# Policies Dictating How Cattle Can Be Marketed Threaten the Beef Industry's Progress

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## Key Points

- Several federal policies have been proposed to regionally limit how fed cattle can be marketed to force minimum volumes of negotiated cash trades for fed cattle.
- Marketing agreements incentivizing producers to generate higher-quality beef have resulted in beef and cattle genetic improvements and more intense cattle feeding practices, which provide higher-quality beef products to consumers.
- Consumers and cattle producers have benefited as beef products have become more aligned with consumer preferences, yet Congress and the Biden administration are contemplating policies that would undermine such advancements.

Commodity supply chains evolve in response to technological innovation and changes in consumer demand, benefiting both producers and consumers. Beef is no exception to this general rule. Nevertheless, arguing for the need to improve price transparency for farmers, Congress and the Biden administration are considering legislation that would force more cattle sales to be channeled through negotiated cash transactions. These involve "day-of transaction" and similar spot market cash sales of cattle from feedlots to meatpacking plants. Proposed "regional minimum" mandates would require such cash sales to exceed a predefined minimum percentage of all transactions. The proposed legislation would increase supply-chain costs and reduce incentives for ranchers and feedlots to produce higher-quality beef products. It would also lower revenues from beef sales to consumers and therefore lower prices paid to feedlots and farmers for their cattle.

## Consumer Preferences and Beef Industry Prosperity

Since 2010, the US beef industry has enjoyed more than a 20 percent increase in domestic consumer demand, and export demand has more than doubled.[1] Meat processors' demand for cattle directly flows from domestic consumer and export demand. When consumers at home and abroad want more beef, feedlots enjoy higher prices for fed cattle (prices increased by 28 percent from 2010 to 2021), and ranchers receive more for feeder cattle (up 37 percent).[2]

Consumer preferences for beef products strongly determine farmer and feedlot prosperity. The beef supply chain's ability to respond to changes in those preferences has been especially important over the past 30 years. In the United States and major beef export markets, inflation-adjusted household incomes have risen markedly, and consumers have increasingly focused on quality in beef purchase decisions.

Consumer demand is multifaceted. However, one fact about the beef market is abundantly clear: Consumer demand is driven by the beef industry's ability to supply consumers with the products they most prefer. The Kansas State University "Meat Demand Monitor"[3] produced by Glynn Tonsor consistently reports that domestic consumers value beef taste, freshness, safety, price, nutrition, and health as the six highest-ranked demand drivers. This confirms results of an extensive body of published research and clearly reflects the increased importance of beef quality to consumers as they have become more affluent.

Incentivized by strong economic signals, the beef industry has responded by developing and using marketing agreements and contracts that reward farmers and feedlots for supplying the improved quality consumers increasingly wanted. That shift has been a central factor in generating the substantial increase in beef demand that has benefited ranchers and feedlots over the past 10 years. However, that shift would be damaged by the regional minimum cash sales mandates Congress is considering.

## Evolution of Marketing Agreements

In the late 1970s, as livestock markets located at terminals were fading away, cattle feeders switched to negotiating cash cattle prices directly with beef packers. Packing plants also shifted from being located in cities near major stockyards to rural areas where feedlots were "finishing" cattle. Directly negotiating cash sales at feedlots was an easy transition from the practice of commission agents selling cattle at stockyards. Direct cash trade was also helpful for publicly reporting and sharing information about transaction prices for commodity cattle.

Starting in the late 1980s, however, large cattle feedlots managing thousands of cattle began to recognize benefits from shifting away from negotiating individual cash sales for blocks of cattle to longer-term marketing agreements with packers. Initially, such efforts were driven by the goal of reducing transaction costs and enabling feedlots to more efficiently manage cattle inventories.

However, over the past 30 years, financial incentives to enter into such marketing agreements, which evolved to include incentives for quality, have become much more substantial. In response, marketing agreements have dominantly become how feedlots market fed cattle to packers (Figure 1).

