

**Statement By James E. Link
Administrator of the Grain Inspection, Packers and Stockyards Administration**

**Senate Agriculture Committee Hearing
On the Office of Inspector General Audit Report:
“Grain Inspection, Packers and Stockyards Administration’s
Management and Oversight of the Packers and Stockyards Program”**

March 9, 2006

Good morning. I appreciate the opportunity to be here today to highlight for you a number of changes underway at the Grain Inspection, Packers and Stockyards Administration (GIPSA) to improve and strengthen the enforcement of the Packers and Stockyards Act.

On October 17, 2005, I became GIPSA's new Administrator, responsible for, among other areas, the Packers and Stockyards Program (P&SP). P&SP facilitates the marketing of livestock, poultry, and meat, and promotes fair and competitive trading practices for the overall benefit of consumers and American agriculture.

I have spent my life involved in American agriculture. I grew up working on a ranch in the Flint Hills region of Kansas and became the owner of the Link Cattle Company of Crowley, Texas. I have served as a committee member and officer for several national and regional agricultural associations. I came to USDA from Texas Christian University (TCU), in Fort Worth, Texas, where I was the director of the ranch management program.

The recent Office of Inspector General Audit Report, “Grain Inspection, Packers and Stockyards Administration’s Management and Oversight of the Packers and Stockyards Programs [sic], Report No. 30601-01-Hy, January 2006”, identified weaknesses in P&SP's programs and controls that are hampering our ability to effectively enforce the Packers and Stockyards Act. Our enforcement activities are essential to promoting a fair and competitive livestock market.

Under my leadership, the employees of the Agency can and will make the needed changes to strengthen our enforcement of the Packers and Stockyards Act (P&S Act). We have already begun making the fundamental changes in the culture of the organization that are essential to empower our employees to enforce the Act, and develop the internal processes and controls necessary to deliver improved results.

Since arriving at GIPSA in October, I have met with nearly all P&S Program employees. The vast majority recognized the program deficiencies identified by the Inspector General, and expressed a strong commitment to aggressively and thoroughly correcting the problems. They have shared many ideas on how to improve service delivery at all

levels of the organization, and I am listening. Together, my staff and I are making changes to effectuate positive mission results.

Background

The P&S Act provides protection for ranchers, producers, and poultry growers who are not paid on time, and are treated discriminatorily or unfairly by a packer, dealer, market agency, swine contractor, or live poultry dealer. Specifically, the P&S Act prohibits unfair, deceptive, unjustly discriminatory, and anticompetitive practices in the livestock, meat, and poultry industries.

During the 1980s, the meat packing industry experienced considerable consolidation. In order to better meet the needs of an increasingly complex industry, both headquarters and the regional offices hired legal specialists to assist in investigations and economists to increase our economic expertise. Also, P&SP began consolidating its 11 field offices to strengthen the Agency's ability to conduct complex anticompetitive-practice investigations by increasing the economic, statistical, and legal expertise in fewer field offices. By 1999, GIPSA had completed the restructuring of its headquarters operation and consolidated the 11 P&S field locations into 3 regional offices located in Atlanta, Georgia; Des Moines, Iowa; and Aurora, Colorado. PSP was restructured to reflect the three primary areas of enforcement under the Act -- financial protection, trade practices, and competition.

- The Financial Protection Branch handles payment protection, including requirements for prompt payment for livestock, meat, and poultry; bonds for the protection of livestock sellers; separate custodial bank accounts for auction markets; packer trusts to benefit cash sellers when a packer fails to pay for livestock; and solvent financial conditions for commission firms, auction markets, dealers and order buyers.
- The Trade Practices Branch handles one of the largest areas of work under the P&S Act, enforcing the prohibition against unfair, deceptive, or fraudulent trade practices. This involves monitoring and investigating a wide variety of activities, including weight or price manipulations, misuse of custodial accounts, commercial bribery, bait and switch advertising, check kiting, using unfair tactics to gain business, defrauding consignors, misrepresentation, false accounting and recordkeeping, and illegal brokerage.
- The Competition Branch focuses on preventing or prohibiting anticompetitive practices in the livestock, meat, and poultry industries. This includes detecting and preventing manipulation of prices, market allocation, restraint of commerce, unlawful monopolistic practices, apportioning of trade, predatory pricing, and conflicts of interest.

By 2001, six legal specialists were hired and placed in headquarters and the regional offices. 28 economists joined the P&SP staff and the Agency established an investigative

process modeled on DOJ and FTC procedures. A Senior Management Review Panel began monitoring the overall management of complex investigations.

