we're going to be in the same kind of shape we have been for the last 10 or 15 years. If there is one thing that I learned during this period of time when I have been involved with this, and again, did a pretty good job of explaining it right there, but I'm going to try to do it simpler and quicker.

Our complete price of our fat cattle is completely controlled by these major supermarket chains. All they have to do is raise that retail price of very small amounts and it takes a certain percent of the American consumer out of the beef market. They cannot any longer afford it.

When that happens, the consumption drops, our supplies build up, our price starts going down, and those people start making more money. And it takes from 2 to 4 months before they ever stop dropping their price, and when they do stop dropping the retail price, then our price starts gradually creeping back up to a level where we can almost live with it and then they go back with their retail price to a higher level and immediately our price starts going back down, and there is just no reason that you should see fat cattle go from 68 or 69 cents clear down to 48 or 49 cents within 6 to 8 months and then within 3 months, go back up to the 68-cent level and then back down in another 3 months to the level where it is today.

And I have no idea where it might be at after what I'm hearing about the futures. They probably dropped the cash market 1 or 2 cents today. Supply and demand has nothing to do with it and until we do something like what I have been talking about, and in getting control of our product, and being able to market it the way it is needed to be done and get that profit back to us, I think we're going to be in the same situation from now on.

There are four things that I think an organization can do for us. First, it could pass the profits that are definitely made on our products back to the producer. Second, it could have control of a certain portion of that retail market enough tob e able to influence it. So when we saw the price building we could be able to lower our retail price, which would force everybody else to do the same thing through competition, which would increase the consumption and reduce those supplies and keep that price drop dropping as far as we have been seeing it.

It would stabilize that price and I think we could see it begin where that price of cattle would not fluctuate over maybe 4 cents in a year.

We could all live with that, but you could not make any plans or operate any kind of a business when you see a price fluctuating 20 cents in 8 months and the other thing, it would enable us to be able to provide us with enough money to be able to promote our product the way it is needed to be promoted.

It would be able to help us to educate the public to the fact that it is a good product. We all know it is, but nobody else seems to know about it. It would also enable us to have a division in this company that would do research and development and come out with new ways to process beef, new ways to market it, new products, new ways to sell it, new ways to package it.

I don't think a year goes by that Ocean Spray doesn't develop a new product that enables us to sell cranberries better, or come up with a new way of packages or selling cranberries that don't increase our profit to the producers. And we're going to have to go out there. There is going to be two things that it would take to make this thing successful, or three. Enough people in the cattle business to get involved in this and invest in it, which would create enough capital to do it, and the second thing, to get the right man and men to manage something like this and with the first thing, which is enough capital, we can hire the right manager.

Now, when Ocean Spray first started, they tried to have a bunch of cranberry growers and it was nothing but a complete wreck. They went out and hired some of the top people from businesses like Campbell Soup, Johnson & Johnson, Proctor & Gamble and they put the people in charge of Ocean Spray and they have done nothing but make us money since that time.

They know how to do it, they know how to market a product, they know how to advertise it and they have to be doing a fantastic job. They have us in a position where we can barely raise enough cranberries to meet the demand. They have just done a fantastic job for the cranberry industry. There are a lot of other large corporations in the country that aren't co-ops and people don't realize it, like Sunkist. And many, like C&H Sugar, have really helped the producers do a better job in those areas.

I guess I probably have left out a lot of things, but we finally have put together in December—we had a meeting in Des Moines, and about 42 people from around the United States that were definitely interested in furthering this concept got together and we put together an organization or a very loose preliminary organization called, a Committee for Better Beef Marketing, and right at that meeting we raised $14,000 to start funding a feasibility study of this and this study is just about through now and the study is going to show us four things.

First, what has been happening to us. I don't really think a lot of the people out in the cattle industry really realize what is happening to us. Second, it's going to show exactly why it has been happening to us. Third, it is going to show us what we can do about it. And fourth, how to go about doing that. And we're about—I would say close to two-thirds as far as raising the money to pay for this thing.

We're trying to raise $150,000 and where the study is practically finished, probably the only thing holding up the presentation of the study is our inability to raise this amount of money to pay for the thing. And when we started out, we thought well, let's see if we can't get 750 people in the cattle industry, which is only made up of 1 million people, to kick in $200 to see if we can't fund something to find out if we can eliminate the problems we have in the industry and it has been very disappointing that that has not happened. We have been at it 2 to 3 months now and I have been getting the results of this study and they say that everything that they found is very positive; that it is very doable and that we can do this thing and that it will definitely help solve the industry's problem.

There is one negative thing they have found in the whole study and I think we'll all have to agree here with that, that are involved in the cattle business and that is, cattle people are long on talk and short on action and I think it is time we change that around and get long on action and short on talk and get it done.

And I guess, basically, you know, you get a little discouraged looking at how can we ever get something like this put together, and I guess, basically, what we're trying to put together is a complete system to market our product. We're looking at all areas. We're looking at the retail area, the wholesale area, the hotels and restaurants, the institutes, trade, the Government contracts. There is no reason why we can't be involved in selling beef to the Government when we raise it. Why have somebody else making money off of it, selling it and us paying for it as tax payers although we haven't paid taxes recently out of the cattle business at least, but every time I get to thinking how are we ever going to get something like this, this big put together, I think of what the smallest, or one of the smallest segments of something agriculture has done, which is the cranberry business and how we're able to put together a fortune. A company that has become one of the most profitable companies in that Fortune 500 and made the cranberry industry fantastic.

Probably one of the few things in agriculture that is really doing well today is the largest segment of agriculture, which is the cattle business, couldn't do the same thing, then there is something the matter with us and I guess we deserve what we're getting.

So, I guess that's all we have to say. I probably left out a lot. I would like to answer any questions you have or try to answer them, but I will just kind of close with that.

Senator ABDNOR. You have quite a statement and I'm sure it is something that's easier than the face of it that creates interest, but what do you do, have you tried to talk to the various livestock groups or is there friction or jealousy that they may lose the organization?

Mr. POTTER. Well, I think there is a lot of momentum gathering out there. There is a lot of people out in the grassroots, cattle businesses, that know about it and understand what we're doing.

There is a present and use number out there that they know what we're trying to do, but they don't really understand exactly what we're trying to do or how we go about doing it and I think once the study is fininshed and we have those results and everything in black and white, that we can take out, and of course some of this $150,000 that we were trying to raise is going to be used to take the results of the study out through the whole cattle industry and show them what we found.

I think that the momentum will continue to build and I think all these things that these cattlemen have said were problems that could be solved by that.

You take tax sheltered situations. If we were making the money on this beef that is being sold or if somebody is willing to get in there and feed cattle and not make money, that is fine, we couldn't care less, as long as we're making the money on our cattle.

The imports, somebody makes money on the imports. I mean, they make just as much money on the imports as they do on the cattle, so if we're making money on our cattle and beef that we're running through our system, we could care less. If they wanted to make money, I'm not, you know, criticizing the middleman, because they're in business to make as much money as possible and what happens to us is by the time the retailer makes what he wants to make, the wholesaler makes what he wants to make and the packers make what they want to make, there is nothing left for us and we can't hold that against them.

They're in business to make as much money as possible, but all I'm saying, is that we need to get into the part of the beef business that makes the money and send that back to us we can continue operating in the cattle business.

You know, all those problems that these gentlemen and lady talked about, are problems in the futures. If there wasn't a big swing in the futures business, which this would eliminate, they wouldn't need to have the futures. They could place their little games with themselves.

The credit—I think one of the largest numbers, you know, of related businesses that called me back or wrote me, were bankers saying this was the first logical idea they had seen in a long time and they would be willing to support their people who are, if they had a good business plan like this, to where they could turn this business around.

We have tried everything in the past and nothing has worked. We have never tried this and this is a very different, you know, way of going at it and it is a tremendous undetaking, but I know that we can do it if enough of us get together and it would cost us individually, peanuts. I'm talking about if we could get 30,000 cattle people in the United States to invest in this corporation, or company and put in 1 cent a pound on what they produce in a year, which is $3 or $4 a head, and this is—wait, $10 through the whole system. We could raise close to $100 million.

We spent that much money putting this together and implanting these animals, and here we could take that kind of money and invest it in a corporation that, I think, could turn the cattle industry around and I think all we need to do is to be able to get the word out to people and the only reason I have had or even would think of something is my experience with the cranberry business. I have seen what a present and use thing it has done for the cranberry business.

Senator ABDNOR. What does your study show. What percent of the cattle production do you have to have in this co-op to make it do what you say and have the effect that you say it would have?

Mr. POTTER. I'm sure it's going to——

Senator ABDNOR. How much or what percent of the total cattle?

Mr. POTTER. I don't know the results of the study completely, but I think it will show that in the study, but I feel like if we had control of 10 percent of the retail market we could influence the whole market through competition to eliminate this big problem of the big swing in the cattle market and we're talking about 30,000 people in the cattle industry out of 1 million of them.

Granted, of those 30,000 we would need a large percentage of the larger operators but it is not limited to the bigger producers. Any legitimate cattle producer could be involved in this thing and no matter how large or how small.

Senator ABDNOR. When you cited the individual example of the meeting in Denver and then it faded out, why was that?

Mr. POTTER. I think at the Denver meeting that was the only meeting I would say that there wasn't a real positive, you know, go ahead and I think we had a lot of people there and I'm not running them down, or anything, but were not completely in the cattle business. They were feed salesmen.

They were great big cattle feeders who, no matter what cattle brought, they were feeding a lot of tax sheltered cattle. They were feeding a lot of other people's cattle and they made $10, $15, or $20 a head on those animals whether the owner made $100 or lost $100 and they are losing big in the commodity business, and that opened my eyes right there.

We're going to have to go to the grassroots cattle people to get this thing done. Now, there was some of them definitely behind it and they could see far enough ahead that they could see they needed to have the whole cattle industry be alive to have them continue in business.

Senator ABDNOR. Have you gone to different cattlemen's organizations and do they fall on deaf ears or show an interest?

Mr. POTTER. There is a lot of State organizations that have gotten behind this. The Montana cattle feeders have really got behind it. The Nebraska cattlemen's group is behind it along with Louisiana, Iowa, and oh, there has been about 15 of them that have really gotten behind it and are helping us to push it.

The NCA has sat on the fence. They have not really went one way or the other with it and I think they feel like Tom felt, they don't want to make the—I mean, Tom didn't feel that way, but he has got a trade to make the retailers mad. Let me just read you this. This guy is from the Wharton School of the University of Pennsylvania. He is supposed to be one of the leading marketing specialists in the United States and to show you how much I know about finance and business I had never heard of the Wharton School, but evidently it's one of the leading financial business schools in the United States, and he wrote me a letter and here's what it said.

Senator ABDNOR. Put it in the record.

Mr. POTTER. It's Scott Ward, professor of marketing, Wharton School of the University of Pennsylvania. He says:

> Dear Mel: About 2 hours before my panel at the NCA Convention in San Antonio I was talking with someone from Kansas about the need to shake up the industry and he mentioned your name and the basic idea you had been promoting.

What he said sounded right to me, so without knowing anything more I said in my speech that the ideas you have been talking about sound like they are very much worth exploring. Now that you have been good enough to send me backup material, I am convinced that what I said in my speech was and is right on target. I have given a few speeches to beef and pork industries, and to the industries last fall, I said that it is not necessarily clear to met that the retailer is our friend.

And I think that says it all right there, and I don't want to read the whole thing. I'll just skip around.

In another paragraph toward the end, he says:

I have accepted a position on the American Meat Institute's Research Advisory Board and we are already getting money together for research, at least part of which will be for beef marketing research. I suspect there will be the usual political problems which go along with such panels, but you can rest assured I am going to push mighty hard to get research dollars behind the creative and life potential saving ideas you propose.

Now, here is a guy that is supposed to be an expert in marketing and he is behind us 100 percent. In talking to him on the phone later, I tried to get some of this money from this American Beef Institute to help do this and they fell on deaf ears and I don't know what that is made up of whether it's made up of producers or people from the retail end of the business, or packers, or what, but evidently there is somebody in there that does not want this thing to go ahead and part of what we would be doing, we're not talking about spending a lot of money on brick and mortar, we're simply talking about having packers custom kill, cut, and wrap our product for us and then having retail outlets under our control, not owning the facility, but leasing them or something, and doing it that way.

And the small packers who have been hurt just as much, would be tickled to get to do what we're asking them to do on a custom basis. It would help them be more competitive with the four large packing companies that some gentleman mentioned before, that are killing the whole packing industry and forcing the smaller ones out.

They have the same thing happening to them as they are happening to us. They go out and buy some cattle to kill the next morning and expect to get a dollar on the beef or something and the next morning, they wake up and it's only 96 cents. They can't stand that where the big operators can and do and they would just love to work with us on that type of situation. And we have a tremendous number of people behind us and I personally think it is going to get done and we'll hope it does.

Senator ABDNOR. Thank you very, very much, Mel, and thank you for coming all the way from Arizona to tell us your experience and what you're working toward and hopefully that will follow, because that is what it takes just to move along.

Our next witness is David Hales, market analyst from Cactus Commodities, Boulder, CO. And David, I will say the same thing to you, thank you for coming here and paying so much attention and giving us the benefit of your experience and thoughts.

STATEMENT OF DAVID HALES, MARKET ANALYST, CACTUS COMMODITIES, BOULDER, CO

Mr. HALES. Thank you very much. I appreciate the opportunity to be here. Being a commodity broker, I appreciate the opportunity for being here and being a commodity broker with my back to a room full of cattlemen is not exactly the most comfortable situation in the world.

I do want to assure you, though, that not everyone in the commodity business is a crook, or out to steal your money. I think it is very interesting, the comments we have heard this morning about the retailer and about the packer. I think the industry is going through a vast and far-reaching structural reorganization at this time. I'm going to cover several areas of my testimony this morning that I think are of importance to the cattle industry today as well as in the future.

There are several things taking place at this time that are considered to be problems now but history may look at them as only the byproduct of progress.

The foremost problems that I'm going to discuss are the deleterious marketing practices that have developed in the cattle feeding industry, the consolidation and resulting lack of competitiveness in the packing industry and the detrimental aspects of the farm programs including the dairy buy out.

The cattle industry is in the midst of a vast far-reaching structural reorganization. The process is painful at best for most of the participants in the industry. It is devastating for most of the smaller cattle feeders, farmers, ranchers, and yes, even the smaller packer. Change comes to the cattle industry slowly and very reluctantly. Small operations are either becoming bigger or disappearing.

Large operators are beginning to integrate vertically. Is that what we want in the industry or do we have anything to say as individuals? I think Mel is talking about vertical integration and my question today, is to the grassroots cattlemen of the Nation, beat the packer and retailer to vertical integration or do they lose out?

About 75 to 80 percent of all cattle slaughtered each year have been fed in one type of feedlot or another. Approximately 95 to 99 percent of the steers and heifers slaughtered in the Nation are considered fed cattle. Thus, the value of all other beef animals in the Nation, whether they are cows, calves, stockers, or feeders is determined by the value of the fed cattle sold out of feedlots to packers.

Thus, it is obvious that there is no direct link between the consumer and the producer. This is as very inefficient pricing structure due to the lack of vertical integration. This system is made up on price takers as opposed to pricemakers. The cattleman has been a pricetaker, unfortunately.

As I see it at this time, one of the major factors affecting the fed cattle market in a negative manner is the change in marketing practices as well as the consolidation of the packing industry. The packing industry has been forced to adopt different approaches to buying fed cattle in recent years due to the tremendous bargaining position of the retailer.

Year after year the retailer has been able to widen the profit margin between the cost of beef from the packer and the sales price at the retail counter. It appears to me that the beef counter has gone from being a loss leader for the retailer to a major profit center.

I have been assured by various retailers in recent years, and in past history, that that is why the beef counter was always located to the back of the store or the far side of the store. People will come in to buy the meat and they will pass all these other products to get to it.

As a result, the packer has been forced to alter his buying practices since he has lost a great deal of bargaining power to the retailer. The change in these buying practices has created some real problems for the cattleman. I am also beginning to believe that it has led to some market manipulation or at least is has created the atmosphere for the manipulation to occur.

The primary change in the buying practice of the packing industry is the forward contracting of fed cattle based on the price of live cattle futures.

This practice appears to be fairly innocuous at first, but let me assure you it is not. It works in the following manner.

The packer agrees to buy a pen of cattle at a future date when they are fed to a finished widght and grade. The nearest futures contract to the time that these cattle are finished is used as the base price. The packer then agrees to pay the cattle feeder a price equal to the futures price plus or minus an established historical basis. At first glance, it appears to be an excellent way for the cattle feeder to shift the risk of adverse price fluctuations without having to use the futures. The cattle feeder has his cattle sold for a price he is satisfied with and doesn't have to stand any basis fluctuations.

Cattle feeders who forward contracts with a packer are the same ones who would normally use the futures contracts as hedges. When the cattle are forward contracted to a packer hundreds or even thousands of cattle futures participants are eliminated and the futures contracts are concentrated in the hands of a few. A few packers may then control literally thousands of future contracts. This is definitely not a healthy situation.

Let me say, at this time, that the futures market in and of themselves, I don't believe, can be manipulated just by being long 1,000 or 5,000 cows or being short 1,000 or 5,000 cows.

The thing it takes, price action of the cash commodity to manipulate the futures market. And unfortunately, I think that the situation that we have right now with forward contracting of live cattle has provided the packing industry that uses the futures market an excellent opportunity to manipulate the markets in his favor.

The incentive for the packer to pay higher prices for beef is no longer present. In previous years when there was a shortage of fed cattle the packers were caught between the shortage and the retailer. In order to stay in business, the packer was forced to pay higher prices for cattle hoping he could force the retailer to pay up and pass along to the consumer the increased costs. This allowed the cattle feeder to reap profits that made up for the increased cost of gains due to the bad weather or losses incurred because of a previous oversupply of fed cattle.

On balance, the industry was able to stay healthy and profitable. Now that the packer has control of an inventory of fed cattle at very little risk, it doesn't appear that there is any way for prices to advance so that the cattle feeder can recoup losses.

The most devastating problem that I see stemming from forward contracting is that it creates an atmosphere for manipulation. Large volumes of futures contracts are controlled by very few people in the packing industry. Once the packer owns a large inventory of forward contracted cattle that he also has hedged by being short the cattle futures, he has the opportunity to manipulate the market to his advantage.

He can artificially create a lower beef market by selling a very small number of loads of beef at down money which will cause the cattle prices and futures prices to drop temporarily. On the dip the packer can cover the short futures position looking to resell on a rally knowing that the drop is only temporary, because he caused it in the first place. He may also buy cattle at lower prices than he could have knowing that prices will come back up, because he causes the break.

The consolidation of the packing industry has definitely reduced the competitiveness of individual packers. The three largest packing companies now account for approximately 50 percent of the fed cattle slaughtered each day. If the packer is able to forward contract for 50 percent of each month's kill in advance of when it is required, then the competitiveness is reduced even more significantly.

The recent dairy program that proposes to reduce the milk surplus by the Federal Government buying and slaughtering individual dairy herds hangs over the beef industry like the sword of Damocles.

The Buyout Program which was released on Friday afternoon, suggests that the spring broke on the sword, and it fell on the cattle industry. And the futures market offered packers bids in the country where fed cattle were 2 to 3 cents below last week.

The beef industry is having a hard enough time by itself without having another 750,000 to 1 million head of dairy cows slaughtered above the normal culling rate. Cattle prices have been low so long now that if the beef produced from the liquidation of dairy cows isn't absorbed into the marketplace easily and with very few price problems, I believe that another round of beef cow liquidation could be the result.

How can the nonsubsidized cattle industry regain profitability when the farm programs of the Government continue to cause interference with the normal workings of the marketplace.

I am not sure if I believe that the industry can maintain the same concept of rugged individualism that it has had in the past without some major changes in the way the cattle industries conduct business.

The small farmer, cattle feeder, rancher, and packer may be antiques in a few years unless the industry takes it upon itself to educate its members in marketing techniques. A part of this educational process is the development and dissemination of reliable, factual information from which decisions can be made. Some immediate remedies that I see are as follows.

I think Mel has brought up about integration in the industry itself. Cattlemen have no power over the product they produce. These will not solve problems, but they will help.

Cattlemen must ban together to educate one another about the problems that come from the loss of bargaining power through deleterious marketing practices.

Ranchers and cow-calf operators may need to vertically integrate to the extent that they no longer sell calves or feeder cattle, they feed and sell fed cattle. Risk management and marketing education are extremely important for the success of this type of program.

The cattlemen must recognize the value of a free flow of accurate information to the marketplace.

There are numerous reports that pertain to the cattle feeder and cow-calf operator that are compiled and disseminated by the USDA. The cattleman should demand better information out of the packer and retailer. Such information might contain reports about the inventory of live cattle owned by packers. Another much needed report would deal with the actual quantities and prices of beef carcasses and fabricated cuts that the packer sells each day. There are numerous other reports that could be of value that simply are not available today.

I think one of the best ways to stop in a free marketplace in this market manipulation is not to do away with one segment of the market, but to provide accurate information so that all members recognize what is going on in the marketplace.

The structural changes that take place in the industry may not be reversible regardless of what is done in the short run. Small operators will continue to either grow or disappear. Large operators will continue to expand their scope of business.

Integration between entities will continue and packers will buy feedyards and cattle feeding companies may buy packing houses. Ranchers and cow-calf operators may feed all of their production while cattle feeding companies and packers may integrate backward through the ownership of grazing land and cow herds.

Eventually, the largest will finally have brand name identification at the retail counter and the vertical integration process that the industry appears to be in the midst of will be complete. Thank you very much.

[The prepared statement of Mr. Hales follows:]

PREPARED STATEMENT OF DAVID HALES

Thank you for the honor you have bestowed on me by inviting me to appear before this committee to testify about an issue that I am vitally concerned with - The Future of the American Cattle Industry. I have spent my live involved in the cattle industry from my childhood on a family farm through college, the commercial feedlot, and finally as a market analyst and cattle futures specialist.

I am going to cover several areas in my testimony that I believe to be of importance to the cattle industry today as well as in the future. There are several things taking place at this time that are considered to be problems that may only be the by-product of progress. The foremost problems that I am going to discuss are the deleterious marketing practices that have developed in the cattle feeding industry, the consolidation and resulting lack of competitiveness in the packing industry and the detrimental aspects of the farm programs including the dairy buy out.

The cattle industry is in the midst of a vast far reaching structural reorganization. The process is painful at best for most of the participants in the industry. It is devastating for most of the smaller cattle feeders, farmers, ranchers, and yes, even the smaller packer. Change comes to the cattle industry slowly and very reluctantly. Small operations are either becoming bigger or disappearing. Large operators are beginning to integrate vertically.

The cattle industry in general is comprised of several separate entities with individual operations of the same general type. Until just recently there has been very little vertical integration and none of it complete.. The chart on the next page shows my concept of the general structure of the cattle industry.

The value of all calves, feeder cattle and cows is derived from the value of the fed steer and heifer sold from the feedlot to the packer. There is a cow value established by the sale of cull cows directly to the packer, however, this value is immaterial for the purposes of this discussion. <u>Thus, what ever effects the value of fed cattle directly effects the value of all other beef cattle.</u>

BASIC STRUCTURE & FLOW CHART OF THE CATTLE INDUSTRY

RETAIL STORES

PACKING INDUSTRY

FEEDLOT INDUSTRY
COMMERCIAL & FARMER FEEDER

PRICE ↓ ↑ PRODUCT

GROWING & BACKGROUNDING
FEEDERS-STOCKERS ON PASTURE

COW-CALF PRODUCER
RANCHING AND FARMING

Between 75 & 80% of all cattle slaughtered each year have been fed in one type of feedlot or another. Approximately 95% to 99% of the steers and heifers slaughtered in the nation are considered fed cattle.

This chart and these statistics clearly identify that the end product of cattle in America is the fed steer and heifer. Thus, the value of all other beef animals in the nation, wether they are cows, calves, stockers, or feeders is determined by the value of the fed cattle sold out of feedlots to packers.

Thus, it is obvious that there is no direct link between the consumer and the producer. This is a very inefficient pricing structure due to the lack of vertical integration. This system is made up of price takers as opposed to price makers.

As I see it at this time, one of the major factors affecting the fed cattle market in a negative manner is the change in marketing practices as well as the consolidation of the packing industry. The packing industry has been forced to adopt different approaches to buying fed cattle in recent years due to the tremendous bargaining position of the retailer. Year after year the retailer has been able to widen the profit margin between the cost of beef from the packer and the sales price at the retail counter. It appears to me that the beef counter has gone from being a loss leader for the retailer to a major profit center.