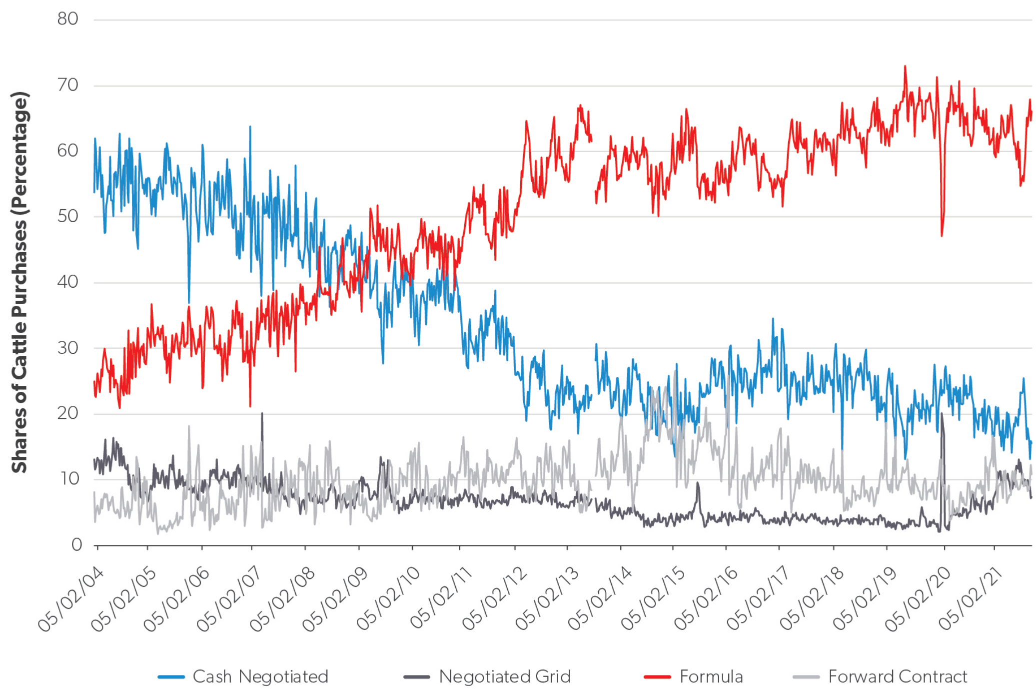
## Incentives for Quality-Focused Marketing Agreements

Today, feedlots pursue marketing agreements and formula pricing arrangements with beef packers for several reasons.

- **Reducing Transaction Costs.** Negotiated cash sales require time-consuming investments in real-time market tracking, and having to negotiate individual transaction prices with multiple potential buyers is costly.
- **Improving Market Timing and Synchronized Production.** Knowing in advance when cattle will be delivered facilitates production technology administration and enables feedlot managers to more effectively meet cattle quality grade, yield grade, and weight targets.
- **Managing Risk.** Marketing agreements enable managers to handle cattle inventories more effectively and minimize underfeeding or overfeeding cattle, both of which affect quality and cost.[4]
- **Increasing Revenue.** Marketing agreements also enhance prices by rewarding feedlots for quality, including cattle grades, red meat yield, improved genetics based on breeding programs, and production verification systems.[5]

These incentives are why feedlots and meat processors increasingly rely on marketing agreements rather than cash sales. In the early 2000s, negotiated cash trades represented about 55 percent of all fed cattle sales. Formula trade marketing agreements, which generally include quality incentives, accounted for 25 percent of all sales;

**Figure 1. Weekly National Cattle Purchase Method Shares, May 2004–January 2022**




Source: US Department of Agriculture, Agricultural Marketing Service.

negotiated grid sales (trades that include predetermined premiums for quality) and forward contracts each accounted for about 10 percent of all sales. By 2012, the share of total sales consisting of negotiated cash sales had dropped to 20 percent, and formula-based sales shares had increased to over 60 percent. Since then, negotiated cash trades' share of all sales has hovered around 25 percent, while the formula trade's share has increased to 65 percent.

## Increased Beef Quality

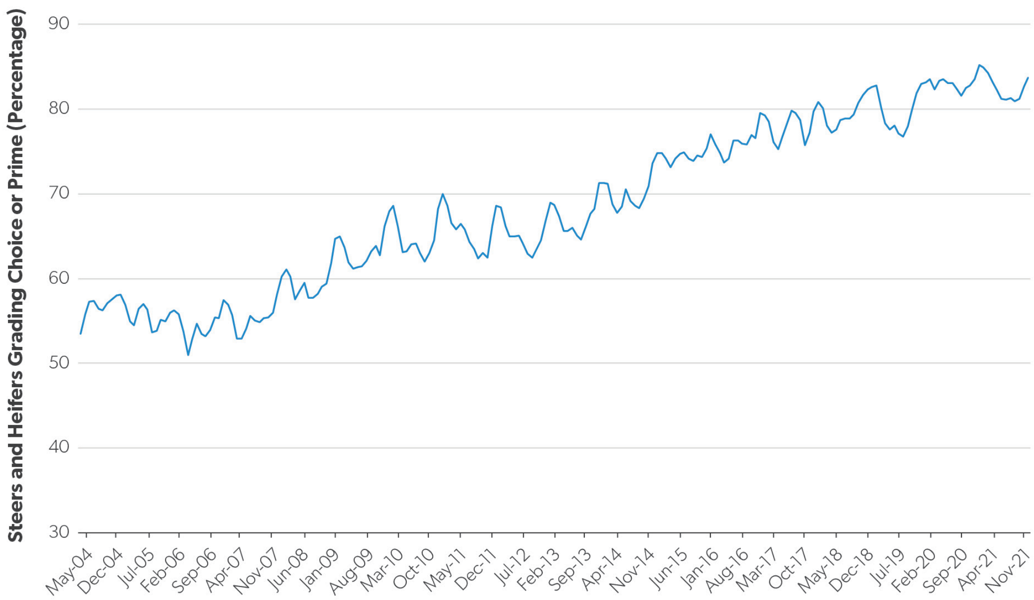
One important outcome of the cattle industry transitioning to marketing agreements focused on aligning cattle valuation with consumer demands has been a remarkable increase in the quality of cattle and beef that farmers and feedlots are supplying to consumers. Since formula marketing agreements have become prominent, 70 percent of which include grid-based premiums or discounts associated with cattle quality, according to the US Department of Agriculture,[6] the percentage of steers and heifers that supply "choice" and higher-quality grades of beef has steadily increased (Figure 2).