Enforcement Activities

P&SP's enforcement activities begin when the program identifies possible violations of the P&S Act or regulations through its surveillance and monitoring work. If a potential violation is detected, an investigator reviews documents and reviews to ascertain whether a violation has most likely occurred. If so, generally the first step is informally working with the business to correct the violation without legal proceedings. If we cannot achieve compliance with the P&S Act in that way, we will refer the case to Office of General Counsel. If legal proceedings are warranted under our administrative authority, OGC will prosecute the case before an Administrative Law Judge, or if it's a poultry case, refer it to DOJ. For all proceedings, informal or formal, P&SP works closely with OGC.

It is important to have a clear understanding of the Department's legal authority under the P&S Act. For example, the Department cannot make a packer who owes money to ranchers for cattle in violation of the Act pay restitution as a sanction in an enforcement case. We generally are, however, successful in gaining violators' agreements to pay restitution in informal proceedings or through a settlement of a formal proceeding. If the Department has reason to believe a packer or swine contractor has violated the P&S Act, we may issue a written complaint and require the packer or swine contractor to testify at a hearing. If the Department finds that a violation occurred, we may issue a cease and desist order and may also assess a civil penalty of up to \$11,000 per violation. Other penalties that are available for violations include suspension of business operations and through referral to DOJ, permanent injunctions, which include fines and jail sentences imposed for the violations of an order of the Secretary.

The P&S Act does not provide any authority to the Department to alter the structure of the livestock and poultry industries. Firms are largely free to pursue their economic interests, such as opening or closing plants, expanding into new geographic areas, adopting new technology and cost-saving innovations, and integrating livestock production. Similarly, concentration, which is often discussed as a problem to be dealt with under the P&S Act, is not a term defined in the Act, nor is concentration in the livestock, meatpacking, or poultry industries directly addressed by the P&S Act. Therefore, a high level of concentration in these industries is not itself a violation of the P&S Act. The DOJ and FTC have the authority to investigate mergers and acquisitions by firms subject to the P&S Act.

Recent Achievements

Given this overview of our program and our authorities under the Act, I will highlight some of the Agency's recent achievements. I will then address the specific weaknesses identified by the Inspector General.

GIPSA works to resolve cases informally to recover money for producers and restore funds to appropriate accounts for financial protection in the event a regulated entity fails financially. In fiscal year 2005, P&SP recovered \$14.1 million for livestock and poultry

sellers and producers, and enforced the restoration of nearly \$350 million to custodial accounts and business balance sheets to correct insolvencies, and to protect producers from financial harm.

In FY 2005, GIPSA, working through informal resolution channels, obtained voluntary industry compliance in an instance wherein a market agency and dealer operation in the upper Midwest discovered that one of its employees had defrauded the company of more than \$1 million. A GIPSA representative met with company officials to audit their financial records and worked with them to secure sufficient financial protection for those who sold livestock to the firm. As a result of the timely intervention, no livestock sellers were harmed financially by the employee's fraudulent activities.

Investigations need not result in a finding of violation to be valuable to the industry. Following the terrorist attack of September 11, 2001, and then again, in 2002, following rumors about an outbreak of foot and mouth disease in Kansas, P&SP investigated to determine if these events were used to manipulate market prices in violation of the Act. In both cases, P&SP was able to identify the market forces causing the price declines and to reassure the market that they were not due to unfair or discriminatory practices.

Recent OIG Findings

Now, I'd like to focus on the findings of, and GIPSA's response to, the recent OIG report.

The OIG report identified four major areas of weakness in the P&S Program: bad record keeping, poor investigation management, lack of policy vision and decisions, and lack of follow-through on the recommendations of earlier reviews. These are fundamental and serious weaknesses. No business can be successful with this report card.

The Inspector General offered 10 recommendations to improve our operations. We have accepted all 10 and established an aggressive schedule to implement them. OIG has expressed satisfaction with all measures we are taking. Adopting the Inspector General's recommendations represents a good start, but it is only the beginning of the changes that we in GIPSA are going to make.

We have undertaken specific steps to meet the recommendations of the OIG Report. For example, we have implemented four new policy directives to address recommendations number 1, 3, 5, and 6 in the OIG Report, which deal respectively with defining investigation versus regulatory activities; revising the organizational structure to provide greater authority to the regional offices; enabling the legal specialists to freely contact and work more directly with OGC; and developing a structure for receiving, reviewing and acting on policy issues and internal requests for guidance. We are also in the process of programming changes into existing software to accommodate the need to track investigations and identify regulatory versus investigative activity in the old Complaint and Investigation (C&I) Log.

My goal is to achieve a results-oriented culture in which all employees understand their contribution to fulfilling our mission, and can see the results of their dedication and hard work through transparent program performance measures.