As a result, the packer has been forced to alter his buying practices since he has lost a great deal of bargaining power to the retailer. The change in these buying practices has created some real problems for the cattleman. I am also beginning to believe that it has led to some market manipulation or at least it has created the atmosphere for the manipulation to occur.

The primary change in the buying practice of the packing industry is the forward contracting of fed cattle based on the price of live cattle futures. This practice appears to be fairly innocuous at first but let me assure you it is not. It works in the following manner.

The packer agrees with the cattle feeder to buy a pen of cattle at a future date when they are fed to a finished weight and grade. The nearest futures contract to the time that these cattle are finished is used as the base price. The packer then agrees to pay the cattle feeder a price equal to the futures price plus or minus an established historical basis. At first glance, it appears to be an excellent way for the cattle feeder to shift the risk of adverse price fluctuations without having to use the futures. The cattle feeder has his cattle sold for a price he is satisfied with and doesn't have to stand any basis fluctuations.

I believe this buying practice to be detrimental to the cattle industry for the following reasons:

1. The cattle feeder who forward contracts with a packer gives up most, if not all of his bargaining power. He provides the packer inventory control of the packer's raw materials (ie fed cattle) at virtually no risk and at very little expense. The packer has the prerogative of picking these cattle up for slaughter at anytime during the month regardless of when the cattle are finished. In many instances, the cattle feeder guarantees the grade and yield of the contracted cattle at well as assuming all of the risks inherent in cattle feeding except for price.

2. Cattle feeders who forward contract with a packer are the same ones who would normally use the futures contracts as hedges. When the cattle are forward contracted to a packer hundreds or even thousands of cattle futures participants are eliminated and the futures contracts are concentrated in the hands of a few. A few packers may then control literally thousands of futures contracts. This is definitely not a healthy situation.

3. The incentive for the packer to force the retailer to pay higher prices for beef is no longer present. In previous years when there was a shortage of fed

cattle the packers were caught between the shortage and the retailer. In order to stay in business the packer was forced to pay higher prices for cattle hoping he could force the retailer to pay up and pass along to the consumer the increased costs. This allowed the cattle feeder to reap profits that made up for the increased cost of gains due to bad weather or losses incurred because of a previous over supply of fed cattle. On balance, the industry was able to stay healthy and profitable. Now that the packer has control of an inventory of fed cattle at very little risk it doesn't appear that there is any way for prices to advance so that the cattle feeder can recoup losses.

4. The most devastating problem that I see stemming from forward contracting is that it creates an atmosphere for manipulation. Large volumes of futures contracts are controlled by very few people in the packing industry. Once the packer owns a large inventory of forward contracted cattle that he also has hedged by being short the cattle futures he has the opportunity to manipulate the market to his advantage. He can artificially create a lower beef market by selling a very small number of loads of beef at down money which will cause the cattle prices and futures prices to drop temporarily. On the dip the packer can cover the short futures position looking to resell on a rally knowing that the drop is only temporary because he caused it in the first place. He may also buy cattle at lower prices than he could have knowing that prices will come back up because he caused the break.
   The consolidation of the packing industry has definitely reduced the competitiveness of individual packers. The three largest packing companies now account for approximately 50% of the fed cattle slaughtered each day. If the packer is able to forward contract for 50% of each month's kill in advance of when it is required then the competitiveness is reduced even more significantly. As a result, fed cattle prices suffer.

The government subsidized dairy and farming industries are causing problems for the non-subsidized beef cattle industry. The programs are costly in terms of taxpayer dollars and relatively unsuccessful in terms of agricultural stability.

The recent dairy program that proposes to reduce the milk surplus by the federal government buying and slaughtering individual dairy herds hangs over the beef industry like the sword of Damocles.

The beef cattle industry is having a hard enough time by itself without having another 750,000 to 1,000,000 head of dairy cows slaughtered above the normal culling rate. Cattle prices have been low so long now that if the beef produced from the liquidation of dairy cows isn't absorbed into the market place easily and with very few price problems, I believe that another round of beef cow liquidation could be the result.

The wheat grazeout program of the new farm program appears to be causing a disruption in the normal grazing patterns of the industry. The wheat farmer is being paid not to harvest a wheat crop. He can however, graze cattle on this wheat until the crop is consumed. This appears to be holding feeder cattle and calf prices artificially high. It is also going to create a bunching of placements into the feed yard in late April and May. Cattle that normally would have been placed 30 to 60 days ago are not going to be placed for another 30 days in most areas.

Unfortunately, the bunching of placements also creates a bunching of market ready cattle. This will create another glut of beef production late this summer or early fall which will in turn create another round of cheaper prices.

How can the non-subsidized cattle industry regain profitability when the farm programs of the government continue to cause interference with the normal workings of the marketplace.

I am not sure if I believe that the industry can maintain the same concept of rugged individualism that it has had in the past without some major changes in the way the cattle industry conducts business.

The small farmer, cattle feeder, rancher and packer may be antiques in a few years unless the industry takes it upon itself to educate it's members in marketing techniques. A part of this educational process is the development and dissemination of reliable, factual information from which decisions can be made. Some immediate remedies that I see are as follows. These will not solve the problems but they will help.

1. Cattlemen must band together to educate one another about the problems that come from the loss of bargaining power through deleterious marketing practices.

2. Ranchers and cow/calf operators may need to vertically integrate to the extent that they no longer sell calves or feeder cattle,they feed and sell fed cattle. Risk management and marketing education are extremely important for the success of this type of program.

3. The cattleman must recognize the value of a free flow of accurate information to the marketplace. There are numerous reports that pertain to the cattle feeder and cow/calf operator that are complied and disseminated by the USDA. The cattleman should demand better information out of the packer and retailer. Such information might contain reports about the inventory of live cattle owned by packers. Another much needed report would deal with the actual quantities and prices of beef carcasses and fabricated cuts that the packer sells each day. There are numerous other reports that could be of value that simply are not available today.

The structural changes that are currently taking place in the industry may not be reversible regardless of what is done in the short run. Small operators will continue to either grow or disappear. Large operators will continue to expand their scope of business. Integration between entities will continue. Packers will buy feedyards and cattle feeding companies may buy packing houses. Ranchers and cow calf operators may feed all of their production while cattle feeding companies and packers may integrate backwards through the ownership of grazing land and cow herds. Eventually, the largest will finally have brand name identification at the retail counter and the vertical integration process that the industry appears to be in the midst of will be complete.

Senator ABDNOR. Thank you, Dave. I don't know that everything you say is right, but in saying it is, I have found at the legislative level in Washington, that trying to get farmers together is one of the most difficult tasks I have ever seen.

I think there is merit in the beef checks. That way they can do some things jointly and positively that help the cause. But the first thing you get is several farm groups fighting you on it and things get kind of mixed up in the Congress. They don't know what they should do, or what they should vote, particularly if they don't know the business of agriculture.

Now, Mel was talking about his problems. Well, how do we do this; do you think you can get their attention? How bad do things have to get before we finally——

Mr. POTTER. Well, I think their attention has been got. They just need to understand the—what the solution is, and I think they will get involved. I see more of them every day. And by telephone especially. My telephone is ringing early in the morning until late at night. And they are wanting to get involved in the thing and knowing what we're doing. And it's hard to tell them one at a time, but I think when we get the study finished and paid for, and we have some people going out in the field in all parts of the cattle country, explaining to them what we're doing and how we're going about it, and showing them what it can do for them. I think we'll have a new effect, and I think we'll get it done.

Senator ABDNOR. As the situation worsens, Dave, are you finding a different attitude? What is the reaction of the people in the business? Are they showing more interest?

Mr. HALES. Oh, I think people are showing more interest, but I think they need to get their act together soon because if they don't, there is large interest in the Nation that will have a name brand product to put on the retail counter and they will lose the race.

Mr. TOSTERUD. I'm fascinated by the very strange merit that appears to be going on here, and my question was to David. Do you think Cactus would be interested in joining Mel's co-op?

Mr. HALES. Meaning, my commodity firm?

Mr. TOSTERUD. Yes.

Mr. HALES. Yes.

Mr. TOSTERUD. What about the Cactus Feeders?

Mr. HALES. I can't speak for those people.

Mr. TOSTERUD. Would you describe for the audience what Cactus is?

Mr. HALES. Cactus Commodities?

Mr. TOSTERUD. The whole.

Mr. HALES. I'm not affiliated with Cactus Feeders. I'm not related to them. I happened to have had an office in the little town of Cactus, TX, and that's where I took the name for my company, from several years ago, but I'm a cattle feeder and I'm a commodities broker and I specialize in live cattle. Cactus Feeders is the largest cattle feeding organization in the United States, I believe, at this time, and it's located in the Texas panhandle and it's headquartered out of Yuma.

Mr. TOSTERUD. Who owns Cactus Feeding?

Mr. HALES. Paul Engler and perhaps Tom Didmer. I don't know if there are other partners.

Mr. TOSTERUD. Those are the two partners in Cactus Feeders and I might add for the information of the audience, we came close to getting Tom Didmer to appear before this committee and he wanted to desperately. It's just that he was off to Europe and it would have required coming back to appear before this committee and then returning to Europe again.

At some future time, I really hope that we are able to get Tom Didmer to appear before this committee, because as I'm sure most of you are aware, if there is a black hat in agriculture he wears it. He is one of the largest commodity future traders in the country. But he has some insights into this industry that would be extremely valuable to the cattle producer, and at some point in time he will be able to share those views with us. Perhaps at some future hearing.

Senator ABDNOR. This whets the appetite even more and I certainly want to say that up until now I think this is one of the best hearings that we have every held. Well, we better keep moving on.

Next, we have Phil Harris of the University of Wisconsin, Madison, WI.

STATEMENT OF PHILIP E. HARRIS, ASSISTANT PROFESSOR OF AGRICULTURAL ECONOMICS AND LAW, UNIVERSITY OF WISCONSIN, MADISON

Mr. HARRIS. Thank you. Mr. Chairman, my name is Phil Harris and I'm assistant professor of agricultural economics and law at the University of Wisconsin.

My research is in the area of tax laws that affect farmers and my extension program is directed to tax practitioners. Those who are helping farmers are the taxes. I might add that my father has a beef cow herd and raises his cows to slaughter market weight. So, I do have a little knowledge on the production side and certainly not what the other witnesses have, but a little knowledge there. I am not only here to share my thoughts, but to learn from the witnesses and from your comments in this area.

My objective is to look at the future of investor-owned cattle and I define that for purposes of this testimony a little broader than Pat Vinton did this morning.

I have defined it for purposes of my testimony to include anyone who is a passive investor in the cattle industry as opposed to those who are actively involved in the business and that includes both those who are in for tax reasons only as well as those who are in it for a profit other than the tax incentives involved.

I'm going to try not to express an opinion whether the laws I talk about are good or bad, because I think it depends on your point of view whether the laws are good or bad in your investor. That will mean one thing. If you are full-time farmer, and if you are a consumer it will have a different effect and taxpayers have to pick up the bill for some of these things and therefore, will have to have a different effect so whether the laws are good or bad depends and that's not my judgment, so I will explain my thoughts on the effects.

There are several factors that affect what the future of investor cattle will be. Some of those have been touched on this morning so

I will run through those. First of all, the structure of the cattle industry, I think has some affect on what investors will do in the future. I want to know that in the cow-calf operations we have a situation where about 83 percent of the producers that market about 35 percent of the calves and these are producers who have 50 or more cow-calf cows and heifers in the operation. And at the other extreme, about 2½ percent of the producers also market about 31 percent of the calves and they are in operation of 200 or more cows and heifers in the operation. So we have both extremes in the cow-calf operation.

By contract and cattle feeding, 3 percent of the producers market 81 percent of the cattle production.

Senator ABDNOR. Give me that again?

Mr. HARRIS. Three percent of the feedlots market 81 percent of the cattle that we have marketed. Those are figures from 1984, so we have much more concentration in the feedlot operation than in the cow-calf industry and this will have an effect on the future of investors in that area.

So, I raise that as one of the factors that will have an effect. Another factor that has been raised earlier is the cattle production cycle. One study shows that it takes 3½ to 5½ years for a price signal to hit on the retail level—to have an affect on the amount of beef that is produced and this is simply as other witnesses have pointed out.

It simply takes time for the signals to work its way through the system for the feeders to purchase less calves for the cow-calf operators to breed more cows and or breed more cows if the price goes down and breed more if the price goes up. And the ag is especially exasperated by the fact that when the price goes up not only does it take time for the level of production to increase, but there is an immediate sag in production, because cow-calf operators resign for heifers to build up the size of herds and that reduces the amount of meat on the market.

So, this lag has a significant effect on the cycles in beef prices and that will affect investor's decisions about whether or not to get into the beef industry. The final factor that I want to talk about in more detail is the income taxes and their effect on investor's decisions to get into or out of the beef industry. I think there are several aspects of the tax system that do affect investors in their decisions and I should point out that these tax consequences also affect what you might call full-time farmer's decisions about to get into or out of the beef industry, because they are also affected by the same tax rules.

The first one I want to mention is cash accounting. Again, it has been raised by earlier witnesses. As you know, the vast majority of farmers use the cash method of accounting. The history I read of the reason we have cash accounting in the farm industry is that farmers were thought to be unable to keep books necessary for an accural method of accounting. That may have been true in early days, but I think we know that today, farmers are pretty sophisticated and by and large, I think if asked to keep an accrual for income tax purposes, I think farmers themselves as well as outside investors in the farm economy are in favor of keeping cash accounting, because of the significant tax advantage of both deferring the recognition of income and therefore, postponing the day when taxes have to be paid as well as leveling out income from one period to the other and by leveling out income because we have a progressive tax system, you can reduce the overall taxes that have to be paid.

So, whatever the origins of cash accounting were, I think those are the reasons that producers are in favor of keeping cash accounting in the farm industry.

Senator ABDNOR. Is it as easy to do that with livestock as it is grain?

Mr. HARRIS. To level out the income?

Senator ABDNOR. Yes.

Mr. HARRIS. It's not as easy to level out, I don't think, the cycles, because of the difficulty of timing the marketing, but I think timing the purchase of inputs to some extent and therefore, do some of the leveling out. It's not as much as you pointed out as grain farmers can, as we will see. The cash accounting does allow a deferral of income to a certain extent expecially in cow-calf operations, because with cash accounting you can deduct the cost of raising that beef cow and not have to recognize the value of that beef cow in totaling up income.

You don't recognize the value of the cow until she is sold, so in effect, you are deferring the recognition of income by deducting the cost of producing her and then not recognizing that income until she is sold.

You did recognize income as calves are sold from her so you don't defer entirely the recognition of income.

Senator ABDNOR. Now that you have said all that, do you feel there is enough difference in one operation to the next, that the cattle people should have available to them both accrual and the cash.

Mr. HARRIS. Yes, well, under our current Tax Code farmers can choose the accrual method for doing their accounting and report for income tax purposes. I would wonder if in the long run that wouldn't help the whole agricultural industry by not only minimizing the tax shelter farming, but also by creating taxes for farmers at the time they have the income and the ability to pay them.

One of the down sides of cash accounting is to the farmer's advantage by deferring taxes, but one of the downsides is what Jim Strain mentioned this morning. And that happens at the time of foreclosure and repossession of the farm business.

What has happened is taxes have been delayed by these deferral methods and when it comes time to a foreclosure and repossession, and the taxes are due, I wonder if producers would be better off if they paid taxes when the income was there under an accrual system instead of deferring things and unfortunately, having to pay taxes at a time when there is very little money around to be able to pay those. So, it might help out around.

I think to answer your question directly, we would not force accrual accounting on everyone to have the effect. Right now, they have the option and as wise businessmen, most farmers choose the cash accounting because they can get tax advantages out of it.

Senator ABDNOR. Let me ask you one last question here, because we have a long schedule after lunch and we're going to come right back.

What would happen, in your judgment, if the type of legislation—a tax loss, was in effect?

What would it do to the business?

Mr. HARRIS. There would be a shortrun effect and it would further drag down the value of the resources that are used in farming and that short run effect would be detrimental to those who currently used resources in agriculture. In my opinion, in the long run, it would remove some of the Tax Code farming and bring the farm economy back to the economic of production rather than Tax Code economics and in the long run, for the producer who is making a living, I think that probably agriculture production, to loan that would be to their advantage.

[The prepared statement of Mr. Harris follows:]

PREPARED STATEMENT OF PHILIP E. HARRIS

The Future of Investor-Owned Cattle[1]

Introduction

Some cattle owners can be described as passive investors since they are not personally involved in cattle production. Their only interest in the cattle industry is the return on money invested. The future of the cattle industry will be shaped in part by the decisions of this sub-group of cattle owners. The decision of this group to expand or contract investment in cattle will affect the structure, profitability and size of the cattle industry.

Several factors affect the decisions this group makes about their investment in cattle. This testimony discusses those factors and their effect on investor-owned cattle.[2]

Structure of the Cattle Industry

Cattle production can be described in two distinct stages. One is the production of feeder calves and the other is feeding the calves to slaughter-market weight.[3] The characteristics of the producers is different for these two stages.

Cow-calf Operations

The production of feeder calves is characterized by a large number of small operations that produce a significant percent of total production. In 1982, there were 794,447 farms (82.9% of all farms that produced calves) that had fewer than 50 head of cows and heifers that have calved. Those farms owned 34.8% of all cows and heifers that have calved.[4] For most of the owners of these farms, the income from the cow-calf operation is not their sole source of income. They own cows for one or more of a variety of reasons. Some qualify for income tax benefits and/or

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[1] Prepared by Philip E. Harris, Assistant Professor of Agricultural Economics and Law, University of Wisconsin-Madison for hearings before the Joint Economic Committee of the United States Congress on March 31, 1986.

[2] This term is used to mean cattle owned by passive investors in this testimony.

[3] U.S. Department of Agriculture, Economic Research Service, The Cattle-Beef Subsector in the United States: A brief Overview, February, 1984.

[4] 1982 Census of Agriculture.

property tax benefits by owning cows. For some, cows compliment other business ventures such as speculating in land or raising grain. Some own cows for pleasure.

At the other extreme, there were 24,468 farms (2.5% of all farms that produced calves) that had 200 or more Cows and heifers that have calved in 1982. Those farms owned 30.5% of all cows and heifers that have calved.[5] The owners of the cows on these farm generally have other sources of income as well. Their primary reason for owning cows is the after-tax profits they realize.

The remaining 35.4% of cows and heifers that have calved were owned by farmers who had 50 to 200 cows and heifers that have calved.[6] Generally, these farmers are more dependent on the income from their cow-calf operations as their primary source of income than the other two groups.

Cattle Feeding

This stage of beef production is dominated to a greater extent by commercial feedlots that have a capacity of 1,000 head or more.[7] In 1984, 81 percent of the cattle marketed by the 13 major cattle feeding states came from commercial feedlots.[8] By contrast, those feedlots were only 3% of total number of feedlots in the 13 states. Sixty-three percent of the cattle came from only 0.64% of the feedlots. A significant portion of the cattle in these commercial lots are owned by someone other than the feedlot owner.[9]

The other 97% of feedlots produced only 19% of cattle for the slaughter market. These feedlots are typically owned by farmers who have several enterprises. Many of these farmers have cattle on feed for only part of the year.

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5 Id.

6 Id.

7 The Cattle-Beef Subsector in the United States: A brief Overview, supra.

8 Pointing the Way to Profits, NCA regional Educational Conference, Louisville Kentucky, July 27, 1985.

9 The Cattle-Beef Subsector in the United States: A brief Overview, supra.

The Cattle Production Cycle

The nature of cattle production causes the cycle of cattle production to differ from the cycle of production for other commodities such as hogs and broilers. There is a 3½ to 5½ year lag between the time an increase in beef prices sends a signal to beef producers and the time consumers see an increase in the supply of beef.[10] The initial reaction to the signal is a reduction in the amount of meat on the market due to holding heifers for cow-calf operations rather than fattening them for slaughter. After the cow-calf herds are increased in size, there is still some lag time to get the calves from the bigger herds to slaughter-market weight.

There is a similar lag in reacting to a decrease in beef prices. The initial reaction of cow-calf operators is to decrease the size of their herds which means they send more cull cows and heifers to the slaughter market. The reduction in beef supply is realized by the consumer only after the reduction in the cow-calf herds has reduced the supply of feeder calves and, in turn the supply of slaughter-market cattle.

Income Taxes

The federal income rules provide a significant incentive to invest in cattle The incentives are stronger for investors in higher tax brackets. Consequently, the incentives give investors in higher tax brackets a comparative advantage over investors in lower brackets.

Cash Accounting

The ability to accelerate the time of deducting expenses and delay the reporting of income is a significant income tax advantage of cash accounting. The advantage is that the time of paying taxes is delayed which is the equivalent of an interest-free loan from the treasury. A vast majority (95 percent)[11] of farm producers use cash accounting. However, restrictions enacted in the last several years limit the ability of some investors to take full advantage of cash accounting.

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[10] Id.

[11] Krause, Kenneth R. and Clark R. Burbee, Federal Tax Policies of Special Importance to Agriculture, USDA Economic Research Service Staff Report No. AGES811204, Washington, D.C., January, 1982.

Farming syndicates. Section 464 of the Internal Revenue Code allows farming syndicates[12] to deduct the cost of feed and other supplies that are used in cattle production only if the supplies are actually used during the tax year. This provision prevents investors who are subject to the limit from buying feed at the end of a tax year in order to artificially increase deductions for that year. However, investors subject to this limit can still use cattle feeding to shelter other income because feed that is purchased and consumed can be deducted in one tax year and the cattle can be sold in the next.

Breeding cows. Cash accounting allows investors in breeding cows to defer recognition of income more dramatically than investors in feeder cattle. The cost of raising breeding cows, such as feed, labor and veterinary expenses, can be deducted in the year they are incurred. Investors in farming syndicates can deduct those expenses in the year the supplies are consumed. The first income generated by a cow will be reported when the first calf from the cow is sold which is at least two years[13] after the cow was born and expenses were deducted. Some of the income generated by the cow will not be reported until the cow is sold. As discussed below, the capital gains rules allow that income to be reported as capital gains.

By contrast, accrual accounting would require investors in breeding cows to capitalize the cost of raising breeding cows and allow them to depreciate the cost of raising them over their useful life. By doing so, the income tax deductions would be claimed in the years the income from the cow was recognized.

Accelerated Depreciation

The option of deducting the cost of assets used in cattle production over a three- or five-year period at accelerated

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[12] A farming syndicate is defined as: 1. A partnership or other enterprise for which interests have been offered for sale that required registration with federal or state agencies that regulate securities, or 2. A partnership or other enterprise for which more than 35% of losses are allocated to limited partners. I.R.C. § 464(c)(1).

[13] One study reports that about 47% of replacement heifers were 16 months of age or more at first breeding which would make them more than two years old when they bore their first calf. Boykin, Calvin C., Henry C. Gilliam and Ronald A. Gustafson, _Structural Characteristics of Beef Cattle Raising in the United States_, Agricultural Economic Report No. 450, Appendix table 16 at page 69, USDA, Economics, Statistics and Cooperatives Service, March 1980.

rates[14] provides some incentive to invest in cattle production since the deduction can be used to offset other income. To the extent the depreciation period matches the economic life of the asset, there is little incentive since the investor suffers an economic loss equal to the deduction. Since the economic life of life of a breeding cow is about 5½ years,[15] the depreciation of cows is quite closely matched to their economic life. If, however, the asset is worth substantially more than the depreciated basis, the investor has again deferred the recognition of income because the depreciation deductions are claimed several years before the income from the sale of the asset is reported.[16]

Investment Tax Credit

The investment tax credit adds to the investor's after-tax return by reducing income taxes due by 10% (or 6%) of the amount invested in some assets.[17] This incentive is the same for taxpayers in all the tax brackets greater than zero since the credit is applied to the tax due rather than taxable income. Since the credit can be carried back three and forward fifteen years,[18] it has some value to taxpayers who expect to owe taxes in that period of time. However, the value of the credit decreases as the time between earning the credit and using it to offset taxes increases. Consequently, investment tax credit gives a significant competitive advantage to investors only with respect to taxpayers expect to owe no taxes for several years.

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[14] I.R.C. § 168.

[15] The average replacement rate is about 18% which indicates the herd is replaced about every 5½ years. (100 18 = 5.55). Structural Characteristics of Beef Cattle Raising in the United States, supra, page 70.