The percentage of cattle grading choice or better rapidly increased shortly after of the use of formula pricing began to escalate in 2008–09. In 2005, about 55 percent of steers and heifers graded choice or better. In 2009, 65 percent fell into those categories. Since 2020, 80 percent or more have graded choice or better. In supermarkets and restaurants, consumers are willing to pay significantly higher prices for choice and higher-quality beef products, with these premiums flowing back to feedlots and farmers.

Improving cattle and beef quality takes time and money. Farms and feedlots are willing to invest in genetics and expanded management efforts and accept the risks associated with producing higher-quality beef only if they have sufficient economic incentives. Negotiated cash cattle trades provide no incentives for producers to take on those costs and risks.[7] Quality-based "grid" pricing embedded in marketing agreements is how cattle producers are rewarded for taking on those costs and risks.

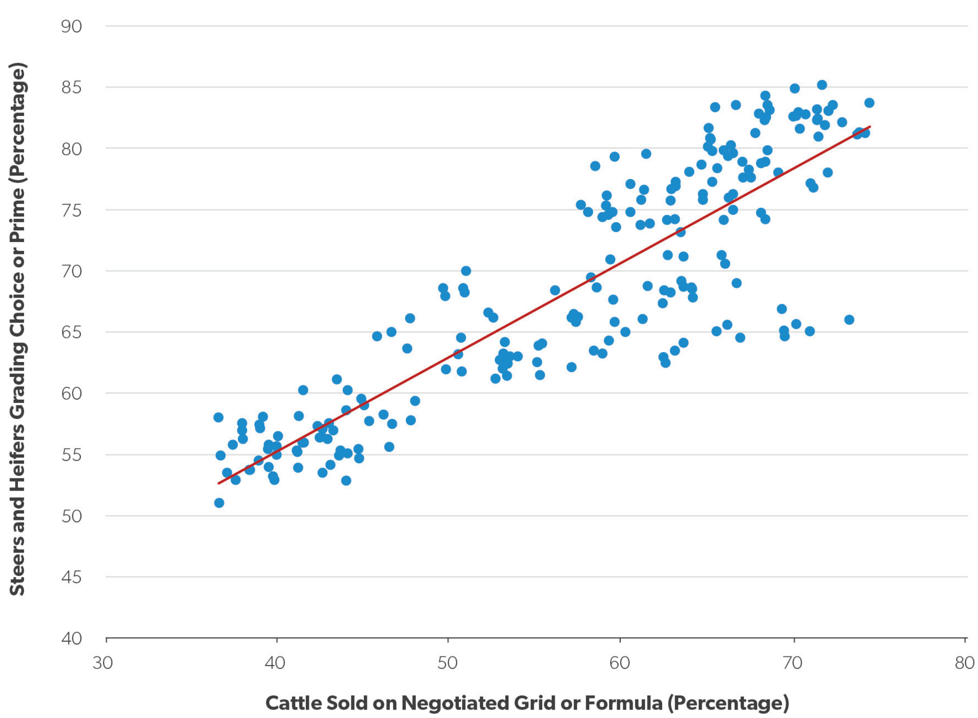
Figure 3 illustrates the strong positive relationship between quality grade and negotiated grid cattle marketing arrangements based on quality grids. The trend is no coincidence. Quality grids incentivize farmers and feedlots to improve genetics and

**Figure 2. Monthly Percentage of Steers and Heifers Grading Choice or Prime, May 2004–January 2022**




Source: US Department of Agriculture, Agricultural Marketing Service.

