



Examining Market Power in the Red Meat Packing Sector
Study Overview
Canfax Research Services

In 2006, Dr. Jeffrey Church and Dr. Daniel Gordon examined the extent to which the closure of the border to live animals had increased the monopsony power of packers in Canada. This study found that when competitive conditions in Alberta limited the potential buyers for fed cattle to a small number of packers in Alberta market power was exercised, but was not consistent with any coordinated exercise of market power by packers.

Since 2006 a tremendous amount has changed in the Canadian fed cattle markets. Market access for fed cattle has increased with the reopening of the U.S. border in 2005 to fed cattle and further reduction of technical requirements with the implementation of Rule II that expanded live cattle trade. In addition Canadian red meat packing capacity, which expanded between 2003 and 2006, has seen some substantial consolidations and reductions. The Cargill acquisition of the Better Beef plant was finalized, the Calgary-based Rancher's Beef was closed, the Natural Valley plant in Saskatchewan is no longer processing cattle, the Quebec-based Billette and Gencor operations were closed. Domestic capacity was further consolidated when Tyson sold their Brooks Lakeside operations to XL Foods, which saw Western Canada essentially down to two major packers (Cargill & XL Foods). Most recently XL closed their Moose Jaw cow plant in March 2009.

Reduced competitive bidding due to reductions and consolidations of domestic packing capacity, has been further exacerbated by the implementation of U.S. mandatory country of origin labeling in September 2008. Mandatory country of origin labeling resulted in a reduction in the number of U.S. packing plants bidding on Canadian cattle due to difficulties in managing and segregating these cattle. Reduced competitive bidding has also been a growing concern of primary producers, with quantitative and anecdotal information showing significant increases in packer ownership and contracting of cattle in Canada over the recent period.

The consolidation of the red meat packing sector, recent regulatory and market events, and concerns over further reductions in packing capacity in light of poor profitability and reduced cattle inventories has seen growing concerns raised about packer concentration and the impact of a high degree of market power on Canadian cattle prices and long-term industry structure. Consequently Canfax Research Services, with support from the Alberta Livestock and Meat Agency, has initiated a research project to update and expand upon the Market Power study completed in 2006.

Key objectives of this study include examining the changes in market power that have occurred since the border reopened to trade in live cattle in the summer of 2005 and further restrictions were removed with the implementation of Rule II in 2007. The study will also provide estimates of the extent of income transfer from feedlot producers to packers and the loss in economic value attributable to the exercise of market power by the packers in the BSE period. Third the study will provide an evaluation of alternative mechanisms to facilitate effective market surveillance, manage the impacts of market power, and guide potential industry and government policy and regulatory decisions moving forward.

The project consists of three major phases:

- 1) The first phase will update the 2005 study providing market power estimates for the beef packing industry in Western Canada. This analysis will provide insight regarding the extent to which changes in market access and packing capacity reduction and consolidation has impacted

market power measures. The analysis is also intended to assess whether the introduction of Country of Origin Labeling (COOL) regulations in the United States have had an effect on the ability of the packers to exercise market power.

- 2) The second phase will assess the effect on the production sectors from changes in market power by the packing industry. While the immediate or direct effect of market power is lower fed cattle prices, there may also be indirect effects on the production sectors. The intent is to identify and quantify the extent to which the exercise of market power by the packers is borne by other sectors within the supply chain; in particular the cow-calf sector and the feedlot sector. Though feedlots are unlikely to have the ability to exercise market power in feeder cattle markets, the reduction in fed cattle prices will reduce their demand for feeder calves and feed. Consequently, the ultimate evaluation of the economic cost of the exercise of market power by packers, regardless of its source, needs to encompass both the direct and indirect effects as all markets within the supply chain respond.
- 3) The third phase of the project will consider alternatives for effective market surveillance, mitigation of any negative impacts of market power, and guide potential industry and government policy and regulatory decisions moving forward that are both practical and result in the least level of intervention necessary. The potential for the exercise of market power by packers suggests an examination of market surveillance institutions and approaches. Market surveillance institutions have been created to monitor and, potentially, control the exercise of market power in markets in other jurisdictions and other industries. Given COOL and the consolidation of packers in Western Canada it will be important to be well informed regarding the strengths, weaknesses, and applicability of alternative market surveillance regimes within a Canadian framework.

A particular focus will be on the potential role for mandatory price reporting by packers. It is often argued that mandatory price reporting is a policy that not only allows for the assessment of market power, but also is a policy response to reduce or eliminate market power. By increasing market transparency, mandatory price reporting, if timely, could improve the efficiency of price adjustments and by reducing information costs improve the efficiency of the market by reducing bargaining costs. On the other hand, the effect of mandatory price reporting may depend on how it is instituted and the market structure of the packers. If there are a small number of buyers, attempts to create price transparency may not have the intended effect and instead may make it easier for the buyers to coordinate on pricing. The existence of price dispersion and secret price negotiations/premiums, when there are small numbers of buyers, is often interpreted as an indicator of competition. Moves in other sectors to increase price transparency have been documented to increase the exercise of market power by making coordinated pricing easier.

The project is scheduled to be complete by January 2012. For more information contact:

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