[16] I.R.C. § 1245 requires the gain realized on the sale of three- and five-year property to be reported as ordinary income to the extent depreciation has been claimed on the asset. Therefore, accelerated depreciation on these assets only allows deferral of the recognition of income and not conversion of income from ordinary to capital gains.

[17] If the full investment credit is claimed (10% on 5- and 6% on 3-year property, the basis of the asset must be reduced by one-half of the credit claimed. The basis reduction can be avoided by electing to reduce the investment credit to 8% and 4% repectively. I.R.C. § 48(q).

[18] I.R.C. § 39.

Long-term Capital Gains Exclusion

The long-term capital gains exclusion allows taxpayers to exclude 60% of the gain realized on the sale of some assets used in a trade or business.[19] To qualify, trade or business assets must generally be held for more than six months.[20] However, breeding cows must be held 24 months or more to qualify.[21]

Breeding cows. This provision allows investors to not only defer the recognition of income as described under cash accounting above, but to also convert ordinary income into capital gains. The conversion is accomplished by deducting the cost of raising breeding cows from ordinary income and by qualifying for the long-term capital gain exclusion upon the sale of the cow. Since no depreciation is claimed on raised cows, there is no depreciation to recapture under I.R.C. § 1245. If the cows are purchased and depreciated, gain on sale is ordinary income to the extent depreciation was claimed. Therefore, there is no conversion of ordinary income to capital gains unless the deductible expenditures on the cow increase her value above the original purchase price.

Land. As noted in the discussion of the structure of the cow-calf industry above, one of the reasons owners of herds of 50 or less own cows is that it compliments ownership of land. One of the incentives for owning land is to qualify for the long-term capital gain exclusion. Therefore, the exclusion indirectly affects these operators' decisions to own cows.

At-risk rules

Section 465 of the Internal Revenue Code puts a limit on the tax incentives discussed above. It limits the losses a taxpayer can deduct from an investment in cattle to the amount the taxpayer could lose on the investment. That is, losses are limited to the amount of equity the taxpayer has invested plus the debt for which the taxpayer is personally liable or for which the taxpayer has pledged property not used in the business as security.[22] For example, an investor who puts $10,000 of equity into a cattle business and borrows another $90,000 for which she is not personally liable can claim deductions only to the extent of her $10,000 of equity plus income that is reported. Similarly, if borrowed money (on which there is no personal liability)

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19 I.R.C. §§ 1202, 1222(11) and 1231.

20 I.R.C. § 1231(b)(1).

21 I.R.C. § 1231(b)(3)(A).

22 I.R.C. § 465(b).

is used to purchase depreciable assets, the at-risk rules limit the depreciation that can be deducted to the amount of equity invested plus the income reported.

The at-risk rules force investors to consider the risk that a cattle operation will lose money. Since they must be at risk to claim the tax benefits, they cannot be shielded from the losses of the business.

Alternative Minimum Tax

The alternative minimum tax[23] limits the advantage of the above tax rules by imposing an additional tax on taxpayers whose regular tax is lower than 20% of a broadly defined income. The broadly defined income includes taxable income for regular tax purposes plus certain items that are allowed as deductions for regular tax purposes. The alternative minimum tax is calculated by subtracting an exemption amount ($40,000 for married filing jointly, $30,000 for individual and $20,000 for married filing separately) from the above broadly defined income and multiplying the remainder by 20%. The taxpayer's tax bill is the higher of the result from the above calculation or the regular taxes.

For cattle investors, the most significant items that are added to regular taxable income are the long-term capital gains exclusion[24] and accelerated depreciation on real property.[25] If investors have a significant amount of these items they may not realize the full benefit of the deductions.

The investment tax credit cannot be used to reduce the alternative minimum tax which may defer the benefit of the credit.

Effect on Passive Investors

If passive investors are in a higher tax bracket than investors who are active in the production of cattle,[26] passive

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[23] I.R.C. § 55.

[24] I.R.C. § 57(a)(9).

[25] I.R.C. § 57(a)(2).

[26] The tax benefits of the cattle industry make it likely that passive investors are, on average, in higher tax brackets than investors who are active in the cattle operation. The passive investor is likely to have invested in cattle only because his tax bracket made the after-tax profits attractive. The active investor has reasons for investing in addition to the

investors will be more sensitive to changes in income tax rules.[27] A decrease in the amount of depreciation that can be claimed or in the long-term capital gains exclusion will have a greater effect on the after-tax profits of the passive investors. Therefore, the future of investor-owned cattle is likely to be significantly influenced by income tax rules.

Changes in the rules along the lines of H.R. 3838 will reduce the incentive for high-bracket taxpayers to invest in cattle. Changes that give greater deductions to owners of cattle will increase passive investment in cattle.

If the tax laws are not changed, the trend toward more investor-owned cattle is likely to continue. The tax incentives will continue to attract new investors whose competitive advantage makes it difficult for farmers in lower tax brackets to compete.

It should be noted, however, that the group of cow-calf operators who own cows as a compliment to other enterprises are likely to continue in the cow-calf business even if passive investors drive the price of cattle substantially lower. The complimentarity of these owner's cow-calf operations means their marginal costs are lower than single-enterprise operations. Therefore, it is profitable for them to operate at lower cattle prices.

The relatively long cattle price cycle also favors the passive investor for several reasons. First, they are better able to survive a long slump in prices because they have more capital. The prospect of long-run profits will encourage them to apply that capital if necessary. Second, since they are in a higher tax bracket, the same before-tax loss translates into a lower after-tax loss for the passive investor. Therefore, the cost of surviving a slump in prices is lower to the passive investor. Finally, some passive investors may not have to suffer the price slumps because they are able to move in and out of cattle investments if they simply have their cattle custom fed in a commercial feedlot.

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tax benefits and therefore would invest even if her tax bracket reduces the magnitude of the tax benefits.

[27] A recent study concluded that tax incentive effect on the farmer in a purchase decision appears less important than the effect on a manufacturer of the same incentive. Peace, Robert and Daniel A. Sumner, "Income Taxes and Farm-Sector Investment," 7 Journal of Agricultural Taxation and Law, No. 4, pp. 347-356, Winter 1986.

Senator ABDNOR. Thank you. I'm going to recess this hearing but I don't want you to leave. We still have a long way to go and who knows who we will be calling from after lunch.

[Whereupon, the subcommittee recessed, to reconvene at 1:45 p.m., the same day.]

AFTERNOON SESSION

Senator ABDNOR. Mr. Davis, we are very happy to have you here today. This subject has caused a lot of concern and misunderstanding, and we would be happy to have you testify and tell us a little bit about the commodity.

STATEMENT OF HON. ROBERT R. DAVIS, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION

Mr. DAVIS. Thank you, Senator. I am Robert Davis, a Commissioner at the Commodity Futures Trading Commission. And it is my pleasure to bring the Joint Economic Committee up to date on the important issue of monitoring the trading that takes place on this country's futures exchanges, and the role that futures trading serves for the American cattle industry.

Also, it is my pleasure to appear today for other reasons. First, my testimony means that I have had the opportunity to be of assistance to you from both sides of the gavel since I served at one time on the Joint Economic Committee staff with Mr. Tosterud, and second, as both you have mentioned earlier, it is important to get out in the country sometimes and listen.

I was able to meet at your request last year about this time with the South Dakota Legislature in Washington, DC, and I'm grateful you have given me an opportunity again, to return the favor and come back to South Dakota and I can assure you that not only am I talking today, but I'm also doing the listening as well.

The Commodity Futures Trading Commission is the exclusive Federal regulator for all trading in the futures contracts, options on futures contracts and options on physical commodities. Futures trading volume in 1985 was about 159 million contracts, which is up approximately 6.2 percent from 1984. Compared to 10 years ago, when we had a total volume for the year of 32 million contracts, there has been a fivefold increase in trading in a relatively short period of time.

Although the most spectacular growth has been in financial futures contracts, agricultural futures trading has also grown.

It is just an example, but 10 years ago, in 1975, cattle contracts represented about 2.5 million in contracts traded. Last year that was up to about 4.4 million contracts in 1985. In addition, volume is growing in a newly available range of hedging products, options on agricultural futures contracts.

The rapid growth of futures trading reflects two important functions of the market. First, it reflects the fact that the futures industry is an important price discovery mechanism where all the known information on expectations and supply and demand are melded into a market consensus at a particular time.

Granted, the cash market does that, the spot market does that as well, but this is an additional function in the futures market.

Second, it reflects the increased significance of the most important role of the futures market—reallocating risk of price movements from those who would be most damaged by adverse price movements, such as cattle feeders, to those who would be relatively less damaged. For instance, with the feeding periods as long as 4 to 6 months, entrepreneurs owning cattle face a tremendous market risk which is not significantly different from the risk of declining prices faced by a firm holding an inventory of a storable product. The futures and options markets provide a vehicle for transferring this risk to speculators willing to accept that risk in exchange for a profit opportunity, or to buyers of live cattle who want to hedge their price risk.

Common uses of futures are to hedge anticipated livestock requirements, livestock or meat inventories, fixed-price forward purchases of livestock and fixed-price forward sales of livestock or meat. As an example, as well as providing this direct hedging opportunity for larger operations that do participate in the futures market, the futures and options markets have enabled the elevator meatpackers and other mergers of agricultural products to offer the smaller producers direct cash prices that eliminate basic risk.

It was commented earlier today that if it was possible to wipe futures markets off the face of the Earth, the foreign markets would go away and while I may not have agreed with all the sentiment and reasons for that, I agree with the fact that it is true.

The forward products that are contracts that can be offered. The foreign cash prices offered to producers today are only offered because the merchandisers and middleman that are able to lay off the risk positions they have built up in the futures market. Well, that is sort of the good news about the functions and purpose of the futures market. It is serving a useful purpose, but that doesn't mean there are problem areas in that.

From the earliest beginnings, however, these futures markets have been subject to charges of market manipulation and abusive trading practices, with agricultural producers usually in the forefront of those raising questions about market integrity.

The charges have been raised over the years that have included prearranged trading, wash trading, brokers trading ahead of their customers, intraday speculative position limit violations as well as market manipulations that have become fundamentally and competitive in charging.

These charges have never been satisfactorily refuted, due in part to the lack of a verifiable audit trail for futures trades. Among other things, such an audit trail could demonstrate the sequence of trades taking place in the futures markets and help to provide assurance as to the competitive integrity of trading in the pit.

The lack of that is also seriously hampering the efforts of the CFTC and the exchanges in attempting to detect, prosecute, or to deter various types of potential trade practice abuses, market manipulations, and speculative limit and other violations.

In response to this problem the Commodity Futures Trading Commission in January 1986 published regulatory amendments requiring the exchanges to develop and implement improved audit trail systems for their futures and options contracts.

Commission rule 1.34, as amended, requires each exchange to state the time of execution of each trade on its trade register to the nearest minute. I appear here today largely to discuss may views on how these new amendments, currently being implemented will enable all customers of futures exchanges to trade with a new confidence in the integrity of those markets.

The audit trail that we had in place required the time of each trade to be recorded within a 30-minute bracket and from early on there were questions concerning the work ability of this bracket system and how workable or how useful some of the bracketing information was since the trades were only narrowed down to a 30-minute period. And subsequent experience has showed us that in fact, the 30-minute bracketing has resulted in an inability to reconstruct trading activity as effectively as we would like.

The large rise and fall of soybean prices in the second half of 1983 focused attention on the need to improve the quality of futures trading data.

Instrumental in this were the hearings held in January and April 1984 by the Joint Economic Committee. Those hearings of course, were hearings in which you, Mr. Chairman, played an integral role.

During those hearings, questions were raised concerning manipulation and other illegal market practicers. A Commission study of the 1983 soybean situation was completed not until October 1984. That study found no evidence of price manipulation, and concluded that general price trends were the result of ordinary market forces.

However, the study was not able to track precisely intraday trading for various speculative accounts to determine whether speculative limit violations occurred on an intraday basis. This left unanswered whether these accounts were traded above the limit during the day to the detriment of ordinary public participants. Moreover, the study took a year to complete, demonstrating the inability of bracketing data to prove or disapprove all complaints, or to answer any complaints on a timely basis.

More generally, in a number of its other surveillance and enforcement activities, the Commission has often found itself unable to prove or disapprove a wide variety of potential trading abuses and manipulative practices. The same has been true for exchanges with respect to their own internal investigations.

To resolve the problems of the bracketing system, the Commission initiated a lengthy rulemaking process, which culminated in an amendment to rule 1.35 which will improve the information recorded by exchanges on their trade registers.

It's a new and more stringent performance goal under which the time of each trade must be stated on the exchange's trade register in increments of no more than 1 minute. The exchanges are not required to inform the Commission of how they intend to comply with this rule until January 1 of this year. So, it is not surprising. As I said, the rule only came into effect in January, so I can't give you detailed outline of how all the exchanges intend to comply.

However, the Chicago Mercantile Exchange, which trades for live and feeder cattle, has already advised the Commission of its plans on the audit trail system, that it intends to implement. Along with the Chicago Board of Trade, the Chicago Mercantile Exchange is developing the computerized trade reconstruction system that they call the CTR, which is expected to identify a computer generated transaction time for every trade conducted on the two largest futures exchanges in the country.

The two exchangers, which, in 1985, represented 75 percent of all futures contracts traded. Under the CTR system, as explained by the Chicago Board of Trade and the Chicago Mercantile Exchange in recent presentations, computer searches of trading data currently available or to be newly collected will generate the exact time of execution and other useful information for a high percentage of trades.

Of course, it is impossible for the Commission to determine how well any audit trail system performs until the system is implemented and in use for some period of time. The Commission has stated in a letter to Senator Lugar, that based on the exchanges' representations of the time and sequencing accuracy of the CTR system. The system has the capability to meet the standards of the rule and provide an effective audit trail.

Accordingly, the Commission has encouraged both the Chicago Mercantile Exchange and the Chicago Board of Trade to develop their proposal and stands ready to assist these exchanges as they more fully develop the technical aspects of the CTR system.

The basis for the Commission's decision to require a more precise trail is to obtain trade time and sequence data necessary for the detection, prosecution and deterrence of trading abuses.

This is not to say, of course, that trading abuse in the futures industry is rampant. Rather, quite the opposite is true. It is my firm belief that the greatest public safeguards against abusive trading practices are inherent in the system of futures.

Any orders, whether for customers or for the accounts of local traders, are exposed to competitive bid and offer in an open outcry environment. This tends to guarantee competitive order fills at competitive prices.

Of course, the exchanges have an obligation to go beyond blind faith in competition or reliance on traders blowing the whistle on each other. Efficient programs of detection and deterrence can exist only if a quality audit trail exists that permits a rapid reconstruction of trading patterns to facilitate both exchange investigations and CFTC investigations or enforcement actions that may be necessary.

In addition, the ability of exchanges and the CFTC to carry out investigations expeditiously should increase the likelihood that suspected trading abuses are brought to the attention of appropriate oversight authorities by public customers and the traders themselves. Therefore, a strengthened audit trail is necessary as an independent deterrent and also as a means of improving the tendency of the system to self-police.

Had the Commission's audit trail rule been operational at the time this committee held its hearings 2 years ago on the soybean market, effective compliance with the rule would have allowed the Commodity Futures Trading Commission and the Chicago Board of Trade to have generated the data quickly to show who traded with whom, when and for how much. Partly unanswered questions which made it impossible to discern whether or not intraday speculative limit violations occurred in the fall 1983 soybean market.

Similarly, had the Commission's audit trail rule been operational during periods of volatile prices in the cattle futures markets, more precise trade sequencing and timing information would have been available to the CFTC and Chicago Mercantile Exchange to answer cattle industry concerns.

The Commission's new audit trail rule is intended to produce this information when needed, thereby strengthening exchange and Commission enforcement capabilities and assuring market integrity and increased public confidence in futures and options markets.

And in closing, let me just summarize what I was saying by stating my belief that a good audit trail is now in place and the Commission is committed to its reasonable and timely implementation and the exchange community is coming onboard with innovative and attractive proposals to gain compliance with the rule and provide the public with the information it wants.

[The prepared statement of Mr. Davis follows:]

PREPARED STATEMENT OF HON. ROBERT R. DAVIS

I am Robert R. Davis, a Commissioner at the Commodity Futures Trading Commission. It is my pleasure to bring the Joint Economic Committee up to date on the important issue of monitoring the trading that takes place on this country's futures exchanges, and the role that futures trading serves for the American cattle industry.*

The Commodity Futures Trading Commission is the exclusive federal regulator for all trading in futures contracts, options on futures contracts and options on physical commodities. Futures trading volume in 1985 was about 159 million contracts which is up approximately 6.2% from 1984. Compared to ten years ago, when we had a total volume for the year of 32 million contracts, there has been a five-fold increase in trading in a relatively short period of time. Although the most spectacular growth has been in financial futures contracts, agricultural futures trading has also grown. For instance, about 2.5 million live cattle futures contracts were

* The views I express today are my own and are not necessarily those of the Commission or any other Commissioner.

traded in 1975, compared to about 4.4 million contracts in 1985. In addition, volume is growing in a newly available range of hedging products, options on agricultural futures contracts.

The rapid growth of futures trading reflects two important functions of the market. First, it reflects the fact that the futures industry is an important price discovery mechanism where all the known information on expectations and supply and demand are melded into a market consensus at a particular time. Second, it reflects the increased significance of the most important role of the futures market--reallocating risk of price movements from those who would be most damaged by adverse price movements, such as cattle feeders, to those who would be relatively less damaged. For instance, with feeding periods as long as four to six months, entrepreneurs owning cattle face a tremendous market risk which is not significantly different from the risk of declining prices faced by a firm holding an inventory of a storable product. The futures and options markets provide a vehicle for transferring this risk to speculators willing to accept that risk in exchange for a profit opportunity, or to buyers of live cattle who want to hedge their price risk.

Common uses of futures are to hedge anticipated livestock requirements, livestock or meat inventories, fixed-price forward purchases of livestock and fixed-price forward sales of livestock or meat. Significantly, while many futures and options instruments provide for delivery, generally less than one percent of the futures and options on live cattle result in delivery. So what the futures industry does, rather than provide a major channel for delivery or allow people to take flyers as some may be inclined to think, is give people the opportunity to restructure their risk profile so that it is more suitable to whatever activity they are trying to carry out. As well as providing direct hedging opportunities for larger operations, the futures and options markets enable elevator operators and meat packers to offer the small producer direct cash prices that also eliminate basis risk.

From their earliest beginnings, however, these futures markets have been subject to charges of market manipulation and abusive trading practices, with agricultural producers usually in the forefront of those raising questions about market integrity. The charges raised over the years have included pre-arranged trading, wash trading, brokers trading ahead of their customers, intra-day speculative position limit violations as well as market manipulations. These charges have never been refuted satisfactorily, due in part to the lack of a verifiable "audit trail" for futures trades. Among other things, such an audit trail could demonstrate the sequence of trades taking place in the futures markets and help to provide assurance as to the competitive integrity of trading in the pit. Lack of an effective audit trail has also seriously hampered the efforts of the CFTC and the exchanges in attempting to detect, prosecute, or to deter various types of potential trade practice abuses, market manipulations, and speculative limit and other violations.

In response to this problem, the CFTC on January 21, 1986 published regulatory amendments requiring the exchanges to develop and implement improved audit trail systems for their futures and options contracts. Commission Rule 1.35, as amended, requires each exchange to state the time of execution of each trade on its trade register to the nearest minute. I appear here today to discuss my views on how these new amendments, currently being implemented, will enable all customers of futures exchanges to trade with a new confidence in the integrity of those markets.

The audit trail rule currently in effect requires the time of each trade to be recorded within a 30-minute "bracket." Questions were raised from the outset concerning the workability of this "bracket" system and subsequent experience demonstrated major problems with it, resulting in an inability to reconstruct effectively pit trading activity. More recently, the Congressionally-mandated "Insider Trading Study", completed in September 1984, disclosed inherent limitations of bracketing in detecting and prosecuting certain types of trading abuses.

The large rise and subsequent fall of soybean prices in the second half of 1983 again focused attention on the need to improve the quality of futures trading data. Instrumental in this process were the hearings held in January and April, 1984 by the Joint Economic Committee, hearings in which you, Mr. Chairman, played an integral role. During those hearings, questions were raised concerning manipulation and other illegal market practices.

A Commission study of the 1983 fall and winter soybean market, completed in October 1984, found no evidence of price manipulation, and concluded that general price trends were the result of ordinary market forces. However, the study was not able to track precisely intra-day trading for various speculative accounts to determine whether speculative limit violations occurred on an intra-day basis. This left unanswered whether these accounts were traded above the limit during the day to the detriment of ordinary public participants. Moreover, the study took a year to complete, demonstrating the inability of bracketing data to prove or disprove all complaints, or to answer any complaints on a timely basis.

More generally, in a number of its other surveillance and enforcement activities, the Commission has often found itself unable to prove or disprove a wide variety of potential trading abuses and manipulative practices. The same has been true for exchanges with respect to their own internal investigations. For example, the common phenomenon of repeating prices within a bracket has often made it impossible to determine the sequence in which a suspect trade occurred, resulting in dropped investigations. Even where trading could be reconstructed, it might require many hours of staff time sifting through thousands of pieces of paper or printed records to pin down a single trade.

To resolve these problems of the bracketing system, the Commission initiated a lengthy rulemaking process, which culminated in an amendment to Rule 1.35 which will improve the information recorded by exchanges on their trade registers. The trade register is a single record, required by Commission regulation, which shows for each futures or option trade a variety of information concerning the transaction, including who executed the trade and the time period in which the trade was executed. New Rule 1.35 imposes a new, more stringent, performance goal under which the time of each trade must be stated on the exchange's trade register in increments of no more than one minute. The actual time of execution need not be obtained by the trader himself but may be captured by an exchange-recorded trade timing or reconstruction system.

The regulation does not specify any particular method for meeting the performance standard, but allows exchanges to develop and use a wide range of approaches. This flexibility is dictated by the diversity of trading environments that can exist at different exchanges, or even at different pits or rings within the same exchange. The Commission was aware that an audit trail requirement that impeded market liquidity or the speed with which customer orders could be executed could literally kill the goose that lays the golden egg. The public interest demands both an active, competitive market for futures and options and an improved audit trail to aid in surveillance and enforcement and to answer customer complaints quickly as they occur. These dual goals can be reached simultaneously only when the federal regulator establishes reasonable objectives and the industry responds cooperatively to provide innovative solutions as only the private sector can. In recognition of these dual goals, the American Soybean Association recently expressed its support to the Chairman of the House Committee on Agriculture both for the CFTC's new audit trail requirements and for granting exchanges flexibility in choosing a system which will comply with those requirements. Similarly, the National Cattlemen's Association, in a recent letter to the Chairman of the Senate Committee on Agriculture, Nutrition and Forestry, noted that "Common sense and currently available high technology offer a variety of alternatives for the commodity exchanges to meet the CFTC performance standard."

While the Commission found the objective of improved trade timing data to monitor trade practices easy to advocate, it found it considerably more difficult to articulate an audit trail standard that is appropriate to the competitive open outcry trading that is integral to the functioning of futures exchanges. Thus, while the rule calls for an audit trail performance standard of one minute increment trade timing, one hundred percent accuracy is not possible in markets characterized by simultaneous trading and high volumes in an auction environment, at least using technology available in the foreseeable future. Instead, compliance criteria will form over time as a result of ongoing Commission evaluation of the efficacy of exchange audit trail programs.

In this regard, the Commission has set up a schedule which allows time for exchanges to implement the systems they select. By October 1 of this year, exchanges are required to have their systems implemented. And by January 1, 1987, exchanges must be able to demonstrate effective use in their surveillance and compliance programs of the trade timing data generated by these new systems. Of course, this timetable might be extended somewhat if an exchange has demonstrated due diligence and progress toward a satisfactory program.

Exchanges are not required to inform the Commission of how they intend to comply with amended Rule 1.35 until July 1 of this year. However, the Chicago Mercantile Exchange, which trades options and futures contracts in live and feeder cattle, has already advised the Commission of its plans on the audit trail system it intends to implement. Along with the Chicago Board of Trade, the Chicago Mercantile Exchange is developing the "Computerized Trade Reconstruction" system, known as CTR, which is expected to identify a computer generated transaction time for every trade conducted on the two largest futures exchanges, which represented 75% of all futures contracts traded in 1985. Under the CTR system, as explained by the Chicago Board of Trade and the Chicago Mercantile Exchange in recent presentations, computer searches of trading data currently available or to be newly collected will generate the exact time of execution and other useful information for a high percentage of trades.