**Figure 3. Percentage of Steers and Heifers Grading Choice or Prime vs. Percentage of Cattle Sold on a Negotiated Grid or Formula, May 2004–January 2022**




Source: US Department of Agriculture, Agricultural Marketing Service.

manage cattle production to generate higher-quality beef. In 2021, about 70 percent of formula-marketed steers and heifers graded 80 percent choice or higher and garnered average net price premiums of approximately $3.30 per hundredweight dressed, compared to cattle sold through negotiated cash trades. This premium added more than $400 million to the revenues cattle producers received in 2021.

## Responding to Consumer Demand

The US cattle and beef industry is better positioned today than ever before to respond to evolving domestic and international consumer demands. Formula marketing agreements have generated quality premiums and facilitated novel cattle production certifications such as naturally raised, non-hormone treated, age and source verified, and traceability and special breed programs such as Certified Angus Beef and Wagyu.

Differentiating and branding beef products and responding more effectively to consumer demands are well-documented incentives provided by marketing agreements between cattle producers and beef packers.[8] Forcing industry participants to abandon some of the gains in beef quality and revenues associated with these agreements with the opaque goal of "price transparency" will not increase farm gate prices for beef cattle.

## Policy Threatens Progress

Several proposed federal policies are designed to curtail or limit the volume of fed steers and heifers that can be priced using anything other than negotiated cash trade methods.[9] Proponents argue that reduced trading volume of negotiated cash cattle has been detrimental to price discovery in the fed cattle market and resulted in reduced fed cattle prices. However, an important recent body of research finds no evidence for this claim.[10] Enhanced beef quality strengthened consumer demand. In response, producers who sought more effective ways to connect cattle production systems to consumer preferences have benefited through price premiums. Any policy that limits the ability of farmers, feedlots, and beef processors to participate in such agreements will be detrimental to them and beef consumers.

## About the Authors

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## Notes

1. Kansas State University, "Monthly Domestic Meat Demand Indices [USDA/BLS Data]," https://agmanager.info/livestock-meat/meat-demand/monthly-domestic-meat-demand-indices-usdabls-data.
2. Melissa G. S. McKendree et al., "Impacts of Retail and Export Demand on United States Cattle Producers," *American Journal of Agricultural Economics* 102, no. 3 (May 2019): 866–83, https://doi.org/10.1093/ajae/aaz034.
3. Glynn Tonsor, "Meat Demand Monitor—January 2022," Kansas State University, January 28, 2022, https://agmanager.info/livestock-meat/meat-demand/monthly-meat-demand-monitor-survey-data/meat-demand-monitor-january-2022.
4. Establishing longer-term relationships between feedlots and packers also advances business-to-business alliances, so when adverse events occur (e.g., major storms, feedlot or plant disruptions, and pandemics), the parties collaborate to minimize adverse impacts.
5. Ranchers and feedlots can often obtain premiums if there is verification that cattle are naturally raised, certified organic, praised in ways that reduce greenhouse gas emissions, or eligible for specific export markets.
6. US Department of Agriculture, Agricultural Marketing Service, "Highlights of the Evaluation of Formula Based Cattle Purchases," June 21 2021, https://www.ams.usda.gov/sites/default/files/media/HighlightsofFormulaCattleEvaluation2021.pdf.

7. Ted C. Schroeder, Brian K. Coffey, and Glynn T. Tonsor, Effective and Efficient Cattle and Beef Marketing Alignment: Price and Value Discovery, Divergent Incentives, Risk Management, and Future Prospects, Kansas State University, August 31, 2021, https://agmanager.info/livestock-meat/marketing-extension-bulletins/marketing-strategies-and-livestock-pricing/effective.

8. Schroeder, Coffey, and Tonsor, Effective and Efficient Cattle and Beef Marketing Alignment.

9. Elliott Dennis and Bradley Lubben provide a useful summary of the various proposals Congress and some, but not all, farm groups are considering. Elliott Dennis and Bradley Lubben, *Regional Minimums in the U.S. Beef Complex*, University of Nebraska–Lincoln, Center for Agricultural Profitability, February 4, 2022, https://cap.unl.edu/livestock/new-report-regional-minimums-us-beef-complex.

10. See, for example, John D. Anderson, James L. Mitchell, and Andrew M. McKenzie, *Analysis of the Cattle Price Discovery and Transparency Act of 2021*, University of Arkansas, January 2022, https://cpb-us-e1.wpmucdn.com/wordpressua.uark.edu/dist/6/907/files/2022/01/CPDTA-analysis-01.18.22.pdf; and Bart L. Fischer, Joe L. Outlaw, and David P. Anderson, *The U.S. Beef Supply Chain: Issues and Challenges*, Texas A&M University, Agricultural and Food Policy Center, June 2021, https://www.afpc.tamu.edu/research/publications/710/cattle.pdf.