Of course, it is impossible for the Commission to determine how well any audit trail system performs until the system is implemented and in use for some period of time. The Commission has stated in a letter to Senator Lugar that, based on the exchanges' representations of the time and sequencing accuracy of the CTR system, it has the capability to meet the standards of the rule and provide an effective audit trail. In addition, the validity of the trade times generated by the CTR system will be enhanced by the fact that, unlike manual recording, where traders may have a direct opportunity to falsify or misstate trade times, traders cannot tamper with the generation of their trade times. Accordingly, the Commission has encouraged the Chicago Mercantile Exchange and the Chicago Board of Trade to develop their proposal and stands ready to assist these exchanges as they more fully develop the technical aspects of the CTR system.

The basis for the Commission's decision to require a more precise audit trail is to obtain trade time and sequence data necessary for the detection, prosecution and deterrence of trading abuses. This is not to say, of course, that trading abuse in the futures industry is rampant. Rather, quite the opposite is true. It is my firm belief that the greatest public safeguards against abusive trading practices are inherent in the system of futures trading itself. Any orders, whether for customers or for the accounts of local traders, are exposed to competitive bid and offer in an open outcry environment. This tends to guarantee competitive order fills at competitive prices.

Of course, exchanges have an obligation to go beyond blind faith in competition or reliance on traders blowing the whistle on each other. Efficient programs of detection and deterrence can exist only if a quality audit trail exists that permits a rapid reconstruction of trading patterns to facilitate both exchange investigations and CFTC investigations or enforcement actions that may be necessary. In addition, the ability of exchanges and the CFTC to carry out investigations expeditiously should increase the likelihood that suspected trading abuses are brought to the attention of appropriate oversight authorities by public customers and the traders themselves. Therefore, a strengthened audit trail is necessary as an independent deterrent and also as a means of improving the tendency of the system to self-police.

Had the Commission's audit trail rule been operational at the time this Committee held its hearings two years ago on the soybean market, effective compliance with the rule would have allowed the Commodity Futures Trading Commission and the Chicago Board of Trade to have generated the data quickly to show who traded with whom, when and for how much--partly unanswered questions which made it impossible to discern whether or not intra-day speculative limit violations occurred in the fall 1983 soybean market. Similarly, had the Commission's audit trail rule been operational during periods of volatile prices in the cattle futures markets, more precise trade sequencing and timing information would have been available to the CFTC and Chicago Mercantile Exchange to answer cattle industry concerns. The Commission's new audit trail rule is intended to produce this information when needed, thereby strengthening exchange and Commission enforcement capabilities and assuring market integrity and increased public confidence in futures and options markets.

An audit trail rule is now in place, the Commission is committed to its reasonable and timely implementation, and the exchange community is coming on board with innovative and attractive proposals to gain compliance.

Senator ABDNOR. Thank you, Mr. Davis. You were here most of the morning and I assume heard most of the testimony, but do you have any evidence that livestock producers benefit in any way for the future trading and livestock?

Mr. DAVIS. Yes, I do, there were 4.4 million contracts traded last year and the majority of those contracts were traded by commercial interest. Some were large commercial interests and some were small producers interest and I have some magnitude of trading greater than the volume of contracts which was represented in the—which wouldn't have existed without futures trading.

I think the demand for those contracts demonstrates that there is a use as being demanded by the public.

Senator ABDNOR. How about the speculators and retailers, do they make up a large majority of this contract too.

Mr. DAVIS. Yes, they do. As a matter of fact, I gave Mr. Tosterud, last night, a three-page summary of the study that was about 1½ years in the making. That was released on January of 1985 about a year ago, that details what some of the activities have been by the largest commercial interest in the live cattle futures market. And I know that long study is much too long to include in the record, but I will provide a copy of the summary for the record so that those who are interested can get a copy of the longer study.

Senator ABDNOR. Well, I would like to have it to study. You said it would be too lengthy to put in the record, but we could keep it with the documents that we do have.

Nevertheless, the futures is probably used just as much if not more by speculative packers and retailers than by the producers because there are an awful lot of producers that are not using them. Would that be an unfair statement?

Mr. DAVIS. That is a fair statement. Most producers are not direct users of futures markets and I don't have them broken down on a contract-by-contract basis, but one rule of thumb is typically that only 5 percent of producers directly use the futures market. That's maybe because they don't feel comfortable about the futures market. It may be that the size of the operation is too small to let them avail themselves of the markets, and I say the majority of these producers are using the market indirectly because they are using forward contracts that would not be available to them without the futures market.

Senator ABDNOR. I'm sure you will either completely agree or disagree with me, that there is an awfully strong feeling that it would be better without futures. Many people think that way. Let's say I wanted to go about getting futures suspended for the trading and livestock. Would it take an act in Congress to do it?

Mr. DAVIS. That is a path that would lead to the clearest results. There is, in fact, one commodity or one agricultural commodity which, by statute, couldn't be traded with the futures contract and this is on jobs, so you can't have a futures contract in on onions since 1950's. I think 1956. Simply, the U.S. Congress banned trading in options from agricultural products in 1936 until 1982, so it is not without precedent that Congress banned trading and futures trading and certain types of instruments and commodities from time to time.

Senator ABDNOR. If you say—I don't know what you mean. Do you suspend futures without any one commodity?

Mr. DAVIS. Before we designate a contract, we were required by statute to have a fairly lengthy investigation of the potential use of that contract and that investigation requires us both to determine that the contract has an economic purpose and we have to identify hedgers in the market that we expect might avail themselves to this contract for hedging purposes, and there is long procedures for doing this.

While it is never occurred, to my knowledge, I believe that under our regulations, simply, it could be proven that a contract serve no public interest and was not used by hedges, then it may be possible for the Commission, directly, to remove the designation for a contract of trade.

Senator ABDNOR. This reporting rule that you speak of, I take it you think it is going to correct a lot of past problems we may have had and take care of abusing the market. This should do it, you think?

Mr. DAVIS. I think it is going to answer a lot of questions that we haven't been able to answer before, because of some skepticism and fire of the futures market. We have seen that evidenced today and with the discussion by way of what happened with the cattle contracts and the dairy herd reduction program.

I will also just say a quick word about that. There are reasons to be unconcerned about what happens in the futures market. We carry out a number of investigations and we throw people out of the markets and we find people from time to time as we find abuses, but sometimes the futures market is the messenger that gets killed and not the cause. And as Mr. Nix indicated and based on his progressing the dairy herd reduction programs, it came in about twice as large as some people have been suspecting.

I have not calculated the numbers, but based on the rumors that are working in the markets today, I understand that people have calculated that that increased meat from the reduction of dairy herd may increase prices over the next 18 months by 2 percent, and this is if the dairy herds are reduced evenly over the 18-month period and there would be a greater supply. And in fact, most of the herds are reduced in 4 months as I indicated might be the case.

If that is in fact true and that is what the market is trying to work out now, I would be worried that they would not react to that. Any time you have a large change in supply or demand and don't get a reaction, something is wrong. Also, I would like to point out that again, I haven't confirmed this, but I understand cash prices are down today over $2 under weight and the futures market has moved $1.50 because that's as far as they can move in 1 day, according to the Chicago Mercantile rules. That would not indicate to me that the futures market in this particular instance is pushing the cash price, but rather, the cash price is leading to the futures market and this can't catch up with where the cash market is going.

And as a result, I would expect to see tomorrow, a catchup in those futures prices down to where the cash price fell to if in fact I'm correct in my statement that the cash price fell today.

Anyway, that is sort of a long story and it did not directly answer your question.

Senator ABDNOR. Well——

Mr. DAVIS. There are abuses that occur in the market. There are some questions that go unanswered where we didn't prove or disprove an abuse. The futures traders are sometimes in the situation of having to prove they did wrong and I don't necessarily disagree with that, but rather, having to go in and prove that they didn't dairy out abusive trading practices. I would be more comfortable if the American agricultural producers would be more comfortable that the Federal categorically prove that nothing happened and I expect that new information to go a long way toward doing that. I'm not sure if it's going to catch more perpetrators of trading abuse because I think there is going to be a great deterrence here with better information and the knowledge that the businessman on the street has better information to prosecute trading abuse to the extent that any of this is going on and that we can't detect now. That may dry up as soon as you shine the light on it.

Senator ABDNOR. You mentioned the Soybean Producers Advisory Group, the Chicago Board of Trade and I was wondering, is there a group for livestock growers? If not, how can you form one?

Mr. DAVIS. You are referring to an advisory committee that could exist in the Chicago Mercantile?

To my knowledge, there is not an outside producer advisory group in the Chicago Mercantile Exchange from the cattle industry. They have been trying to review some contracts or stipulated trading in contracts that might be to their interest to explore that possibility. It's sort of their business call, but it certainly, I would think, be in their interest to cooperate with the industry that they were serving and I certainly would look favorably on any efforts they would undertake to cooperate with the industry.

Senator ABDNOR. You think it might have some merit? Let me ask you, and we don't usually do this, but would you mind taking one question from the audience?

Mr. DAVIS. I'll take as many as there are.

Mr. STRAIN. You mentioned the retailers in the market on both sides, long and short, and would your data tell you that?

Mr. DAVIS. The data could tell me that and I could get better breakdowns on that and submit it for the record.

Mr. STRAIN. I can understand with a retailer being long in the market, but I can't understand that a retailer has a business on a short side of the market for the reasons I cited today.

Mr. DAVIS. He is in a position to influence especially in terms of hedging extensions to use contracts and they have exemptions from speculative limits in this commercial enterprise and has to prove a cash inventory or they are anticipating cash inventory and lock in a price or protect themselves from the vice, which may occur in that physical inventory of the commodity. You are correct in your statement that there is no reason for a firm to receive an exemption from speculative limits on contracts if they are not going to have an inventory of the product that they are trying to protect themselves on. And that is something we look at quite closely in terms of hedging exemptions. The hedges are hedging exemptions and we go in and review all the exchange decisions from time to time to make sure that they are allowing hedging exemptions appropriately.

Mr. STRAIN. Thank you.

Senator ABDNOR. Thank you. I think we better move along. It was brought to my attention that one of the key witnesses has a plane leaving at 4:45. I have the Governor here too, but I hate to bring him all the way from Kansas—where are you?

Mr. DAVIS. Let me say that I expect to be around later on this afternoon and if any members of the public attending today really want to press a question or thought, I would be happy to hear from them. Thank you.

[Letter supplementing Mr. Davis' testimony, answering questions or providing additional material for the record, follows:]

COMMODITY FUTURES TRADING COMMISSION
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Robert R. Davis
Commissioner

(202) 254-6354

April 15, 1986

The Honorable James Abdnor
Vice Chairman
Joint Economic Committee
Congress of the United States
Washington, D. C. 20510

Dear Senator Abdnor:

This letter supplements the testimony that I presented during the March 31, 1986 hearing of the Joint Economic Committee on "The Future of the American Cattle Industry," answering questions or providing additional material for the record.

(1) In response to your inquiry on committees that advise the Chicago Mercantile Exchange (CME) on cattle issues, the CME has an advisory committee for its live cattle futures and options contracts and an advisory committee for its feeder cattle futures contract. The function of these two committees is to assist the CME in improving the usefulness of its futures and options contracts. For instance, the conversion of the CME's feeder cattle contract to cash settlement was a very lengthy process that involved a great deal of advisory committee input. A list of the 1985 members of these advisory committees is enclosed for the record.

The CME also obtains input from the livestock industry through several of its public governors. Three past Presidents of the National Cattlemen's Association have served or are serving as governors of the CME Board, and other members of the livestock industry have also served as public governors. In addition, the CME Compliance Division reports violations in trading of the cattle contracts to the National Cattlemen's Association.

(2) During the hearing one witness expressed an interest in obtaining more information on whether meat retailers were active in the live cattle futures markets. The Commission's staff has advised me that during the week of March 31 through April 4, 1985, a week of unusual price volatility, there were no reportable long or short positions held in any futures month by a retailer.* Commission staff is reviewing the activities of the live cattle futures markets during that time period, and I will forward to you and the Committee any significant information that is disclosed.

(3) A summary of a two year study on the "Uses of Livestock Futures Markets by Large Hedgers" is enclosed for the record. The study originally appeared in the Commission's 1984 Annual Report and may be of interest to the Committee.

Thank you again for inviting me to address the Committee on some of the very important issues that face the cattle industry today. If I can be of any further assistance, please do not hesitate to contact me.

Best regards,

Robert R. Davis

Robert R. Davis
Commissioner

Enclosures

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* Positions of less than 100 futures contracts are not required to be reported to the Commission's surveillance staff. The maximum speculative limits in live cattle futures contracts are 300 long or short in the spot month and 450 for any of the other months.

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From the Commodity Futures Trading
Commission's 1984 Annual Report

Uses of Livestock Futures Markets by Large Hedgers Summary

An interim report of large hedgers' activities in livestock futures markets during early 1983 was included in the 1983 Annual Report of the CFTC. The futures contracts considered in this study are live cattle, live hogs, and pork bellies. The complete two-year study is included as an Addendum under separate cover to this report. The final study's first section measures the extent of large commercial participation in livestock futures markets, examines the size of the largest commercial positions, and compares them to large speculative positions. Comparable data for selected grain futures markets are examined to provide comparisons between the newer livestock markets and the longer-established grain markets in terms of the market shares and absolute position sizes of large hedgers' futures positions.

Staff economists collected 18 months of data from 12 selected large livestock hedgers. Data included the cash and related futures positions for the large traders in each of seven categories of cash livestock businesses. Surveillance staff interviewed the executives responsible for futures trading of each of the large hedgers in order to learn how, when, and why they used livestock futures in relation to their their cash businesses. These commercial traders were also asked policy questions including what restrictions, if any, are placed on personal trading by employees.

Finally, the study assessed the impact of the largest hedgers on futures markets by reviewing their trading activities and positions in expiring livestock futures contracts. Conclusions were drawn as to whether or not, judging by the activities and positions of these large livestock hedgers, they may have caused price distortion or market disruption.

Both the CFTC and the CME have extensive market surveillance programs designed to prevent the disruption of futures markets by large traders—whether hedgers or

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Editor's Note: The full text of this study has been published as an addendum to this Annual Report, in limited quantities.

speculators. The Commission and the exchange have the power to preserve or restore orderly trading in threatened markets. The effectiveness of these emergency powers was demonstrated by the CME when it acted to facilitate the liquidation of the August 1983 pork belly future.

One of the most significant deterrents to excessive futures positions by large livestock hedgers is the hedge exemption procedure of the CME with respect to their speculative position limit rules. Hedgers are exempted from these limits to the extent they can justify greater futures market positions required to hedge their cash operations. Nonetheless, hedgers routinely are required to reduce their positions in expiring livestock futures to designated levels. Thus, during the sensitive liquidation periods of livestock futures contracts, large hedgers are prevented from having extraordinarily large positions that could exert undue market power. Analysis of position data confirmed that no commercial trader accounted for an excessively large share of the open interest in an expiring livestock future during the last few days of trading for the contract.

Nevertheless, commercial traders did appear to contribute to the two contract liquidations that were of some concern in the livestock markets between October 1982 and June 1984. In both instances, however, the most worrisome commercial positions were below the speculative limits and were small compared to the open interest. Yet, the traders caused concern by standing for, or announcing plans to stand for, a substantial number of deliveries.

This surveillance experience suggests that the greatest potential for unwarranted price impact on the part of large livestock hedgers—at least during liquidation periods—may stem from attempts to use these futures markets as a major source of supply for their businesses. Cash settlement rather than delivery may present a solution, provided requirements for appropriate cash price series can be satisfactorily met for the respective livestock commodities. Nevertheless, both the CFTC and the CME currently are prepared to take any necessary steps to protect the markets from attempted manipulations or major market disruptions. The CME's action in the case of August 1983 pork bellies provides a clear indication of that exchange's determination to prevent disruptions in its markets.

In addition to examining the trading of large livestock hedgers during delivery periods, data also were examined for evidence that the traders used their hedge exemptions to affect deferred futures prices. Although large commercials made extensive use of livestock futures in the 21 months observed, there appeared to be only one commercial trader whose positions in deferred delivery months—in this case hogs—tended to be both larger than the positions speculators were allowed to hold and large enough relative to the open interest to raise serious concerns about the trader's ability to affect futures prices. A review of that trader's activity, however, did not reveal any significant effect on hog futures prices.

A substantial number of live cattle positions were much larger than the speculative limits for individual futures in the most actively traded months. The largest live cattle positions were held by cattle feeders who are also cattle processors, although individual shares of the total market were quite small. Commercials together comprised, on average over the period studied, a greater portion of live cattle futures than in either live hog or pork belly markets. Further, commercials' share of the long side of the live cattle futures market rose substantially during the recent two years.

The analysis of the cash and related futures activities of the selected large hedgers over an 18 month period also revealed that the firms produce, process, and merchandise livestock and meat products and employ futures in numerous and diverse manners. Executives that were interviewed reported futures were used in increasing volume for forward pricing purchases and sales of livestock and meats as well as to hedge inventories.

Commercial use of livestock futures is apparently expanding, particularly to facilitate the competitive forward pricing activities of cattle processors. Indirect beneficiaries of these activities include institutional food preparers and cattle feeders who buy and sell at forward fixed prices without committing margin money, paying brokerage commissions, or assuming basis risk from direct futures hedging. Live hog futures also facilitate fixed forward pricing of producers' hogs to hedgers who are both hog processors and hog merchandisers, with the advantage to producers of not requiring direct positioning in futures contracts. Pork belly futures provide a significant risk shifting device to facilitate financing major pork belly storage programs from surplus to deficit supply periods.

The large hedgers studied tended to maintain substantially different futures positions and different cash business exposures, and a majority tended to change their positions often as measured by monthend reports. Because 10 of the 12 traders practiced selective hedging, the data suggest that the traders' price and market views at any one time were dissimilar and changed frequently, sometimes causing their futures positions to change substantially.

In conclusion, the 12 large hedgers studied closely for 18 months used three livestock futures markets extensively to shift inventory risk and increasingly to fix forward prices with producers and other commercials. Although these hedgers at times held large futures positions, the CFTC and the CME market surveillance programs have adequate powers to be effective deterrents to abusive trading by large hedgers in livestock and other futures markets. Specifically, we found no evidence that any commercial trader used a CME hedge exemption to disrupt the live cattle, live hog, or pork belly futures markets. In fact, on the two occasions when large livestock hedgers did become involved in problem situations, the CFTC was primarily concerned that the traders wanted to take too many deliveries—not that their positions were excessively large.

Senator ABDNOR. We're going to have some of the same witnesses back. I appreciate your coming and I know you have to get back to Kansas. You are the publisher of the Drovers Journal. One of our listeners came up and told us that this is one of the best publications and he wanted to have me read this newspaper, so you have a reading audience here today in South Dakota, I assure you.

STATEMENT OF FRED KNOP, EDITOR, THE DROVERS JOURNAL, SHAWNEE MISSION, KS

Mr. KNOP. Well, thank you. I am Fred Knop and I'm the editor of the Drovers Journal. This is the largest circulation weekly livestock newspaper in the United States. My personal background included this and about 25 years in industrial marketing. My comments are going to talk more about cattle as many as of our testifiers have done so today.

I would first like to review where I think we are presently. It has been said that the beef cattle industry has matured to a point that the past is no longer a basis for forecasting the future. I accept this, and, therefore, I will review only the present in an effort to establish a meaningful context for my thoughts on the future.

The industry, as it exists today, has both positive and negative aspects. On the positive side are the following: Beef is a highly nutritious product. According to new data developed by the U.S. Department of Agriculture, it is low in calories and superior to pork, poultry, and fish in most essential nutrients.

The national beef herd has a broad genetic base. In the last 25 years, American breeders have imported the best breeds the world has to offer, raising to almost 50 the number of breeds in this country.

The United States has a highly developed marketing system. Auction markets and cattle dealers exist wherever there is a concentration of cattle.

Cattlemen are served by an advanced, competitive transportation system. Our farm-to-market roads are the best in the world, and our trucking system provides efficient, competitive service.

The industry has avilable a wide array of vaccines, drugs, and chemicals with which to minimize losses to diseases.

The industry has available ample feed and feeding facilities. We have more than enough grass in our national pasture, more than enough grain in our national grainery, and more than enough pens in our national feedlot. But, unfortunately, these positive factors are opposed by serious negative factors.

One, producers are caught in a cost-price sequeeze that makes it difficult to impossible to operate at a profit. It is estimated that the cash cost of producing a calf to weaning age is 80 cents a pound, and the total cost is $1.20. This compares with current calf prices in the upper seventies.

Two, something seems to be seriously wrong with beef demand. The national herd had dropped from 132 to 105 million, but prices have not risen as they theoretically should. Instead, they remain on a low plateau.

Third, contributions to this is beef's deteriorating image. For some reason, beef, more than any other meat, is the focal point of the diet-health and food safety issues. On the diet-health issue, there is a deep-running unwillingness to focus on the wholesomeness of lean tissue. Instead, the focus is on fat, and an illusion is being created that its cholesterol and calories apply to lean as well. On the safety front, the image of beef is being tarnished far beyond reality by such issues as the low level feeding of antibiotics and the use of chemicals.

These factors are having an impact on all sectors of the cattle industry, and particularly on the cow-calf sectors. This sector suffers more than others, because it is capital poor, yet capital intensive. It is losing numbers because too many cows have been pledged as collateral for farm operating loans, and because too many bankers have lost interest in financing cows. It suffers too from want to management skills.

Iowa records show that some managers are making money while others fail.

All this is particularly serious, because if the cattle industry is not viable at its base, the cow-calf sector, it will wither and shrink.

I will give you the thoughts on the future and follow that up with some thoughts on implications.

I will say that I am apprehensive about the future of the beef cattle industry. I am apprehensive mainly because of the changes going on in our society and their implications for beef demand. I am also apprehensive because of the attitudes of many persons in the industry as they relate to identifying real problems and supporting real solutions. It is in this context that I offer the following comments.

One, research shows that the U.S. population is swinging rapidly away from the meat lower segment that has long been beef's stronghold. A rapid buildup is occurring in the active lifestyle and health conscious segments. I believe this is true. I also believe that this is working against beef because of the interest of persons in these segments in food that is low in calories and in perceived potential for causing such health problems as cardiovascular disease and rectocolon cancer.

Two, research shows that the increase in the number of households with a single working parent or two working parents is increasing the demand for precooked, microwavable foods. I believe this is true. I also believe the beef industry has been asleep at the switch and is ill prepared to fill this demand.

Three, research shows that the consumer's definition of beef quality centers on leanness and marbling. This research also shows that consumers are also turning away from highly fat meat, both for health and economic reasons. I believe this is true. I also believe that beef producers are being slow in accepting this and are not yet ready to reduce fat through breeding and feeding.

Four, respected economists state that the market for beef has matured, meaning that it has lost its price elasticity. Such markets are more commodity in nature; consumers are less loyal, and adjustments in supply do not always result in increases in price. I believe this is true. I also believe this has not yet been accepted by cattle producers.

Five, current experience shows that beef producers especially cow-calf producers, have little marketing clout. I believe this will continue to be true unless effective action is taken.

Six, current experiences shows that cattle feeding has become so concentrated that its errors can have devastating effects on the cow-calf and grower sectors. This can be seen in present depressed fed cattle prices and those for most of 1985 when, in spite of fewer numbers being marketed than the previous year, beef tonnage increased over that of the previous year.

Seven, current experience shows that the size of the farm-to-market spread is vital to the interests of beef cattle producers and feeders. I believe this is true. I also believe, contrary to the popular view, that a small spread does not necessarily serve the industry's interests. Presently, a large spread is encouraging retailers to emphasize beef and invest more money in new product development and beef promotion.

Eight, current experience shows that the beef cattle industry can not be isolated from what goes on in other sectors of agriculture. Evidence of this is the whole-herd buy out program in the dairy industry. It has been estimated that this will result in the slaughter of 1 million dairy cows in the next 18 months. I believe this will continue to happen. I also believe beef producers must do everything possible to prevent this, but must also factor their businesses to live with it to some degree.

The implications of these thoughts on the futures are as follows:

One, with regard to social shifts in the U.S. population, we must view these shifts as irreversible, and we must cater to them. This will mean marketing a product that is more lean, and that is packaged and presented in a manner that will appeal to creative cooks and weight conscious individuals. The development of these products will require the joint efforts of the beef industry, packer-processors, and retailers.

The shift of people into the health-oriented group is a special concern. The beef cattle industry, through its national organizations, the National Cattlemen's Association and the National Livestock and Meat Board, seems to be making headway through communications and advertising that stresses the wholesomeness of lean tissue.

You, Senator Abdnor, and your colleagues in Congress can aid in this effort by assuring that dietary guidelines issued by Federal bureaus deal more with the qualities of lean meat, and that the appropriate sections of the National Institutes of Health do this also.

It should also be accepted that cattlemen, starting with cow-calf producers, must make better use of the genetics and management technology available to breed, feed, and market leaner animals. To illustrate this, I point to a recent statement of the Kroger Co., the Nation's second largest supermarket chain—Kroger estimated that by taking action to reduce the fat trim on retail beef cuts they would keep 13 million pounds of fat off the market.

With regard to the safety issue, Senator Abdnor, you and your colleagues must prevent such things as the super bug theory and extra label drug use from becoming political footballs. Needless rhetoric on these points triggers a distortion process in the consumer press and complicates the producer's efforts.

Two, with reference to the growing number of single parent and two parent working households, the beef cattle industry must respond promptly with new convenience products that can be prepared quickly. To fail in this will play into the hands of the poultry and seafood industries which are already marketing a substantial number of such products.

Three, consumer driven must become the nature of the beef cattle industry. With completion of the National Consumer Beef Study in 1985 by Texas A&M University in cooperation with the National Live Stock and Meat Board, the industry has a clear signal that fat is out and lean is in. Cattle breeders and feeders must respond to this through using available genetics and ceasing to use fat to increase yield.

Fourth, producers must learn to understand or otherwise come to accept the term "mature market" and how it applies to the product beef. Philip Smith, president of General Foods Corp., explained this ably last week at a meat marketing conference in Dallas, Texas, using coffee as an example. It is not widely known that the coffee market matured some years back, but kept on growing through such innovations as instant coffee, flavored coffee, and decaffination.

Similarly, new products, and such innovations as fat trim programs will break the commodity logjam for beef.

Five, the marketing clout that's so badly needed, especially by cow-calf operators, can also be obtained through innovation. We are beginning to see the emergence of marketing cooperatives through which groups of producers pool their cattle for direct sale to growers and feedlots. Texas A&M University is presently experimenting with the concept of organizing these cattle according to genetics in an effort to provide the homogenity and predictability that will become increasingly important as the industry moves into branded products, et cetera.

Programs like this will cost the cowman some of his treasured individualism and independence, but better he should lose these than his livelihood.

Six, it will never be easy, or perhaps possible, for one sector of the industry to avoid depressing the economics of another. However, a try could be made by creating an industrywide production and marketing template on an annual basis. Such a template could provide valuable guidance for all sectors. In this connection, the U.S. Congress can play a role by maintaining a strong Crop and Livestock Reporting Service in the U.S. Department of Agriculture. The information generated by this agency is vitally important to cattle businessmen, and is virtually impossible for private industry to generate.

Seven, packer-processors and retailers are of vital importance to the beef industry. For example, retailers are today paring off the fat from beef cuts and in the process are adding viability to the product. Retailers and some packer-processors also taking the initiative in developing new beef products. The Kroger Co., for example, currently has 12 new beef products in test market that were developed in cooperation with meat suppliers.

Monfort, a Colorado meatpacker, is on the verge of launching nine precooked, microwavable products. In view of the poor record of the beef production industry to develop these products, restraint must be exercised by cattlemen when it appears retailers may be getting an undue piece of the action. A positive development in this area is that a dialog has at last been established between the leadership of the cattle industry and that of the packer-processor, and retailing industries.

Eight, you, Senator Abdnor, and your congressional colleagues share responsibility for preventing legislation in other sections of agriculture to impact on the cattle industry. Remember, the cattle industry epitomizes the market-oriented type of agriculture that was the objective of the 1985 farm bill. The cattle industry is vulnerable to damage from such programs as the whole-herd buyout in the dairy industry, and programs that put grain prices on an artificially high basis.

As you will note, I have avoided direct discussion of cattle futures, imports and investor money. These subjects have been debated over and over, and perhaps they need to be discussed some more. But, such discussion should not occur here at the risk of neglecting the more fundamental issues I have explained.

The industry has much to do and little time in which to do it. As I said, there are some things that you and other elected representatives can do to help. However, on other things it is best that you stay out of the way and let the cattle industry help itself.

Senator ABDNOR. Thank you, Fred. You certainly confirm my belief that journalists do have a very, very valuable insight to the cattle industry, or to agriculture and I want to ask, can I have a copy or do you have another copy of that report?

I know you have a plane to catch, but there is one other thing I want to say. I accept all the challenges we have, but we also need the cooperation of the cattle groups and I don't mean one, but all. They have to work with us to get the messages across and I'm not convinced we have all the livestock producers behind us. Now, I would be happier to see the Cattlemen's Association here today and I would like to think that we're going to get the support, because we can't afford to go before Congress and we have to do certain things to do. I would think you would agree to that?

Mr. KNOP. Yes, I would, and I want to congratulate you for bringing this hearing out here today because it has attracted the participation of more people than it could possibly have attracted had you held it in Washington.

Senator ABDNOR. I feel strongly on that and that is true. Maybe some of these people will generate some interest among others in various organizations.

Well, listen, thank you very, very much. It's quite a ways out to the airport. Do you have someone to take you?

Mr. KNOP. I'll get a cab. Thank you.

Senator ABDNOR. Yes, Mr. Seeley Lodwick. You certainly are a long ways from home and we are very grateful that you have stayed this long with us.

Personally, I was happy to see you here to hear some of the testimony. Maybe you hear it all the time, but this is coming out to the grassroots to hear it. We are very pleased to have you here today. I'm going to call on you, Mr. Lodwick, first, because I understand your plane leaves within the hour. So, whenever you're ready to go, go right ahead and start.

STATEMENT OF HON. SEELEY G. LODWICK, COMMISSIONER, U.S. INTERNATIONAL TRADE COMMISSION

Mr. LODWICK. Well, thank you very much, Senator, and I certainly appreciate the opportunity to be here. You were very kind to invite me to come and I'm always glad to get out in the country. I get home to the farm sometimes, but in fact, this last weekend I spent several days there at southeastern Iowa. I can't help but recollect some of my experiences as earlier I heard from the testimony this morning, because at one time there in south-central Iowa and some of the grass lands, we did operate a cow-calf herd and also fed out some cattle so some of the things that these folks were describing certainly we didn't have conditions then like they have today, but in general, the principles were the same.

It's also a pleasure to be here in the distinguished panel and particularly the opportunities you mentioned to hear the people who are directly concerned with the industry with that testimony this morning.

I think as we look around, that we obviously see many important and trying issues confronting our agricultural economy today and these issues are diverse in nature—covering such as Federal budget deficits, farm credit, surplus production, soil conservation, grain inspection, red meat demand, transportation, international trade, and more.

In fact, sometimes it even seems that the cattle problem is greater than some of its parts.

As much as I wish I did, I have no miraculous solution to offer for all these pressing problems, nor for the individual problems of the cattle industry.

However, I would like to share some thoughts with you this afternoon about two different trade-related subjects. Now, the first is a series of observations on international trade. The second is a discussion of the structure of an important U.S. trade remedy law.

But before beginning though, let me stress that I am speaking to you today on my own behalf and the views I express are my own and do not necessarily represent the Commission.

One could spend all afternoon and night, and the next day too, reciting observations on international trade which are discussed in Washington conversations, heard on the radio, seen in the press, and viewed on TV. But since we do not have all that time, let me distill them into the four most important ones.

The first observation is that it is no figment of imagination that protectionism is growing. Even among farm groups there appears to be a heightened concern about the effect of import competition on U.S. farmers.

For many, many years agriculture enjoyed such a large and growing surplus balance of trade that there was little reason to worry about the effect of imports. But recent developments have caused trade patterns to shift and producers of commodities heretofore unaffected by international trade competition are suddenly looking to Washington for assistance in holding back the rising tide.

Many of these developments which contribute to the protectionist mood among agricultural producers are the same factors driving other sectoral groups, like textiles, footwear, steel, and others to protectionism.

A second observation is a growing awareness by many agricultural producers that our trading partners are not playing the game of trade fairly. There is a common belief that the European Community's high production support prices, variable import levies and large export subsidies have instigated many of the current problems for U.S. farmers in international commodity trade.

Restrictive import policies, such as many enforced by the Government of Japan, also serve to limit the expansion of United States agricultural exports. Since exports are now equivalent to one-fifth of total U.S. cash receipts from farming, anything that limits U.S. exports directly impact upon total farm income.

Senator ABDNOR. Could I stop you?

Mr. LODWICK. Surely, Senator.

Senator ABDNOR. One-fifth are agricultural exports?

Mr. LODWICK. The exports are equivalent to one-fifth of the total U.S. cash agricultural receipts.

Senator ABDNOR. Is that a low or is that a high? I mean, hasn't it been higher at one time?

Mr. LODWICK. It possibly could have been a little higher. The one-fifth is a general figure and is accurate for, oh, probably 3 or 4 years on an average, but Senator, it's quite possible that just in the immediate years it was even higher than that and I do know in some commodities it is considerably higher.

Senator ABDNOR. OK.

Mr. LODWICK. This brings us to a third observation and that is a concern for agricultural exports. From their peak in 1980 to 1981, agricultural exports, like manufactured goods, have declined significantly in both volume and value. The decline in agricultural exports is attributed to several factors, such as the relatively high value or the dollar in recent years. Not only does the high dollar deter exports but just as significantly it lures additional imports to our shores.

A hopeful sign for a reversal of this trend is the 30-percent decline in the value of the dollar against other major currencies that has occurred this last year. However, since there is from 6 months to over a year lag between such indicators and actual impact, it will be awhile before we know how that decline will affect U.S. agricultural exports and imports.

Another factor affecting agricultural exports is that the United States continues to be the world's biggest provider of basic commodities as opposed to value-added or high-value commodities. The USDA has found that the unit value of all U.S. agricultural product exports is only $260 per ton, compared to an average value of $1,200 per ton for the European Community. In light of the recent falling prices for basic commodities versus steady prices for high value products, this factor has contributed significantly to our declining balance of trade in agriculture.

Still another factor is the severe debt situation in many less developed countries which has also contributed to the decline in U.S. agricultural exports.

For example, from 1981 to 1983, Mexican imports of United States farm products dropped by $1.3 billion, a decline of more than 50 percent. Over the same period, Brazil's imports fell by $210 million, a decline of 33 percent.

Furthermore, the strong recovery within the United States during the last few years has preceded such recovery in other parts of the world, thereby further exaggerating the strength of U.S. demand for imports in relation to external demand for U.S. exports.

The last factor affecting U.S. agricultural exports I'll mention is the effect caused by years of high Government commodity price support levels which disadvantage some U.S. crops in world markets. The recently passed Farm Security Act of 1985 addresses this problem. Another effect of this legislation will be to lower feed costs for the cattle industry.

All of these factors add fuel to the protectionist fire among people who traditionally believed that U.S. farmers are the most efficient, lowest cost producers in the world. As a result, those people believed that free trade would benefit them and it was in their long-term interest to support an open world trading system. However, in light of the factors just cited, the free trade advantage to U.S. farmers is somewhat skewed and this is one of the reasons why we are beginning to see a shift toward protectionism among some in the agricultural sector.

The fourth and last observation of regarding international trade is that the value and volume of agricultural imports are being scrutinized more closely than for many, many years, especially as they relate to U.S. produced food. A close examination shows agricultural imports totaled $20 billion in 1985. Of those imports, 33 percent or $6.6 billion were complimentary products, that is, products of which there is little or no U.S. production—like coffee.

The other 67 percent of imports are divided into 2 groups—those subject to some quantitative U.S. import restriction and those which are not. Cheese, dairy, peanuts, sugar, and meat are examples of those subject to quantitative limitations. And to some extent wheat, corn, grain, soybeans, et cetera, are also limited by a trade law known as section 22.

The other group of agricultural imports, those not subject to quantitative import restrictions, are subject to U.S. dumping and subsidy trade laws. This group includes live cattle.

Most United States trade in live cattle is with our neighbors, Canada and Mexico. During the past 5 years, total imports of live cattle ranged from 659,000 head to about 1,000,000 head without showing a discernible trend. This compares with average domestic slaughter of cattle of about 40 million head over that period. On average, about 60 percent of the imports consist of feeder cattle, mostly from Mexico, 25 percent of fed cattle from Canada, and 15 percent of calves and purebred cattle for breeding purposes from Canada.

The quantity of live cattle crossing into the United States from Mexico is determined by two primary factors: First, the number of export permits issued by the Mexican Government; and second, the demand of U.S. ranchers of feeder cattle. The number of permits issued depends on Mexican grazing conditions, feed availability, and domestic meat prices.

On the other hand, the quantity of live cattle imported from Canada, since duties are low or zero, depends primarily on the price relationship between the United States and Canadian markets for cattle and beef. Sluggish U.S. prices have served to keep imports from Canada below their 1982 level.

I just want to interject something here, Senator, and you are probably aware of this, but the International Trade Commission is going to be having a series of hearings along the Mexican border a week from today and it is quite possible that one of the subjects that will come up is the subject of imports of cattle from Mexico.

Just a few minutes ago I mentioned agricultural imports subject to U.S. dumping and subsidy laws, which leads in to the second part of our discussion this afternoon; namely, trade remedy laws.

There are several trade remedy laws which Congress has passed and which the ITC administers, but the two most common to recent agricultural commodities are the dumping and subsidy laws. Eighty-six years ago Congress passed a set of laws that discouraged other nations from subsidizing their exports to the United States and from dumping their exports on U.S. markets. Over the years, Congress has amended them to fit changing conditions. In fact, just last year the laws were amended. Congress has charged the ITC with the administration of those laws.

Specifically, the U.S. Congress, under the antidumping and countervailing duty laws has empowered the Commission to determine if unfairly traded items are injuring the U.S. producers of like items.

Let me stress at this juncture that the process is a two-track process. The domestic industry can be anyone. It can be a labor union, a trade association, it can be an ad hoc committee of various industry people or it can be a single individual. Not too many months ago there was a single individual from Texas that manufactured these little pads. They're called music pads and they fit in the saxaphone and he was having problems with these pads.

He walked in the door of the ITC and told them the problems and evidently he came before the ITC, and the interesting thing, Senator, is that he did not have a lawyer there. He did not have help at all except a little help filling out some of the papers, and he conducted this thing himself. He didn't have the money to put into a high-priced case.

Well, the domestic industry, whoever it might be, found, simultaneously with the International Trade Commission, which is one-track of the two-track system and with the Department of Commerce, which is the other track.

Commerce has two specific functions: First, to define the scope of the case, that is, to determine exactly what imported product is under investigation, and second, to calculate the amount of margin by which the foreign imports are dumped or subsidized. And to this, the Department of Commerce sent out representatives to the various countries to look at firsthand to see what the subsidies are and also, to see what, if any, the dumping margins are.

The ITC's responsibility is to determine injury and in this case they are responsible for making three substantive findings: First, the definition of the domestic industry and that is just exactly what it is that we're talking about as far as the domestic industry is concerned. This can get a bit complicated and I'll use an example later on.

The second thing the ITC does is to determine the existence of material injury to that industry. Is the domestic injury being hurt? And the third thing is finding a causal link between the unfairly traded imports and the material injury. In other words, are the imports actually causing the injury to the domestic industry?

Once a petition is filed, the ITC institutes a preliminary investigation to determine whether there is a reasonable indication of injury or threat of injury as a result of the subject imports. This investigation is completed within 45 calendar days from the day that it is jointly filed with the ITC and Commerce. These are statutory deadlines that the ITC complies with. So that a person that brings the case doesn't have to wait and wait and wait. The statutory deadlines are recognized and the ITC certainly abides with them. Now, if the Commission makes a preliminary affirmative decision, Commerce continues its investigation and makes its finding of dumping or subsidy. Once Commerce announces an affirmative finding, then the ITC proceeds to institute a final investigation of injury which takes 120 days to complete.

The first of the ITC's substantive findings concerning the definition of the domestic industry for the purposes of finding material injury is the one that has caused the most controversy in agricultural cases. This is because many so-called agricultural cases are filed by producers of a raw commodity input against imports of the processed forms of the product, rather than against imports of the raw product itself.

Examples of this include cases on frozen concentrated orange juice, canned mushrooms, and table wine.

The statute specifically states that the domestic industry should be composed of those producers of a like product. It further defines the like product as a product which is like, or in the absence of like, most similar in characteristics and uses with the imported article.

Therefore, the controversy arises as to whether, for instance, in the case of an imported canned food product, the domestic industry is composed of the farmers who produce the raw agricultural product which eventually goes inside the can or the companies that buy the raw commodity and then manufacture the canned good, if they are not one and the same, or perhaps both together. In fact, in each case of this type the decision of who to include in the industry for consideration of material injury has been made on a case by case basis.

In the past, the Commission has looked to certain factors for guidance on this issue. One is whether the structure of the production process is accurately characterized by a single, continuous line of production, starting with one raw material that yields only one commercially significant end product. In addition, in some cases the Commission has looked for a high level of interlocking ownership between the processors and the growers in the U.S. industry.

Many in the farm sector argued that the fact that farmers are sometimes excluded from the definition of the domestic industry has essentially precluded them from gaining equal access to U.S. trade laws for protection from imports. They contend that a farmer could be injured by imports of a processed product even though the processor is not. This is because the processor may be able to maintain a constant markup and simply pass through price reductions to the farmer in the form of lower commodity prices.

No doubt the debate on this question of whether agricultural producers should be included will continue. However, it is important to reiterate here that the question regarding the domestic industry is only one of the three substantive findings made by the ITC. The petitioner also must prove that he is materially injured and that the injury is due to those imports that the Commerce Department has determined are dumped or subsidized.

A relevant example of how these laws work, is the recently concluded countervailing duty case concerning live swine and pork meat from Canada. The Commission determined that there are two domestic industries—one producing live swine and one producing pork products. After carefully considering all the documents and the testimony presented before it, the Commission split its decision and found that U.S. producers of live swine were being materially injured by live swine from Canada.

On the other hand, producers of pork products were not being injured by Canadian imported pork meat products. As a result, the duty on Canadian live hogs has risen from zero to 3.1 cents per pound. In the months following the Commission's decision, imports of live swine from Canada declined about 56 percent, while imports of pork products from Canada increased about 19 percent over the same period.

To wrap up this presentation, we have listed four observations on international trade—protectionism is growing, an awareness that our trading partners are not playing by the rules, concerns for declining agricultural exports and interest in monitoring closely agricultural imports. And then we talked some about two of the trade remedy laws, the ones used most commonly in agricultural matters; namely, the dumping and subsidy laws.

In conclusion, let me commend you cattlemen here in South Dakota for taking such an active interest in international trade issues. The knowledge that these people have in both the agricultural sector and the legislative process, plus your ongoing determination, can permit you to lead the way in examining and perhaps adjusting U.S. trade laws so they are even more responsive to the needs of those affected by them, as well as for the benefit of our Nation in general. Again, thank you very much.

Senator ABDNOR. Thank you, Mr. Lodwick. Let me ask you something. What time does your plane leave?

Mr. LODWICK. 3:30.

Senator ABDNOR. We better go ahead with the other two gentlemen then, if you don't mind?

Mr. LODWICK. No.

Senator ABDNOR. You'll be in a little rush in getting to the airport. I understand the International Trade Commission completed a study on the competitiveness of the United States pork industry for Canada and the European economy. I would like to have you describe the studies and the findings and I want to ask you something else about that. Could you tell us about that study?

Mr. LODWICK. Yes, Senator. This study was completed a few months ago and, incidentally, it is available to any of your constituents that might want it and if he would get in touch with our office, or my office, we would be glad to send one.

It's entitled, "Conditions of Competition Between the United States and Canadian Live Swine and Pork Industries."

And then there was another one, later, that had to do with, as you indicated, with our committee and what it does, is it talked about the custom agreement talks with the United States and Canadian industries and that is kind of an industry profile where there are large hog farmers in Canada or small ones.

The retail price spread—it talks about United States Government and Canadian programs and it talks about particularly the Government program in which assistance is given to the pork producers. It talks about the U.S. market. It talks about the Canadian market and delineates precisely the imports and exports. And then eventually, it sums up about the various advantages and disadvantages that the two countries have. This is a rather extensive survey.

Senator ABDNOR. Yes. Did it take quite a bit of time?

Mr. LODWICK. Yes, it does. This one, Senator, was made at the request of the Senate Finance Committee and it took, if I remember right, about 10 months, or something like that, to complete.

Senator ABDNOR. Well, how do I go about getting the ITC to do a similar study for beef cows? I have a lot of complaints on that.

Mr. LODWICK. Senator, the method is that the House of Representatives Ways and Means Committee or the Special Trade Representative, or the Senate Finance Committee, all have access to the ITC to request a study like this, and I would think that you see fit to persuade the Finance Committee to write the ITC and that certainly there would be a prompt response, but I would caution you on one thing. It does take time to do this, but it would be certainly a very thorough study. We heard one mention this morning that maybe somebody was going to do an extensive survey and study about what I interpreted to be primarily the domestic beef industry.

And if a study like this was done by the ITC this would look into the competitive industry—international as just compared with within the United States.

Senator ABDNOR. Do you do a lot of those every time someone——

Mr. LODWICK. It varies. Usually 15 or something like that a year; 10 to 20 a year.

Senator ABDNOR. Have you been doing one with Canada on the lumber business?

Mr. LODWICK. No, but—oh, yes we did. There was a study that was made about the competitive conditions of the U.S. soft wood lumber industry and this came out not too long ago. The other thing, Senator, that is going on and that is that there is belief that perhaps some negotiations about the free trade zones between Canada and the United States might take place, and if that happens, the ITC will be called upon to analyze in detail, the various products that would be affected.

Senator ABDNOR. Well, now, do these studies—what does it take to constitute a violation? Where would you put restriction? I mean, how bad does it have to get.

Mr. LODWICK. Well, as far as the studies themselves go, Senator, they will—they do not involve recommendations and they do not involve any punitive actions at all, but as far as dumping or the subsidy cases, then the amount of subsidy is determined, or the amount of dumping and then that is reflected in an additional tariff on those products as they come in.

So, if the amount of the subsidy is say, 3 percent, why then there would be additional 3 percent tariff put on the commodity that is coming.

Senator ABDNOR. Using kind of a tariff. Do you ever just put numbers on it and say the quantity?

Mr. LODWICK. Yes, there are provisions under one or the other trade laws that provide for the International Trade Commission to recommend to the President of the United States under certain conditions that either tariff or quotas be put out, and in times past, sometimes the quotas have been put on and sometimes the press has seen fit to do not follow the ITC recommendations.

One thing I would point out, Senator, and that is in this particular case, the ITC makes a recommendation to the President to relief injury of the domestic industry and this was the case 1 year ago last summer; however, the President's responsibility is not only to look to the domestic industry, but his responsibility is to look at all the people in the United States. His responsibility is to look at the foreign policy and the defense posture of the United States as well.

Senator ABDNOR. I'm afraid the State Department ends up with a lot of the decisionmaking; at least I'm inclined to feel that way. What I witness and see, among other things like the grain embargoes. Well, I'm going to talk with Chairman Packwood and if I have any influence with him at all you can expect a letter requesting the study, because I personally have had some reports and we have heard today about the number of cattle—they are increasing—coming in from Canada. Apparently they're coming in large numbers and I'm afraid that we really aren't too restrictive. It can get bad if we don't do something. We have seen it with the hogs coming in too. Nevertheless, I'm sure we're going to be calling on you at the Finance Committee.

It takes a letter signed by Senator Packwood, is that the idea?

Mr. LODWICK. Yes, that is correct.

Senator ABDNOR. I hope he will cooperate.

Mr. LODWICK. Incidentally, we would be happy to cooperate with you, Senator Abdnor, and Senator Packwood, and the staff to work out the kind of information that you find most helpful.

Senator ABDNOR. Do you ever call on the industry itself in this country?

Mr. LODWICK. Yes.

Senator ABDNOR. They do have a chance to come in and testify?

Mr. LODWICK. Yes, this is correct. Oftentimes there are hearings in the field and in case—well, in the case of hogs, for instance, there was a hearing in Cedar Rapids, IA, and in other cases there was a hearing in North Carolina on furniture. There have been hearings in the South on fish, and yes, they are held outside and then if not outside, then they are held in Washington and anybody is entitled to come. In fact, we certainly welcome anybody that is interested at all and particularly the actual producers. They usually have helpful testimony.

Senator ABDNOR. Have they showed an interest or are they likely to get an opportunity to appear?

Mr. LODWICK. Yes, definitely. Now, obviously a site has not—well, we don't know for sure that the study is taken, but assuming that it would be, a site has not been determined, but yes, the individuals or the associations or the groups or whatever, we'll be glad to keep your office informed as things develop.

Senator ABDNOR. Going back a few years, we have always had trouble with beef imports, and not from just Canada. There is a quota figure that is triggered, and I guess what happens is that for a period of time no more cattle are let in.

Mr. LODWICK. Senator, I'm not familiar with that as I should be, but I'm under the impression that it relates only to meat as compared to live animals.

I would be glad to look that up.

Senator ABDNOR. What is the arrangement with Canada and with Mexico. I heard you say that is limited only to the numbers that the Government allows to come in. Is that the idea?

Mr. LODWICK. The Mexican Government issues permits and——

Senator ABDNOR. We have no control. They can bring as many as they want to in?

Mr. LODWICK. Depending on the permits and of course, Senator, depending upon the price relationship here in the United States too. If Mexican cattle, for whatever reason, are more expensive than similar cattle in the United States, I don't believe we will find too many people that are interested in buying it.

Senator ABDNOR. That is the only thing holding them up. They have the cattle to do it?

Mr. LODWICK. Under certain circumstances there could be a lot of cattle, yes.

Senator ABDNOR. Well, I don't know whether the numbers are on the increase from Mexico or not, but that could be a serious situation, I'm afraid. The other day I heard a Senator in the customs and I was wondering what the group of farmers were doing. Apparently they want to work out a deal with customs where they can ship American cattle down to Mexico and they bring them back with no custom charges.

They have to get clearance at least with customs to do it for slaughtering. Well, in the case of Mexico and pretty much Canada, then it doesn't make a difference on the effect of the price. They can pretty well keep bringing them in. Is that done by law so you have to follow that, or is that done—how is that done?

Mr. LODWICK. Well, Senator, the initiative has to come from the industry itself and if the industry thinks they have a case, then they come to the International Trade Commission and the Department of Commerce and the wheels start turning in regular process of a case.

But the ITC has no authority by itself to institute a case. It does have the authority to institute a study, but does not have the authority to institute a case.

Senator ABDNOR. You make your recommendations to the President?

Mr. LODWICK. Yes, in some cases we make them to the President. In the case of the subsidy or the dumping the additional tariff, if there is any, is automatically put in place and then the parties have an opportunity to appeal the ITC decision, but the tariff is put in place right away.

Senator ABDNOR. I understand that the International Trade Commission is sort of an office and program to provide assistance to small businesses and organizations in filing trade remedy cases before the ITC. Would the South Dakota Stockgrowers be eligible for the assistance?

Mr. LODWICK. Well, certainly associations are eligible for assistance. The purpose of—well, it's called trade remedy assistance Senator, and the purposes are twofold. One, is to disseminate information and the other is to assist small businesses and organizations and associations and so on. And certainly we would be happy to look into that and find out what the possibilities are.

Senator ABDNOR. Will you let me know?

Mr. LODWICK. Yes.

Senator ABDNOR. If they are, how do we get the ball rolling on that?

Mr. LODWICK. I have heard about it, but I'm not familiar with it.

Senator ABDNOR. Well, you say I want to go back to the agricultural exports. You say that apparently agricultural imports are coming into this country. Are there items that we ship out, is that what you're saying?

Mr. LODWICK. By and large, yes. And the specific numbers that I use, they are compared value per ton of agriculture exports of the United States where the value per ton of agricultural exports from the European Community and in the case of the United States, it was $260 per ton and this reflects to a great extent, our exporting of soybeans and corn and wheat, and cotton, and things like that.

Now, the European Community figure of 1,200 represents their exports of cheeses, of meats, of poultry, of textiles, to some extent and other value products.

Well, another one, Senator, is wheat, or I mean, flour. The European Community exports flour and, of course, we do too, but certainly not in that range and of course by exporting the processed products it certainly entails additional employment in the country in which those are processed.

Senator ABDNOR. You have to follow a GATT agreement when you make the decisions and things?

Mr. LODWICK. Our obligation, Senator, is to uphold the laws of the United States and obviously from time to time we take a look at the laws, but the binding mandate for the exchange and trade commission is to judge the merits of the case compared to the laws of the United States and that's it.

Senator ABDNOR. Sometimes I wonder. Let's take the example of the cattle livestock in a group. With all the restrictions they turn around with all their electronic equipment—or whatever it might be—and they ship it here. Do you take that into consideration?

Mr. LODWICK. The International Trade Commission takes into consideration only one product at a time and does not take into consideration the cumulated effect of—well, for instance, the problems the United States has with beef going into Japan versus the problems that the United States has with all the electronic gear coming in to the United States.

Senator ABDNOR. It's difficult for people to understand. Like the other day with Spain and Portugal was it?

Mr. LODWICK. Yes.

Senator ABDNOR. With all these, I guess they come to the ECC, the restrictions on soybeans.

Mr. LODWICK. Feed grains.

Senator ABDNOR. And products and we have to sit back and look at it. It's a very difficult thing to understand. I assume there is work going on right now, I think, with them in trying to make them back off of that but that doesn't—whatever transpires there doesn't have an effect on the decisions you make because yours is only on the single product?

Mr. LODWICK. We take one product at a time. The other characteristics of the International trade Commission, Senator, is the fact that it is pretty much a quasi-judicial operation. It is pretty much like a court. Pretty much like a judge, whereas the U.S. Trade Representative and the Secretary of Agriculture or Secretary of Commerce and so on, are involved in policy developments and also in policy advocacy.

The International Trade Commission is not involved in policy development. It's not involved in policy advocacy. It is 95 percent of its resources are used as a quasi-judicial body.

Senator ABDNOR. Well, thank you very, very much for coming here from Washington. I'm sure there are people here that would love to ask you questions, but we appreciate the fact that you were here to listen to some of the testimony from some of the witnesses. We don't normally do this, but I have to call on Jack first.

STATEMENT OF JACK McCULLOH, SOUTH DAKOTA STOCKGROWERS ASSOCIATION

Mr. McCULLOH. I would like to point out that to my knowledge one of the last ITC hearings on beef was held in this community and while I am not too accurate as to the dates that that was held, I guess the thing I would like to point out is that we have been through this route.

The Commission was here. They took a look at the whole process and if I have anything to contribute to this part of the discussion we'll welcome that at this point. The point has been made here in terms of our frustration as a result of the study. It was on the basis of beef. Live is exempt. We were attempting to demonstrate economic problems in terms of the borders that was beyond the scope of the study—beyond the reach of the law and it may be helpful to have that noted at this point and I think you have covered it, but I'm not sure that there is yet among the kind of people that I represent, a clarity and a full understanding of the narrow area that you look at. And in its application in terms of where they really are.

And again, it's been generally covered in the testimony, but if you can expand on that point using the Rapid City results as an illustration it would be helpful for this record. Thank you.

Senator ABDNOR. How long ago was that, Jack?

Mr. MCCULLOH. Well—do you recall, sir?

Mr. LODWICK. No, I don't. It was prior to my being on the Commission and I've been on it about 2½ years.

Mr. MCCULLOH. I'm going to say 6 or 7 years. If anybody in the audience recalls this? Well, 6 or 7 years ago right here in Rapid City. I have documentation for it, the whole bit, but 6 or 8 years ago and again, to be clear about what I'm trying to say, it was on the basis of feed and so here comes the volume, because it was on the basis of a formal complaint by the industry—by an organization and as far as—I know it was well done, but when you get down to the end of it and say, hey, the Mexican and Canadian and other live imports have no effect on what we're investigating, the air is out of our balloon, or the frustration has increased.

Mr. LODWICK. Senator, I would be glad to look that up when I get back to Washington tomorrow and be in touch with your office.

The other thing, Senator, that might be helpful and that is if you and your staff are interested and certainly as your constituents might be, either from here or as they visit in Washington, but I hope you will feel free to call on me any time and set up meetings and look into some of the things that Mr. McCulloh discussed and so on.

Senator ABDNOR. I appreciate that very much and I'm sure Jack does too.

Maybe we can get an answer back to you when he is familiar with the situation. Thank you. We'll move on once again. Thank you for coming.

The next witness is Jim Nix from the World Agricultural Outlook Board, USDA. Mr. Nix, I'm one of the people who is not totally familiar with the Outlook Board. Why don't you tell us a little bit about you?

STATEMENT OF JAMES E. NIX, AGRICULTURAL ECONOMIST, WORLD AGRICULTURAL OUTLOOK BOARD, U.S. DEPARTMENT OF AGRICULTURE

Mr. NIX. Thank you, Senator. It's a pleasure for me to be here today to look at some of the factors that affect the cattle industry and as a member of the World Agricultural Outlook Board, this is the type of thing which I'm constantly involved with.

The World Outlook Board is a small agency in the Department of Agriculture and we work primarily in the outlook reports. We chair the committees in the Department which work on the forecasting and then we work with looking at policies. Some of the programs and all that comes down from analysis we work with different programs in the groups in analyzing these.

Some of the topics that I've been asked to look at today was on the investor-owned cattle feeding, the cattle and beef imports, and relevant provisions in the Food Security Act of 1985. Many of the factors that we have that are affecting the cattle industry—some of them are ongoing things like the imports that we've been talking about and others are new developments which comes up in something like the Food Security Act.

One of the most important current trends is that the U.S. cattle inventory has been declining. In fact, as we look at the size of the breeding herd that we have now, it points toward another decline in the total inventory this year.

As we look into this investor-owned cattle feeding, first I want to do a little background information on the cattle feeding industry. During the past 3 years, cattle feeders in the 13 States for which USDA makes the quarterly estimates and these count for about 85 percent of the cattle fed in the United States. They have marketed between 22.5 and 23 million head.

This was about 50 percent more than these States marketed in 1965, which is about 6 percent less than was marketed in 1978, the year of our record high marketing of fed cattle.

The cattle-feeding areas and feedlot sizes have shifted during the last two decades. For example, in 1965 Iowa accounted for about one-fifth of the cattle fed in the 13 States. Illinois accounted for almost 9 percent, and Texas, for another 7 percent.

But last year, Texas fed 22 percent of the cattle marketed in the 13 States while Iowa accounted for less than 8 percent and Illinois only 4 percent.

These changes reflect a general shift from the farmer-feeder type operations to the commercial feedlots. South Dakota has accounted for 2 to 4 percent of the marketings throughout the last two decades.

Senator ABDNOR. Are they up and down?

Mr. NIX. They fluctuated along with the numbers in South Dakota which have fluctuated along with the total for the United States so that they have maintained roughly the same percentage, whereas there has been the other shift like from Iowa to Texas we've had an increase in the percent in Texas, and some of the other States to that has larger commercial lots. I use Iowa and Texas as two examples here.

The number of feedlots has dropped about two-thirds since 1965, with the decline being in feedlots with under 1,000 head capacity. Even though these under 1,000 capacity feedlots still accounted for nearly 97 percent of all feedlots in 1985, their share of the marketings has dropped sharply from 54 percent in 1965 to around 18 percent in 1985. And the number of lots with a capacity of over 1,000 head or more has increased slightly, but their share of the marketed cattle rose from around 46 percent in 1965 to over 82 percent in 1985. Using 2 years in here and you can get some shifts around, but I think it illustrates the shifts that we have been seeing from the smaller lots and numbers and what they're accounting for in the total, and to the larger lots accounting for a larger percent of the total cattle marketed.

The ownership of the cattle varies by the size of the feedlot and probably by region in which the cattle are fed. The smaller feedlots are primarily the farmer-feeder type operations and the feeder generally owns most of the cattle. And in the large commercial feedlots, however, ownership is more varied.

A high level of capital investment and operating capital is required to operate the large commercial feedlots. And many of the large lots depend on custom feeding to keep their lots operating near capacity, thus spreading their fixed costs among more head. And they offer their services, then, to many different clients including ranchers, packers, and investors.

There is not a lot of data available, really, on the investor-owned, and you know, the exact numbers and all, but there are a couple of studies in two States that gives us a little insight into that. These are from Colorado and Texas. And the Colorado study, 73 percent of the feedlots surveyed did custom cattle feeding 1983. All of the feedlots with a capacity of 16,000 head and over custom-fed cattle, two-thirds of those with a capacity of 8,000 to 15,999 did, and one-half of those with a capacity of 4,000 to 7,999 did custom feeding. And 58 percent of the custom-fed cattle were owned by nonfarm investors. This included 50 percent of custom-fed cattle by nonfarm investors. This included 50 percent of the cattle in the feedlots with a capacity of 16,000 and over, and about 60 percent in the other.

Now, the Texas study found that during 1980 and 1981, almost three-fourths of the cattle fed in Texas were on a custom basis. About 35 percent of the custom-fed cattle were owned by cattle buyers and investors, and that they fell into there and then there was a small other percentage that were done by some feeding funds. And then a lot of the cattle that were fed then, were owned by ranchers.

This was down from what it was in 1972 through 1974 when the occupations of over 90 percent of the cattle feeding fund investors in Texas feedlots were nonagriculturally related. During 1980–81, feedlots with 4,000 to 31,999 head capacity fed a higher proportion of cattle on a custom basis than did feedlots which had a capacity of over 32,000 head.

Now, the changes that we have had in the tax laws have made it less attractive to the investors than what it was several years ago. And as we heard today, that there is still quite a few of them that do have the investor-owned, but I think the tax laws as have been discussed today, will have something to do with the trends that we see in the future.

Mr. Lodwick covered quite a bit on the beef cattle imports. I have some in my testimony that essentially about the same thing, about the factors from Canada and Mexico that effect it. I might say that on the beef imports we do expect that the beef imports are going to be up a little this year than what they were in 1985, but they won't be enough to trigger the meat import law and that meat import law is just for meat.

It's the fresh chilled and frozen beef that comes in from the countries that can ship to us the fresh chilled and frozen type. It does not cover some of the canned beef that comes into the countries that have had the problems like the hoof and mouth disease.

Senator ABDNOR. What about the numbers of live cattle? I know you're not——

Mr. NIX. The meat import law——

Senator ABDNOR. I know that. What do you keep track of?

Mr. NIX. The live number?

Senator ABDNOR. Yes.

Mr. NIX. The live numbers have fluctuated a bit over the years and they have ranged from 390,000 head in 1975 and this was the year when the cattle feeding wasn't too good and we didn't get very many imports. As he was saying, that that was a big factor in determining the imports from Mexico and that year we got very few cattle in and we have been up as high as 1.25 million head and that was in 1978, and that was the year that we fed more cattle in the United States and marketed them out of feedlots than we have in any other year. So, it is a lot to do with what the Mexican Government will give the license for the expert, but then to, it is the demand for feeder cattle in that area that has a big influence on it.

We were somewhere around 800,000 last year.

Senator ABDNOR. I guess I have a problem, wondering why Mexico would restrict any members. The market down there can be as good as ours.

Mr. NIX. Well, it's when they're trying to hold their beef prices. If beef prices are going up too much and the Government can try and hold a few more cattle in the country and hope that is going to please the consumer side, I think, you know, in Mexico as far as if they keep a few more cattle home then hopefully the retail prices won't go up as much. So, that is part of the thing they get into in looking at those licenses and then a lot of it is what the feed supply is. Sometimes if they have good grazing and they want to keep them around and then another year they want to turn them loose if they don't have the grazing for them. We might shift now and look at some of the provisions of the Food Security Act and I guess one that has created the most interest and is one of the dairy termination programs. The whole herd buy out as we call it.

This program will result in an increase in the supply of beef during the next 18 months. The Secretary announced Friday that USDA has tentatively accepted 13,988 bids to participate in the dairy termination program. And 39,534 dairy farmers submitted bids, but there was three periods in which they could put the bids in and they could put them in one or more of those periods and this resulted in over 105,700 bids being submitted.

Those submitting bids marketed about 33 million pounds of milk in 1985. This is equivalent to 23½ percent of the U.S. total. So, the one's submitting bids submitted bids enough if all of them had been taken or to have taken 23½ percent of the milk production out. The bids tentatively accepted were resulted in a reduction in milk production of about 12.28 billion pounds.

Now, the number of animals that are to come out of dairy herd as a result of this for the entire period is 951,619. All these numbers are preliminary and they are making their final adjustments on those, I think. In addition to those cows, these 340,789 heifers, these would be bred heifers, or over replacement heifers, that is, held in the breeding herd and then in addition to that, there are almost 258,000 dairy calves to come from those farms.

This is, I guess, what you call it, frontloaded into the first period, which is April 1, 1986, through August 31, 1986, and during this period there are 633,176 cows. In all of this results in the marketing being at about 8.7 percent at 12.2 or 8,000 pounds and of the milk that is marketed in 1985. The afterhand bid was $14.88 under that and anybody that submitted a bid of $22.50 or under was accepted. For South Dakota, the marketing that, or the bids that were accepted equal to the 11.7 percent of the 1985 marketing, so that is 11.7 percent of the milk market in 1985 that would be accepted into this program and expect that type of a drop in production from South Dakota during this period of time.

Senator ABDNOR. What's the number of head?

Mr. NIX. All right. We have 18,951 cows and 6,135 heifers, 4,871 calves.

Senator ABDNOR. Is that over the 18 months?

Mr. NIX. That's over the entire period and again, it's like the United States and it's frontloaded in the first period with almost 12,000 of the cows coming out in the first period that is between now and August 31. And incidently, the average bid in South Dakota was 13.88 which was a dollar or hundred under the U.S. average.

There were 994 contracts submitted in South Dakota and 452 of the bids were accepted.

Senator ABDNOR. Would you make any kind of projections? What effect would that have on the cattle market?

Mr. NIX. Well, I think that today it has already happened. What I was afraid of when I saw the numbers on Friday. It is more because particularly in the early part of this period than what I think the market had built into it.

Senator ABDNOR. What do you think?

Mr. NIX. Over a long period it is going to be negative on cattle prices. This is going to be more beef than what was expected and we have come out of a fed supply and I think our fed cattle numbers were tightening up a bit over the next month or two from what they had been over the past couple months when we have seen prices under pressure and we were looking at this. We may still get some increase in prices later on over the next few weeks as this thing kind of gets itself worked into the market, but still, it's going to take—I don't think the process is going—the prices are going to be as high this spring as what they were expected to be.

Senator ABDNOR. Suppose they are going to buy 400 million pounds for school and military. That is not going to be a pound-for-pound balance is it?

Mr. NIX. Right. Well, let me come to that in a second and give me one more thing on the supply side then. The thing about the dairy cows are that they are heavy animals and they are a lot heavier than the beef cows that we haul out of the beef herds and the carcasses that come from them are going to be heavier than our average cow carcass that we usually see. So, we could have from those total numbers here, over the 18-month period, it could exceed 550 million pounds just from the cows on that.

If you had dairy cows that were averaging on the carcass, up to 590 pounds, which some of them do, like the holsteins.

Senator ABDNOR. 1,100 or 1,200 pounds?

Mr. NIX. You have the heavy dairy cows that weigh probably 1,200 or more probably. The other thing on this that we need to remember is that these 951,000 head is not an addition to what we would have had. We have a normal addition of dairy farmers and these are people that are paid to go out. They would have gone ahead and been a part of the normal dairy cow slaughter and some of the others in it would have been.

Senator ABDNOR. So, do you think it may have an adverse effect on cattle prices. It might be a boost to it, but if the regular dairy numbers aren't coming on board for the sale very year——

Mr. NIX. This is the positive thing from the dairy program now. Back 20 years ago, or 30 years ago, beef from the dairy herd made up a large majority of the total beef supply. The dwindling number of dairy cows that we had brought the beef production down from that majority and made it a more positive environment for the beef producer. And from the beef producer, I'm talking about the non— from the nonpart.

If we get the cattle numbers down in total, the cattle numbers are down now and the dairy herd would be down and that would be positive over the longer term. The important thing is that we maintain a program for the dairy industry that doesn't get us back into the type of situation we have been in for the past several years that gave them the incentive for overexpansion.

Senator ABDNOR. What, do you suppose, will be the initial impact? Are the numbers up more later? The Government buying will be mostly in that first go around will it?

Mr. NIX. The secretary announced Friday that the purchases were going to begin immediately under this—under the Food Security Act. They were to buy 400 additional pounds of beef or meat than what they usually do. Now, the Agricultural Marketing Service [AMS], usually supplies 125 to 145 million pounds and it goes to school lunch programs and other needy programs. And 200 million of the 400 million goes to the domestic market so this is 200 million more pounds that they are to buy for these dispensation programs in the domestic market and we're talking about 24 million in addition to the 145 they had, so that's a significant increase for them to deal with.

Senator ABDNOR. If you have 400 that must mean the remainder is going to the Government. You're talking about 600-some and isn't that many more pounds. What was the figure? How many pounds is this going to amount to all together?

Mr. NIX. The cows were somewhere around 550 billion if you take them as a total. It wouldn't be in addition.

Senator ABDNOR. No, I know. If you take 200 million of that first and going around, and everything is left over, it will be bought by the Government?

Mr. NIX. The 200 is to be in 18 months prior, but they're going to begin buying canned beef and the ground beef immediately.

They're trying to get that program underway.

Senator ABDNOR. Well, the Government isn't going to take 400 million of the market and there is less than 200 million going on the market?

Mr. NIX. Right.

Senator ABDNOR. Over the 18 months and most of that is coming in the first go-around?

Mr. NIX. The production will and they will try to get the program started today and the other 200 million though, is for the exports market or for use by the Department of Defense and that is where they're working then, to try and find markets or at least to get that meat in so some of it—since it was there, would be impacts not only on the cattle industry, but also on the pork industry from the additional cows from the dairy termination program.

There will be some pork buying probably, but the primary thing is going to be beef and so what we will have is to buy 4 million additional pounds and that is in addition to the normal purpose. Two hundred of it for the domestic market. Two hundred for the export market and that will take a large part of the total of the market, but it does have to be distributed back into that 200 million which comes back to the domestic market, so you have the problem there of where you can have additions or where you have some displacement and it will be very important that the donations and all, like the school lunches and other needy programs that we don't have a displacement of beef that we would have sold them anyway.

Another provision in the Food Security Act established the cattlemen's beef promotion and research board is composed of producers and importers. The board will be responsible for carrying out a research and promotion program which would be funded by $1 per head assessment.

Senator ABDNOR. It will come under you?

Mr. NIX. This won't. The Agricultural Marketing Services is the one who handles the beef promotion programs and any of the marketing orders and promotion-type programs. And this is underway now as far as setting up all these and the Agricultural Marketing Service is now asking for comments on these and we'll be holding hearings for this program.

Senator ABDNOR. Isn't there a commission that goes with that too?

Mr. NIX. Yes, they are setting up a—it provides for a beef promotion operating committee composed of 10 members elected by the board and 10 producers members who are directors of qualified State counsels and they will be the ones who are calling the shots. In other words, on this program but it does have to—it has a referendum which it has to pass after a period of time for it to continue and the initial assessment of the revenues raised under this program that will be $70 million annually of funds to be raised under this program.

The Security Act also has provisions that are expected to affect feed supplies and prices. The grain programs are expected to result in lower levels of grain prices and make U.S. grain more competitive on world markets. And as it does this, it holds the feed costs down for the livestock and poultry producers and feed costs have already been down from levels of a year ago and this helps a little bit on the returns to the producers when they're squeezed from the other side with the low prices.

Senator ABDNOR. While we're at it, so we don't get mixed up, let's point out that doesn't mean the prices drop at all?

Mr. NIX. Right.

Senator ABDNOR. It isn't going to cause a drop in the income because of that? The prices stay the same?

Mr. NIX. That is correct, but the market prices can buy the grain at a lower price.

Senator ABDNOR. Well, I was hoping it would help increase export sales overseas.

Mr. NIX. That is correct and depending on what kind of growing conditions we have this year, but with the provisions of the act and then the stock that we have now, it is likely that feed costs are going to hold down and we'll have another year to at least—of relatively low feed costs for the livestock side. The act also results in a lot of acreage being taken out of these price supported crops and we have been into some discussions already today of the crops that will be established on those and whether or not they will be grazed. A lot of these do depend on the State Agricultural Stabilization and Conservation Committee in the various areas. They determine whether it can be grazed.

Senator ABDNOR. The Senate can overrule that to?

Mr. NIX. Right, but one of the things it does do is that I think we have seen it before when we had things like this if we do get into severe droughts, it has a cushion out there at times and it helps the cattle industry along. We have enough grazing right now to support the reduced cattle herds, you know, in most parts of the country.

Senator ABDNOR. That's because they ran out of feed and they reduced the amount. At least in South Dakota there were a lot of cattle dispersed because of the lack of feed.

Mr. NIX. That is right, but if you had more of this type of acreage from the cuts back in the other crops it might help cushion this type of a situation for the cattleman. I think that sums up the remarks I had.

Senator ABDNOR. You heard today from those opposing the livestock reporting service. I suppose what they report comes from you does it? From the Outlook—from your group?

Mr. NIX. The reports that the crop reporting service, which we use them as inputs ourselves and we try to analyze those reports. The crop reporting board, you know, they do their service and then I get that information at the time that everybody else does when they are released.

Senator ABDNOR. Well, they have had some great discrepency in the figures and the actual totals when the time came, and in some cases it's had bad effects on market prices. We haven't talked about that today, but I remember the situation with soybean. I think we found that situation with cattle last year. We have all this heavy cattle and the testimony of many of the livestock groups tells us what they read and that projections in the fall cattle were going up, so they all got the cattle up to 12 and 13 pounds instead of 1,000 and 1,100, which makes it excessive, even though the numbers weren't there—the numbers of cattle—the weight was there, and it created many of the problems we had; isn't that correct?

Mr. NIX. Well, I think one of the things that has happened in trying to look at the numbers and forecasting from them is that the cattle inventory has been coming down and under most circumstances this would suggest that we were going to get the drop in beef production and we have ended up with several factors that haven't let it drop like most people expected. And what I would think would be normal under "Normal circumstances" in the farm financial situation, and we have heard today that a lot of people have had to continue to market their—some of their cattle because of this and I think that that kept more of the breeding-type animals on the market last year and that health beef production up when you haven't had that kind of forced selling. You certainly would have seen a larger drop in production.

Senator ABDNOR. I think I remember about a year and a half ago when we were looking into soybeans, and all the projections and reports of the livestock. The crop reporting said soybeans were going up to $7 or $7½, and then they ended up at $5. And I think everybody was hanging on to them because they were told it would be higher and they weren't happy with the $6. They were going to get $7 or $7½. So, there was a lot of ill feeling and bitterness. We have had amazing numbers of people thinking we should do away with livestock reporting.

I was bringing that up in the farm bill this year and I ran into a lot of opposition, I must say, but depending on the accuracy, it does cause concern and they tell me the projections go on when the Department of Ag did it.

Mr. NIX. I think that is true and the fact that—I think, and it is a bias opinion, that the Department does a fairly good job on this and the forecast and all the data are accessable to everyone, and if someone else would be doing the surveying and this type of thing and they would not be agreeable to everybody if they were coming from these types of things and maybe they would not get as good a coverage on the surveys as the Department does and the Department runs into more and more problems, as you know, in their responses and the data they gather can only be as good as what we give them when any of us have an input into something.

Senator ABDNOR. One last question, Mr. Nix, because I know we have had you here quite awhile. In your opinion, what needs to be done to neutralize this neglect of the cattle markets of the Dairy Buy-Out Program. Do you think we need to have some legislative action?

Mr. NIX. Well, I think that the thing to do is to try to work within what we have got. We have got this buy—purchasing of the beef and it's to be as aggressive as the Department can be in trying to purchase that beef and I think from what the Secretary said on Friday, that the intent to get that going immediately and to get as much of that off the markets as we can. Then to go ahead and get these dairy cows out and get that surplus down, but then to make sure that the Dairy Program does not get into a situation of where it brings on the incentive for producers to over expand again.

And the thing—that's when we said the feed cost for the cattle producers are going to be down, because of the lower grain prices. We have to look at that. It's a reduction in the feed cost to for dairies, so that, you know, we don't want a program then to be in place on the dairy side that if the feed costs stay down at a low level that the ones in the areas where they can produce to the low cost over expand and come back and get the inventory numbers from the dairy side up, which causes a problem not only on the purchase in the diary products, but the Government—it also adds to the beef supply again.

Senator ABDNOR. You are more familiar with the dairy than I thought you were.

Mr. NIX. I deal with dairy and poultry and cattle and hogs all the time.

Senator ABDNOR. Is there a discrepency that exists between the North and South. Has that been there quite awhile?

Mr. NIX. There is differences there and the farms—the Food Security Act is putting together some more provisions in that, I think. I am not familiar with the workings of those marketing orders, but it is going to keep the differentials in place.

Senator ABDNOR. Isn't it true that most of the milk in the South doesn't rely on price supports of any kind?

Mr. NIX. It goes primarily into the fluid market.

Senator ABDNOR. Very little actually goes—that's why they yelled so loud. They didn't like the 10 cent assessment because price supports really don't bother them the slightest. Instead of reducing the price supports of 50 cents a 100 under the Gramm-Rudman cuts for the dairy buyout, we changed that over to a 10 cent a 100 assessment or maybe 12, but every dairy person in the country would be assessed. We have to make the load a lot lighter on our people up here, because that support thing really was relative to the people in the South and they apparently have a market for all the milk that they have.

Mr. NIX. Very little of it would go to the processed product, but this is where we have a big part of our participation in this program. In Georgia, about 22 percent of the 1985 marketings are signed up under this program. Alabama, with 24 percent and Texas is up to 16, so we have got a pretty high level of participation among the Southern States.

Senator ABDNOR. Why do you suppose that is?

Mr. NIX. They were signing up to go out of this. Their cost of production. This is where Wisconsin only had 3 percent of the marketing and Wisconsin, the largest State signed up.

Senator ABDNOR. Does that surprise you? It does me.

Mr. NIX. I guess that I thought maybe some of the—that there would be more operations in the big dairy States that might have participated in this program, but we expect that some of these other States do have a higher cost and support prices haven't been cut down and we're in a whole U.S. market so that the program operates in. And we had a bigger participation in that diversion program in some of the Southern States and there was milk called during some periods of the time into those States from the others to supplement that.

Senator ABDNOR. So, it's not practical to try to live on milk from here to—raw milk from here to the Southern States because I think we could undersell them.

Mr. NIX. That's what they did.

Senator ABDNOR. The other thing was to ship the dry milk?

Mr. NIX. They had a lot of tanks of milk that went south.

Senator ABDNOR. How far away?

Mr. NIX. From Wisconsin and I haven't had the chance to—we'll be sitting down and looking at all the numbers later this week, but I think on the surface there may be some milk called again this fall when we get through the season and by the time they have made the adjustment in the States where the biggest production cuts are coming.

Senator ABDNOR. It's pretty apparent that milk is a heck of a lot more costly to a consumer in the South. If we can haul our milk down there and compete with them, that's all I'm saying. That tells us something that they obviously are not relying much on price supports regardless of what the marketing order says.

Mr. TOSTERUD. I would make one point. I would say that the non-traditional dairy States that are the larger percentage of their dairy farms are going out of business or being bought out. It suggests that the dairy industry is returning back to its more traditional area such as Wisconsin and the upper Midwest.

Mr. NIX. Well, it never has left. The others have probably expanded more. That is where the expansion has come, I think, in a lot of the other States and I'm not sure of the numbers exactly, but California and some of the Western areas have had big expansions in milk productions in the last several years and some of the Southern States probably have expanded and now they're the ones who seem to be pulling back on the production.

Mr. TOSTERUD. Do you have a feel for the size of the operations that have gone out of production or are bought out?

Mr. NIX. I tried to calculate guesses here on part of it on the plane last night, but roughly it looks like in California you're looking at $350 or so average size of herd that went out. I'm not sure of the numbers yet, because they will have the data, I think, later on that we will get, but then you get into like Wisconsin that might have been 37 cows per farm that went out, so you were looking at those that did go out. They're mostly very small ones and the ones in Georgia, it looks like, it was around 136.

Mr. TOSTERUD. So, those are basically average operations on a State level?

Mr. NIX. I do have larger operations than you had in Wisconsin and some of the traditional dairy States where you had a larger number of small dairy farms, but you have large ones in the Western area, but you did get—you have large farms into this Buy-Out Program it looks like.

Mr. TOSTERUD. I recall the debate and during the farm bill on this Dairy Buy-Out Program and the quid pro quo and all this to protect the cattlemen was the Government purchase of 400 million pounds of beef and it was argued at that time that that would not raise the price effects on the cattle market. Well, obviously given the evidence today with the prices going down, I admit that hasn't been the case at all, that perhaps 400 million pounds wasn't enough.

Mr. NIX. Well, today though, there is no additional dairy cows on the market and there hasn't been any purchases. Everything has happened today in a psychological-type thing preparing for what is going to happen.

Mr. TOSTERUD. But the market has known for months that this was coming.

Mr. NIX. And it may have a couple hundred thousand out this way or that way, but the market has known for months that this was coming down the pike, and you can't tell me that the market hasn't adjusted over the last several months to accommodate that and all of a sudden when the numbers hit the newspapers, we get hit by another buck and a half.

How does one explain that kind of a market?

Mr. TOSTERUD. The market did not anticipate this much though.

Mr. NIX. Maybe they anticipated 750,000 but I think we're really talking about the margin here. I think the market probably in this first period where we get 600,000 or more may have been anticipating 300,000 or 350,000.

Mr. TOSTERUD. The market is a smart operation and you know that, and I can't believe they haven't had the fingers on the pull of dairymen as they're signing up for the program and they may have known well before the Secretary of Agriculture as to what the final number is looking like and it appears it's purely speculation as to what it is. I have a great deal of trust in that market. Trust in the sense that I think they measure or they know what is going to happen well before all of us do perhaps.

Mr. NIX. Well, I had some calls Friday when they heard there is a press conference and there was a lot who really wanted to know. I didn't know what it was until I went to the press conference and I couldn't give them any information and they—after the press conference, and I got back and started returning calls, they were surprised it was that high.

Mr. TOSTERUD. All in all, do you think the Dairy Buy-Out Program is good?

Mr. NIX. Well, I think it has to be tested. We have to have something that gets the dairy numbers down and the surplus to where we're not purchasing those levels of dairy products. This is the method that was given for us to do that. Now, they may have been other methods that are good or better, but this is one that we have now and I think the thing we have to do now is try and make this thing work as far as we are into it and it can be positive for all of the agriculture.

I think if we get the surplus down on the dairy side so that we're not buying those products and it's positive for the meat side that we don't get that production from that of the beef side or the meat supplies from those animals.

Senator ABDNOR. Do you have a better way for the system?

Mr. NIX. I think it would have taken time, but if the price supports had come down, I think the cuts we have seen—the price supports never did get to really work because the feed cost keep dropping right along with the price support cuts, so that you really weren't changing the net effect there. You weren't getting what you thought you would if you had just cut the dairy price support and held your feed cost up there and if we had the keys on the return from that side, I think that would have got them out and it might have taken longer than what we'll get over the next six months. Thank you very much.

Senator ABDNOR. I apologize, but we appreciate the opportunity to talk and ask you these questions and thank you for coming all the way from Washington. It is good to come out and hear the discussions and to have you participate in them.

[The prepared statement of Mr. Nix follows:]

PREPARED STATEMENT OF JAMES E. NIX*

Thank you for the opportunity to be here today to address some topics that relate to the future of the American cattle industry: investor-owned cattle feeding, cattle and beef imports, and relevant provisions in the Food Security Act of 1985. Many factors affect the cattle industry--some ongoing and others that are new developments. One of the most important current trends is that the U.S. cattle inventory has been declining. In fact, with the reduced size of the breeding herd, there likely will be another decline this year.

Investor-Owned Cattle Feeding

Before discussing investors' role in cattle feeding, I would like to provide some background on the cattle feeding industry. During the past 3 years, cattle feeders in the 13 States for which USDA now makes quarterly estimates marketed between 22.5 and 23.0 million head annually. This was about 50 percent more than they marketed in 1965 but around 6 percent less than was marketed in 1978, the year of record large marketings.

Cattle-feeding areas and feedlot sizes have shifted during the last 2 decades. For example, in 1965 Iowa accounted for about one-fifth of the cattle fed in the 13 States. Illinois accounted for almost 9 percent, and Texas, for another 7 percent. Last year, Texas fed 22 percent of the cattle

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marketed in the 13 States while Iowa accounted for less than 8 percent and Illinois only 4 percent. These changes reflect a general shift from the farmer-feeder type operations to the commercial feedlots. South Dakota has accounted for 2-4 percent of the marketings throughout the last 2 decades.

The number of feedlots has dropped by about two-thirds since 1965, with the decline being in feedlots with under 1,000 head capacity. Even though these under-1,000-head feedlots still accounted for nearly 97 percent of all feedlots in 1985, their share of marketings dropped sharply from 54 percent in 1965 to around 18 percent in 1985. The number of lots with a capacity of 1,000 head or more has increased slightly, but their share of cattle marketed rose from around 46 percent in 1965 to over 82 percent in 1985.

The ownership of the cattle varies by the size of feedlot and probably by region in which the feeding is occurring. The smaller feedlots are primarily the farmer-feeder type operations and the feeder generally owns most of the cattle. In large commercial feedlots, however, ownership is more varied. A high level of capital investment and operating capital is required to operate the large commercial feedlots. Many of the large lots depend on custom feeding to keep their lots operating near capacity, thus spreading fixed costs among more head. They offer their services to many different clients including ranchers, packers, and investors.

Data are not available for regions or the United States, but data from studies in 2 States, Colorado and Texas, give some insight into the ownership of cattle in feedlots. In the Colorado study, 73 percent of the feedlots surveyed did custom cattle feeding in 1983. All of the feedlots with a capacity of 16,000 head and over custom fed cattle, two-thirds of those with a capacity of 8,000 to 15,999 did, and one-half of those with a capacity of 4,000 to 7,999 did custom feeding. Fifty-eight percent of the custom fed cattle were owned by nonfarm investors. This included 50 percent of cattle in feedlots with a capacity of 16,000 and over, and about 60 percent in feedlots with 4,000 to 16,000-head capacity. The Texas study found that during 1980-81, almost three-fourths of the cattle fed in Texas were on a custom basis. About 35 percent of the custom-fed cattle were owned by cattle buyers and investors, and packers and feeding funds accounted for a small additional percentage of cattle custom fed. This was down from 1972-74, when the occupations of over 90 percent of the cattle feeding fund investors in Texas feedlots were nonagriculturally related. During 1980-81, feedlots with 4,000 to 31,999 head capacity fed higher proportions of cattle on a custom basis than did feedlots which had in excess of 32,000 head capacity.

Beef and Cattle Imports

Beef imports during 1985 totaled 2.1 billion pounds (carcass weight), up 14 percent from the 1984 level. The 1985 total was still down from the 2.3 and 2.4 billion pounds imported in 1978 and 1979, respectively. After a sharp reduction in cattle inventories in Australia and New Zealand, herds have begun to be rebuilt and beef production is rising. Exportable supplies of beef from these countries, the major suppliers of U.S. beef imports, are increasing. U.S. beef imports are expected to be up in 1986, but they are not expected to exceed the level needed to trigger the meat import quota. Another important factor in the world beef market is the accumulation of large stocks of beef in the European Community (EC). The EC has instituted programs to reduce a surplus in milk output. This has resulted in an increased dairy cow slaughter and beef production, and the EC is now looking for third-country markets for beef. This is causing concern among beef exporting countries. EC beef production is expected to be down this year and stocks of beef likely will be declining. The EC has promised Australia and New Zealand that it will not try to sell beef into their traditional markets. If the EC exports the large supplies to countries such as the Soviet Union (which has already taken part of it) there should be little impact on additional beef being shipped to the United States.

The United States imports some live cattle, almost entirely from Canada and Mexico. Most of the cattle imported from Mexico are feeder cattle. The level of imports from Mexico is highly dependent on decisions made by the Mexican Government regarding the number that can be exported during various periods. Cattle feeding activity in the United States also affects the demand for feeder cattle imports. We import a wider variety of cattle from Canada. During some years, we import a substantial number of lightweight calves. We also import a number of heavier weight cattle from Canada. Economic conditions in the Canadian cattle industry as well as feed supplies are important factors influencing the level of imports from Canada.

The total number of live cattle imported per year during the last 2 decades has ranged from 390,000 in 1975, when conditions for cattle feeding were very poor, to 1.25 million in 1978, when feedlots marketed a record number of fed cattle. Future imports likely will continue to be primarly influenced by the same factors mentioned above as having had an impact in the past.

<u>The Food Security Act of 1985</u>

The Food Security Act of 1985 contains several provisons that are of interest to cattle producers and that likely will have some long-term implications. Of these provisions, the whole-herd buyout for dairy farmers has caused the most concern. Potentially, this program could result in an increase in the supply of beef during the next 18 months. The level of cow slaughter and the timing of the slaughter that results from this program will depend on the bids accepted. The beef industry would receive some long-term benefits from a reduction in the number of milk cows, and thus the number of milk cows slaughtered. The share of cow beef in the total beef supply declined with the shrinking dairy herd until the 1980's. Getting it back on this downward trend would be positive for beef cattle producers.

To help offset the impact of additional beef from cows slaughtered under the whole herd buyout program, the Food Security Act mandates that USDA purchase 400 million pounds of additional red meat during the 18-month program starting April 1, 1986. USDA is making plans to purchase this meat.

The Agricultural Marketing Service traditionally supports the red meat market through surplus removal purchase programs. Products purchased are distributed to participants in the National School Lunch Program and other domestic feeding programs such as needy families, Indians on reservations, elderly, and charitable institutions. Under current market conditions, the normal level of red meat purchases would likely fall in the range of 125 million to 145 million pounds. Two hundred million of the 400 million additional pounds to be purchased are to be distributed domestically. This is a significant increase in quantities normally purchased.

As recognized by Congress in passing this legislation, the increased slaughter of dairy cattle under the whole-herd buyout is expected to impact all red meat markets - beef, pork, and lamb. Accordingly, the Department is considering all red meats in its purchase plans; however, beef purchases are expected to be the largest (mainly ground beef). The type and quantity of actual products to be purchased, as well as specific purchase periods, will be based on actual market conditions, cost factors, and user needs.

Two hundred million of the 400 million pounds of red meat required to be purchased must be exported. In developing this export program, consideration must be given to the impact on the world market. The Foreign Agricultural Service is working closely with the U.S Trade Representative and the Department of Defense to identify export outlets including overseas commissaries.

Another provision of the Food Security Act establishes the Cattlemen's Beef Promotion and Research Board composed of producers and importers. The Board would be responsible for carrying out a research and promotion program which would be funded by $1 per head assessments, or in the case of imported beef and beef products, the equivalent as determined by the Secretary. Up to 50 cents credit per head is provided for producers participating in a program of a qualified State beef council. The Act further provides for the establishment of a Beef Promotion Operating Committee composed of 10 members elected by the board, and 10 producer members who are directors of qualified State beef councils. The Act requires a referendum not later than 22 months after issuance of the order, with approval by a majority of producers and importers voting in the referendum. A one-time refund is provided prior to approval in referendum, with provision included for establishment of an escrow account of not less than 15 percent of total assessments for purposes of paying such refunds. If refunds exceed the amount contained in the escrow account, and the continuation of an order is approved, the Board shall continue to place funds in escrow until the total amount of requested refunds is paid. If continuation of an order is not approved, refunds shall be made from the escrow funds on a pro rata basis. Revenues to be generated under the program are estimated at $70 million annually.

The Food Security Act also contains provisions that are expected to affect feed supplies and prices. The grain programs are expected to result in lower grain prices and make U.S. grains more competitive on world markets. The lower grain prices would reduce feeding costs for livestock and poultry producers. Feed costs are already down from levels of a year ago and this is helping to offset some of the pressure on beef producers' returns. Depending on growing conditions, grain production likely will be at a level this year that will hold feed costs down, given provisions in the Act. Thus, beef producers should continue to see their feed costs decline. Then, if cattle prices increase as expected, producer returns will improve.

The Act likely will result in acreage being taken out of most of the price supported crops. Cover crops that will be planted on a portion of such acreage will increase the available supply of forage. However, the availability of this acreage for haying and grazing is determined on a State by State basis by the State Agricultural Stabilization and Conservation Committee. With today's smaller cattle inventory, existing acreage available for grazing appears to be sufficient. Thus, there is little need during normal growing seasons for additional grazing acreage. The acreage that is devoted to a conservation use which could be used for haying or grazing may help provide additional forage to the cattle industry, should there be a drought that severely reduces grazing.

Conclusions

To sum up my remarks, studies in two states indicate that investors owned a large proportion of the cattle custom-fed in large feedlots. Custom feeding represents an important source of capital for larger feedlots, and these lots have accounted for a growing share of fed cattle marketed.

U.S. beef imports and live cattle imports have fluctuated over the years, reflecting changing cattle numbers and feeding economics in both exporting countries and the United States. Beef imports are increasing this year from Australia and New Zealand, but are unlikely to trigger the meat import quota.

The whole-herd buyout provision of the 1985 Farm Act has the potential to increase beef supplies over the next year and a half, but reduce them in the long run as the milk cow herd declines. The Act provides several programs to offset the near-term impact of added beef supplies. Grain programs under the Act are likely to lower grain prices, reducing costs for livestock and poultry producers.

Senator ABDNOR. Governor Janklow, please proceed.

STATEMENT OF HON. BILL JANKLOW, GOVERNOR, STATE OF SOUTH DAKOTA

Governor JANKLOW. Senator Abdnor, thank you very very much for the courtesy you are extending here today to have an opportunity to come before your committee and give some testimony.

I would like to cover a couple of grounds today if I could. I obviously couldn't help but hear some of the previous witnesses that testified after lunch at the point when I got here. And to put some of this into perspective, I would like to repeat for the record something that you and I were just visiting about and that is, when I was watching the Farm-Aid Conference several months ago that they had on that National Farm-Aid plea for funds. I think part of the problem, and just part of it, but part of the problem was epitomized by the statement that Willy Nelson made when he was up there explaining to the public, between some of the songs, how terrible it is to be in the cattle business, or in the farming business, and how difficult it is to be a farmer nowadays. And he said, as a matter of fact, farming is so terrible that I lost $500,000 last year feeding cattle.

And I think that puts it into perspective when people like Willy Nelson look at the cattle industry as a place where they can make their fortune and two, get some unique types of benefits that don't accrue from the marketplace but accrue under some of the laws that we have in the country. I think it is the type of thing that helps feed part of the problem that we have.

Second of all, I think we are up against some unique forces. Our National Government and all kinds of national interests for decades now, have preached, don't eat red meat and stay away from red meat, cut down on the consumption of red meat, red meat will kill you, red meat is not healthy for you, it carries chemicals, insecticides, fertilizers, herbicides that are unhealty for you and in addition to that, it uses drugs to promote healing and promote growth that are unhealthy for you.

In addition to that, it's too full of cholesterol and they give you a thousand different reasons not to eat it. One of the leading proponents in the Nation for this has been a lady named Jane Fonda and some of her friends. As a matter of fact, virtually every book that she has written and every tape that she has made, every presentation she has ever given, she tells everybody not to eat red meat. And then she comes before Congress before a House-Ag Committee a year ago and breaks into tears as only a Hollywood actress could do, along with some of her friends that were crying there with her lamenting the plight of the farmer and wanting to know what's happened to the American agricultural producer and how come they're all going broke.

One of the reasons is they told us not to eat everything that we know how to eat and start in with things that nobody wants to eat and they beat it into our heads for so many decades that some of the people, unforunately, in the country are starting to believe it.

But I would like to point out, Senator, a couple of problem areas. First of all, I think to put it into perspective I have a chronological order of events that have taken place in South Dakota since last July. Last July 24, Public Law 99–71 became the law of this country. It was supplemental appropriations for the Commodity Credit Corporation in the amount of $1 billion to save the CCC from bankruptcy.

On September 13, 2 months later, Secretary of Agriculture John Block designated 25 South Dakota counties eligible for emergency feed assistance due to a drought. Three months later, on December 9, I made a formal request to the U.S. Department of Agriculture, specifically, Secretary John Block, that the emergency feed program be implemented to aid South Dakota cattle feeders—cattle growers, due to the shortage of feed caused by the summer drought and then aggravated by the major early winter snow storms.

Three weeks later, I issued a press release, saying that I thought Federal officials were attempting to use the plight of western South Dakota farmers and ranchers for political reasons. Secretary Block, at that time, had not yet responsed to the 3-week-old request that we had under his emergency drought declaration.

On January 9 or 7, a week later, USDA announced that grain owned by the Federal Government CCC would be made available in the areas for emergency feed assistance including western South Dakota, to help alleviate the feed shortage.

Six days later, Mr. Dale Anderson, the executive director of the South Dakota ASCS said, I think we can get the grain in the hands of the producers in time to do some good. We realize that time is of the essence. Four days later, the USDA announced that Milo was the grain that was going to be made available to western South Dakota farmers.

Our State Secretary of Agriculture, Marvis Hogan came over to my office in an outrage at that point in time and said, try to dump Milo into those western South Dakota cattle was just as good as putting gravel into their stomachs.

On January 18 or on the 17, I complained to the South Dakota news media, I called individuals in Washington, DC, about it and on January 18, Mr. Anderson, the executive director of the ASCS said that Milo was originally approved for the program but now had been changed to the corn and oats that could be used.

Six days later, on January 24, USDA announced it wasn't going to ship corn; that they were shipping wheat as the cattle feed. Four days later, on January 28, the USDA officials announced they changed their mind. Now they were going to ship corn and oats as emergency feed for livestock in western South Dakota instead of wheat. Seven days later, on January 7, the Commodity Credit Corporation ran out of money again. At that point in time it was necessary to get additional supplemental appropriations.

Three days later, the President signed House Joint Resolution 520 into Public Law 99–423 and it was an urgent supplemental appropriation in the amount of $1.5 billion. It was suppose to be enough funding to last through the end of the month, and the President originally asked for $8 billion and the congressional leaders said more would be provided later.

On March 6, the Commodity Credit Corporation ran out of money for the third time in 8 months. In response to a letter from myself, Frank W. Naylor, Jr., the Acting Secretary of USDA, told me that South Dakota didn't need any additional programs. As a matter of fact, he wrote me a letter that was incredible. He said:

Thank you for requesting the implementation of the emergency feed program in South Dakota.

This was dated March 6, 3 months almost to the day after I made my request.

We realize that a combination of low prices and unfavorable weather conditions is putting stress on livestock producers and specifically, that early heavy snows are compounding the problem faced by these producers. However, we've implemented a number of emergency authorities to help producers through this difficult period. Producers have been allowed to hay and graze their acreage which is devoted to the acreage conservation reserve.

I mean that was an interesting thing because we didn't have water in western South Dakota last year so nobody had acreage to graze. Under the Commodity Production Adjustment Program as well as their acreage which is subject of a contract under the Water Bank Program when it is determined that there is a shortage of livestock feed as a result of disaster conditions.

In addition, we have expanded the provisions of the Emergency Feed Assistance Program in response to programs faced by livestock producers. Stocks of gain owned by the Commodity Credit Corporation are available under the program for sale to eligible livestock producers at reduced prices. While your concern and recommendations are appreciated in this matter, we conclude, as a result of the availability of other forms of assistance as outlined above, we can not justify implementing any additional programs at this time.

Then on March 6, the Senate passed a $5 billion appropriation to provide funding for the CCC. The Senate's version was different than the House's that they passed the week before. On March 11, the conference committee was ordered to have its report completed by midnight, March 12, The CCC had been without funding for 5 days. On March 13, the House passed the urgent supplemental appropriations conference report to fund the Commodity Credit Corporation in the amount of $5 billion. this was still $2.3 billion short of the amount requested by the administration.

March 18, a new conference committee was appointed by both the House and Senate to resolve the dispute over the urgent supplemental. The CCC had been without funding to help the farmers for 12 days. On March 19, the Senate passed a new conference report.

On March 20, the House passed a new conference report. On March 21 it was presented to the President for approval and 2 days later the President signed the bill.

Senator, I think that is a classic example of some of the types of things we have run into in trying to deal with things of an emergency nature that we've run into with respect to the administrative agencies on the national level.

Specifically talking about the livestock industry in South Dakota, I think we are faced with some problems that are really unique in our times as they all compound themselves together. One, we're in a situation where we are having a very, very difficult time in competing in world markets. One of our major potential customers is a nation like Japan. Obviously, the more developed the nation, the more inclined they are to have meat as one of the stables in their diet.

I accompanied John Morrell & Co. over to Japan last year in an attempt to try and sell more red meat to the Japanese. What I ran into was a complete understanding and knowledge of a thing they have over there called the LIPC, which is the Livestock Improvement Production Corporation. The LIPC they said is a privately held company. There are shares of stock that are issued for it, but 100 percent of the stock is owned by the Japanese Government.

The chairman of the board of the LIPC is owned, or excuse me, is appointed by the Prime Minister and the Agriculture Minister of Japan and they make the determination as to how much red meat is authorized to come into Japan, whether it's grass fed or grain fed, from what countries it comes and what the price is. There is absolutely no semblance of a market situation in terms of dealing with the Japanese for the importation into their country.

I explained to them that I thought maybe we ought to have an LIPC in America and it ought to cover Japanese cameras, Japanese cars, Japanese petrochemicals and that would take down our barriers if they were willing to take down their barriers.

As a matter of fact, there is a tax that it equals several dollars a pound to import red meat into Japan and that tax is used, which is not any expense to the Government, it goes directly to their consumers and that tax is used to subsidize the cattle producers in Japan, which is, as you know, are very, very inefficient producers and not capable of competing in a traditional sense in terms of what they manufacture.

Then we run into the situation America has outlawed, through the Federal Food and Drug Administration, certain types of chemicals that cannot be ingested, injected or exposed in any way or fed to our livestock industry. But our counterparts in the world have not gone along with this. For years and years we've talked about it. But in 1981 we had 125,000 live Canadian hogs that came into the United States and by October of last year we had 2.5 million Canadian hogs in the first 10 months of last year that came to the United States.

As you know, Senator I use the health laws of South Dakota to prohibit cattle and hogs that could have been exposed to, were exposed to, were ingested with, were injected with chlorophenicol. And although the Governor of a State does not have the power to interfere with foreign commerce, or foreign treaties, they do have an awesome power under the health and welfare laws and I utilize those laws to put a stop to that livestock coming into South Dakota except under strict regulatory controls.

But Senator, not a day goes by that I don't receive complaints from cattle producers in western South Dakota complaining of the number of Canadian cattle that are still coming down from Canada. They are not coming into South Dakota in great numbers unless they go through a circuitous route. They can't be directly offloaded in this State because of the unique bureaucratic constraints or hoops that we made them jump through and that they really won't be able to jump through.

With respect to the Dairy Program, I listened to one of the previous witnesses testify under the Food Security Act aspects of the

Dairy Program. The fact is, that putting that much meat on the market notwithstanding the Government's pledge to make substantial purchases can help, but have an impact on investor psychology and on purchasing psychology when it comes to the futures market.

The unique situation that was brought about by the passage of that Act, I think, is something that we really have to be concerned about. The dairy marketing orders and the prices have always been greater in the South and in the East than they have been in this country, which is dairy land. But the fact is, under the Food Security Act, we went up an average of 10 cents in the eastern South Dakota, northern South Dakota, Minnesota, northern Iowa tier. Southeast United States there is an area in Arkansas that went up 43 percent. They went up 80 some cents as opposed to our dime. There are areas in Georgia and Florida that went up anywhere from 30 percent to 75 percent. These are very, very substantial increases and some of them as much as 700 percent greater than the increases that were given up in this country.

And our people on the State level feel that we're going to face a unique problem now. Not only are they going to expand their herds with the ingestion of foreign capital and specifically, countries like Ireland coming into southeast United States to get involved in the dairy business, but they are also going to greatly expand their grain growing businesses and they have the ability to double crop down in that country. So, we're also going to lose the grain sales that are heretofore and have historically gone to this area of the country to the southern and southeastern portion of the United States.

We feel that we will probably start using some of the grain sales as they will expand their herds to the point that they will be able to sustain a grain base with respect to the industry that they're going to be able to develop.

With respect to one additional thing, and I say this respectfully and noncritically and I really hope you take it in that vein, Senator. But since 1981 there have been 29 congressional hearings.

From 1973 on, there has been nothing but hostility and nothing but confusing regulatory activity and nothing but governmental intransigence that has brought about the inability of our people to be able to compete with it and stay on top of it.

We're losing livestock producers at a phenomenal rate. We're losing farmers, as you know, at a phenomenal rate. Last winter, when we were short on feed out in this part of the country, we set records almost on a daily basis in the middle of the winter as cattle went through the Belle Fourche Livestock sales ring—the St. Onge Exchange and the various other exchanges that there are out here—trading centers for livestock. And the problem is, is those people will not have the financial wherewithal, many of them, in order to recoup and get started once again building foundation herds.

The economic future of South Dakota is going to be very dim when we get to the point that we do not have a sustained population base in our rural communities. Of the 310 towns and cities in the State, the 14th largest has less than 5,000 people. We become very rural, very dispersed and very quickly. For every 10 farmer and ranch producers we lose one small town main street business.

Not in Rapid City, not in Sioux Falls, not in Brookings or Watertown, but we lose one small town main street business, and one that is never going to come back again to provide any real economic impact or any economic force to our communities.

And so on the basis of the fact that this matter has been studied for at least six-tenths of a decade in depth, reports have been issued in excess of 130 and we have really come to the point in time where a specific plan has to be set in place, but it's a plan that people can assume it will be followed for at least a decade so they can learn how to play by whatever rules are imposed them so they can get forward, the business of trying to survive in an economic sense.

With that, Senator, I appreciate the opportunity to have to come here to testify to you today.

Senator ABDNOR. Well, thank you, Governor, you did a very thorough job of covering the situation and there is some differences on what can be done with it. I think in all fairness what we didn't mention here was agriculture having been eroded for a long time, but I think if we went back to the fact that the period of 21½ percent interest and 13 percent inflation, that probably would be the biggest single cause and yes, the Government was the cause of it, but not contrary to some. Not every Member down there in Congress voted for all the things. It's been a popular thing to do to keep voting for more spending and as the spending increased, no one was too concerned about the cattle industry and agriculture. There were 29 congressional hearings from 1981 to 1985. The first one was an analysis of future trading activity in live and feeder cattle contracts at large. Traders on the Chicago Merchantile Exchange by the Committee on Small Business, House of Representatives. That was conducted way back in 1980 and 1981.

Since that point in time, there have been 28 other congressional hearings that have been conducted. In addition to that, since 1981, there have been 133 publications and studies that have issued to the Congress of the United States or for the National Government with respect to cattle feeding, the livestock industry, and things such as this nature. The bottom line really is that we to the point in time where we can no longer wait to continue to see what is going to happen.

With mixed signals that come from our National Government and embargoes going back as far as 1973 for when the price of red meat did jump at the counter on the retail level because of a perceived shortage in the producing area. We had a President of the country from my party that imposed a beef embargo on the world—a limited beef embargo which sent a message to our trading partners throughout the world about the deficit. When there is no one that would jeopardize by the situation more than these in agriculture, and we have really never responded and I would be equally unhappy by trying to bring the undeveloped countries into the field of agriculture which we have been pleased about.

Probably one of the greatest side effects of all that inflation was that our currency suddenly became inflated as did our inflation itself and made us not really competitive as the foreign exports market. Hopefully, we're starting to come around, if there is anyone left to deal with it. Now, I'm not questioning the problem that these farmers are having.

It wasn't too long ago that I was a farmer myself and I know what they're going through. I know what their expenses are and I know what the prices are. We have tried to get solutions from Washington and no one can call Congress pikers or Washington pikers. We went from $11.9 billion in trying to boost the farm prices up to where we can continue anywhere from $23 to $28 billion in the near 1986 and before we're through with it. We're still not getting to the real source.

Occasionally there might have been some touched briefly on, on the unfair laws that we have on the books that makes it unfair for agriculture in trying to compete with it, whether it's Willy Nelson or anyone else. There again, not everyone in Congress is cooperative as they might be. So, we try and make things like that not happen. I'm sure I will run into all kinds of opposition from the Texas delegation from the big feedlots and future businesses up here.

Not everybody is quite as eager to go along and that is just a fact of life, and this is an element that we're trying to fight. I think we made a little headway in it, but Lord knows we have interest rated down to 9½ percent, but it's not being reflected at the bank. I think you will admit that. We have got the 9½ percent and it could go to 9 percent.

Today we had testimony from farmers and ranchers that pay up to 15 percent interest and we're trying to cover for those going broke. So, no matter when we go to try and bale out the ones hurting today, then we hurt the ones who are trying to struggle and have their head above ground and trying to make ends meet. It is a difficult situation and when you have a Congress that isn't particularly farm-oriented for one thing, plus you have farm groups that don't agree that we should be discussing that today. It would help immensely if we could get the farmers and their farm organizations, particularly, to come together and give us what they like to see so that we can be working in unison instead of trying to feed each other, and trying to fight our city cousins of farmers.

We have too many diverse opinions on the problems. We don't find that with labor unions when they come before Congress. I couldn't agree more with you with the trouble we had in the CCC.

I struggle just as hard to give my amendment that was passed that would have at least taken the grain out to the areas of the disaster so they wouldn't have the extra transportation cost of it. We finally were successful, but it's late in coming and I'll be the first to admit that.

Why it takes so long to get something through only bureaucracy can tell you. I was very unhappy with my bill, but I have a lot of milo. If anybody tells you they won't eat milo, then our Secretary of Agriculture will have to do some checking. It's a nuisance and you have to have something to put it in, but it's 95 percent the value of corn and my people produce it and use it and fatten cattle on it. Yet this is an excuse for not bringing in oats, corn, and so forth, but I won't question one bit of it.

People have told us that they would have never gotten the Government in agriculture or farmers would be better off today and they may well be. We would have farmers maybe and not the Willy Nelsons in the farming business, so I'm not arguing that everything you say is very, very true here. We made a lot of mistakes the way we have handled this, but I hope we're on the right course trying to get the interest rates down.

Windfalls of $5 an acre for everything, they may help. Let me ask you this: I thought we had solutions to this mess, but we don't agree completely with the programs of the South. What do you think about the dairy program?

Governor JANKLOW. One of the key things, Senator, is it be uniform in its application. If you give the southeast United States a 7- or 8-cent increase, then if you give them a 15-cent increase, we ought to have a 15-cent increase. It ought to be uniform in terms of individual applications. For too long, every time they have a Federal formula, we end up on the short end of the stick. And you have done work on it with FKCI insurance on dairy markets in Arkansas that went up like I say, 83 cents. They went up in terms of the marketing orders whether we went up 7 cents or whether we went under a dime and I think that whatever program is established, that it has got to be uniform. As Governor of the State, I couldn't implement a single, like I said, if the people in Harding County get 5, the Sioux Falls people get 20 and the Vermillion people get 12 and Mobridge gets nothing. This can't go on or we're going to continue to end up on the short end of the stick.

Senator ABDNOR. Those marketing orders, it's been in a long time and they have been trying to get that changed, but unfortunately those boys are in the South and we have both chairmen of Ag Committees, control ag chairmen, the subcommittee ones and there is no excuse except that they are difficult to try and make the changes. I'm on the highway and every time a citizen comes in with the formula to change the highway, we get $2 for $1 and Texas gets 70-some cents. Senator Bentsen is unhappy, but he fights like a hog, because he wants to keep getting it and that probably isn't right, but again, you can justify, in my mind, the fact that they will never use the marketing orders to a large degree in the South, because as you heard earlier, they are getting better market prices.

The market price itself is greater than the support prices down there, but it doesn't make it right and I couldn't agree more that I wish we could get more. We have not heard the last of the dairy problems just because of selling a million head of cows. I don't think that is the answer and one of the gentlemen, Mr. Nix, says the way to do it is lower the support prices and as you say, if we can get them lowered the same price for everyone it might help, but it might put a lot of dairy people out of business.

Governor JANKLOW. It just points out that we have a long way to go before anyone can call it in shape. The State of South Dakota is the most agricultural State in the Nation and it makes it tough for us. If I could, I would like to respond briefly to a couple of comments that you made.

First of all, 10 years ago the average ag producer in America spent 4 percent of their expense money on interest payments and right now it's approximately 22 percent of their expense money in interest payments. The discount rate from the Federal Reserve has dropped to at least 7 percent.

The prime rate is around 9 and never before did we have people who had loans that were tied to the prime. Only when the prime got up to 20 did people start driving in to the prime and even though the prime has dropped dramatically and at the time the rediscount rate has dropped dramatically the amount of debt that our people have accumulated over the last 6-year period. The debt load they carry at today's rate of interest is phenomenal.

It is almost impossible in South Dakota to get any type of agricultural loan at less than 12 percent. Albeit, it is done in some places, but it is very, very rare. Fourteen and 15 percent is not unusual in the experience that I have in the people that we're dealing with through the renaissance programs to provide them assistance and you mentioned the exchange rate on the dollar and how it became implemented, but I think honestly, Senator, the reason for it, it took this country 200 years to get to $1 trillion and that is 12 zeros.

It has only taken us the last 6 years to get to a $1 trillion and yet, when half the capital that comes in to fund the deficit from foreign countries, of the $100 billion deficit $100 million came from foreign countries. That is one, one-billionth that wasn't available to be used by American pork, beef, corn, wheat, American G.E. stoves and the products made in America because American's debt is such a good investment on the world markets. If we go back to 1973 and 1974, in that area, when we had up to $6 on wheat and $350 on corn, we had decent cattle prices and that's why they put the embargoes on the National Government level. In 1973 it was beef, and in 1974, as you know, it was soybeans and wheat and the net result is that it was an infringement impact on the world markets. And we, in South Dakota, experienced that. In 1978, the South Dakota State Cement Plant ran out of cement and it had an obligation. It sold more cement to the United States than we could produce, so we defaulted on some of the out-of-State producers in order to take care of the instate producers.

When I became Governor, we had a tough time rebuilding that because they said they would never trust us again. I'll never give you all my business again. Japan used to purchase 100 percent of the soybeans from the United States and now it purchases half of its soybeans.

The last figure I will give you is that in 1980 it cost 10 German marks to buy a bushel of soybeans and they were selling for better than $10. By 1985, it cost 15 German marks. This was a 15-percent increase in soybeans and American soybean producers were getting less than $5 or at the local market and the result has been a rate which has been driven up directly in proportion to the amount of debt that this country has accumulated. And one of the things we tried to do was lower the interest rate. In 1983, we paid thousands to issue a tax-free bond which would be able to be sold at tax-free rates. This would have gone to the financial institutions. Immediately after that, legislation passed—Congress passed a new law that included the Pickle amendment or the Pickle law, which prohibited us from doing those types of transactions and took away the power to provide tax-free, low-cost interest money for operating capital and for financing these operations.

The final thing I will say is this. I recognize that the Congress is primarily urban oriented with respect to the House of Representatives. There isn't a question that is true. Three percent of the American people live in the rural area, and 3 to 5 percent, but in North Dakota, South Dakota, Nebraska, Wyoming, Colorado, Montana, Nevada, Arizona, Kansas, Idaho, and Washington, which I think we would all agree are agricultural rural States. That's 22 percent of the U.S. Senate. So, 22 percent of the drought that is available in the U.S. Senate.

As a matter of fact, 4 years ago they changed the formula and they haven't got it through the House, but through the Senate—it has cost the people of this State $30 million in highway funding that they didn't reach when the formula went from a 75 percent of lane miles and 25 on miles traveled, to 55 percent on lane miles and 45 percent on miles traveled, so we fully understand the impact of the change formula and the 10 of millions of dollars it costs the people in the State under the unfair formulas.

At the time, you say that shouldn't have happened and yet the South was willing to—I agree with you. As a matter of fact, three times since then they have come to change that. With the dollar figures that we get, we are the No. 1 State in the Nation on a per capita basis with the highway dollars we are getting, but that doesn't mean you have allowed these jokers that.

I have a friend of mine, Senator Bentsen, that thinks we should get 72 or 73 percent on the dollar.

If it was uniform I wouldn't complain because we pay gas taxes to build subways and most transit into Rapid City where we have gone to a straightening out of that whole situation and it would not work ultimately to the detriment of South Dakota, if, under the federalism, the President did propose something and we were able to sort out.

The final thing I will say, the classic example is where the funding source is destroyed in the Food Security Act itself. They took away the power of States to continue to charge sales tax on food. The impact on the State of South Dakota will be approximately $1½ million a year in loss to the general fund and one in which we don't have a replacement for and we give $100,000 to the municipalities in South Dakota that have a sales tax in food and yet, it is causing all these merchants hundreds of thousands of dollars in South Dakota to change all their computerized cash registers and machinery because they will be able to charge sales tax on all food purchased except for those paid with food stamps, which is going to create a monumentally expensive tax in changing over.

Now, I did appeal and petition the Agriculture Department to give us a year's extension and I was notified last week that we will be given an extension under unusual circumstances until 1987, but at that point, it is going to be triggered in, and that, frankly, doesn't affect the treasury 5 cents, one way or the other. But it is taxable power that has been lost to the people of South Dakota that will also be made up from the people within the economy.

Senator ABDNOR. Let me say one thing on the deficit. I couldn't agree more, but we have another trillion dollars in 5 years if that isn't done. Some of us for a long time have been advocating that if we did something about that 10 years ago it wouldn't be the way it is, but I'm happy to tell you that we have made a lot of headway in the very brief time and Gramm-Rudman has done nothing more than made a limit on how much we can have in the deficit or we would apply cross the board cuts that would bring it down into that figure. As a matter of fact, instead of having to cut $55 to $60 billion we're told now that it's $37 billion, things are picking up and we found in some parts of the Nation they're doing better. I wish I could say that for South Dakota.

You are right, thought, that we spend too much money and the revenue bond, I get that thrown at me. There are a lot of people, including Patrick, who like to disallow those altogether and he is not geting away with it apparently.

Anyway, I would like to thank you very much for coming. I appreciate it.

Governor JANKLOW. Thank you very much. Let me leave you with one thought on the tax rebonding because it is very important. We have $200 billion in ag debt in America. Two hundred billion dollars. If we were to be able to be allowed to take $100 billion of it, which is half of it and issue tax refunds and phase them into the marketplace so it wouldn't upset the market, we would be able to issue those for 8 percent, because you can issue long term bonds for less than that.

We could put them in for 8 percent and the interest paid in a year would be $8 billion. If every purchaser of those bonds was in the 50-percent tax bracket the impact on the Federal Treasury would be $4 billion a year in lost taxes paid in the Treasury.

But for every 1 percent interest rate there is a change in the market effecting ag income from $1 to $2 billion. In South Dakota, that would transfer to $50 million per year, per percent, and point.

If we could lower it 4 percent in South Dakota for half the debt, the impact would be $100 million a year. It's been a long time since there was a program—like an airplane flying over South Dakota and throwing $1 million a year out.

The impact from shopping to manufacturing to ag successs to viability of small counties would be phenomenal and I urge you, Senator, not only at this hearing, but the impact of the Federal Treasury would come back to them many times over, in increased taxes and activities, that would take place and go a long way from making this State viable and healthy and free us from the needs for Federal funds and allow the cut back under the Gramm-Rudman for that type of proposal.

I did suggest it to the gentleman who staffs Senator Garn's committee. But I would really enjoy the opportunity to work with you, Senator, and I say that seriously and maybe we can get something like this done for South Dakota and for America.

Senator ABDNOR. That is a wonderful idea. I thank you very, very much for coming here today. This is not the first time you have appeared before the committee and I appreciate this.

I want to say to all of you that this has been an excellent hearing and we have a hard time getting our findings sold because of agriculture, and sometimes some of the programs run into opposition but I can assure you we are going to do everything we can possibly do to get the story told that we heard today.

It has been a long day and the problems and challenges which confront us are now out of the closet and on the table. All we have to do is figure out what to do about it. We have some good thoughts on this today. The traditional cattle producers and feeders have retreated far enough and we have a great deal of this to be covered. The American cattle industry is being butchered by Federal taxes, farm monetary and farm policies. It's as the Governor said, sometimes we have people in Government that pay more attention to foreign affairs than what is good for other counties in America.

And what parts are kept and what parts are being thrown away are a national disgrace and the independent bona fide stockgrower is a prime candidate of this industry and is being thrown into Washington and we are certainly not happy with what we see. And with your help we can work together, but as I said earlier today, I really am going to get something done and I'm sure there are a number of my colleagues that will help us. It's also going to happen by being outspoken and getting the message across by working together, and by working together, I'm sure we can do it. Thank you very much.

[Whereupon, at 6 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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