To accomplish this goal, we must begin by addressing the needs of our employees. I have opened my door to all employees by establishing a confidential employee-Administrator communication website, by making onsite visits to field offices, and, most recently, by initiating a full-scale organizational review and assessment of the Program. The review team, comprised of USDA officials outside our Agency will begin by analyzing the organization of headquarters staff and continue the evaluation to the field staff. The review team started interviewing Program staff January 30th. By the end of this month I expect a report from the team identifying effective and ineffective activities of the headquarters and field staffs, effective and ineffective interactions with others in GIPSA, and areas for improvement. I also expect the team to identify options for structuring staff and allocating staff resources with advantages and disadvantages for each option. Their analysis will provide me with expert and objective information to aid in creating a more efficient staff structure. I have also contracted with the Office of Personnel Management (OPM) to administer an Organizational Assessment Survey. This voluntary survey, which is currently being conducted, gives employees an opportunity to anonymously let me know what they think about the organization's strengths and weaknesses in a variety of areas. I will use the survey results to enhance our work environment and culture, and to improve our organizational effectiveness.

In the end, our response to the January 2006 OIG Report findings will result in P&SP headquarters and regional management working collaboratively to provide the oversight and guidance that will allow multi-disciplinary teams, comprised of economists, auditors, and legal specialists, working hand in hand with OGC and DOJ, to fulfill our mission.

Competitiveness in Livestock and Poultry Markets

Before concluding, I would like to offer some comments on two characteristics of livestock markets that continue to generate concern – market concentration, and increased use of contracts or alternative marketing arrangements for the procurement of livestock and poultry.

Buyer or market concentration is generally measured by the proportion of total livestock purchased by the four largest firms. During the 1980s, a series of plant closures and mergers raised that proportion to 80 percent in the steer and heifer market. The hog industry four-firm concentration ratio reached 64 percent in 2003 with Smithfield's acquisition of Farmland. In the sheep and lamb industries, the four-firm concentration ratio fell from 72 percent in 1992 to 65 percent in 2004.

Academic research has generally found that livestock markets are competitive. A 1996 study (Azzam and Anderson), reviewing research completed prior to 1995, found that economic factors, and especially technological changes, have driven most of the structural changes in commercial meatpacking. They concluded that research literature suggested that the structure of markets in the red meat packing industry, although not the

ideal of perfect competition defined by pure theory, is not burdened by significant anticompetitive features. More recent studies also have not found a predominance of anticompetitive structure in meat processing or the sale of meat (Koontz and Garcia 1997; Schroeter, Azzam, and Zhang 2000).

The movement towards contracts or other alternative marketing arrangements is another area that continues to generate concern about the potential abuse of market power. Typically, contract prices for cattle and hogs are tied to the spot market price. As a result, as more animals are sold through contracts or other arrangements and fewer through the spot market, the actual number of transactions on which contract payments are based becomes smaller. This “thinning of the market” is often alleged to increase the ability of large buyers to manipulate prices. Research on this issue has been mixed.

Contracts also play a significant role in the poultry markets since nearly all poultry production is grown through contracts. Often, the contracts compensate growers based on their cost performance relative to other growers. Producer concerns frequently involve the substantial investments required for poultry houses and the growers’ subsequent dependence on a poultry processor for ongoing contract renewal.

Our role is to protect the specific regulated industries under our authority from corrupt or discriminatory business practices that negatively impact the ability of sellers or producers to compete, and cause competitive harm. A detailed knowledge of the industries and ongoing monitoring of market activity allow the P&S Program to detect damaging business activity in an incipient stage and work with firms to prevent harm to producers and sellers.

We carry out our responsibility by monitoring market behavior; maintaining a comprehensive understanding of industry practices; investigating complaints of alleged violations of the P&S Act, such as price manipulation, unjust discrimination, and apportionment of territory; and conducting studies of market activities. For example, RTI International, Inc. is currently conducting a congressionally mandated study to assess the impact of alternative marketing arrangements of the cattle, hog, and sheep markets.

To monitor the fed cattle markets, we analyze USDA published weekly cattle prices for five direct-fed cattle markets. These publicly available prices are developed using an econometric model to predict prices for the week based on the historical relationships between each market’s price and those of the other five markets. With a national market for fed cattle, all market prices tend to move together. If one goes up, the others usually follow, and usually in proportion to each other’s prices. Hence, if an actual market price starts to move contrary to the direction of the other markets, rising past a statistically determined boundary predicted by the model, it is termed a “trigger price.” Trigger prices are indicators of sudden changes in either supply or demand factors within a market that are not affecting the other markets as a group. The appearance of a trigger price sets off a P&SP review into the possible causative supply or demand changes. If the trigger price cannot be explained based on the publicly available data, P&SP requests

nonpublic, data from the firm to determine if a single firm is the cause of the trigger price and, if so, what behavior of the firm is causing the price behavior.

During fiscal year 2005, we conducted reviews of 25 trigger prices in steer and heifer pricing. P&S staff conducted detailed analyses of these prices to determine whether there were factors not included in the statistical models that explained the outliers. They found no evidence of violations in 24 of the instances; the last investigation is still open.

We recently implemented a similar econometric model to monitor hog markets. The five hog price markets monitored are based on the publicly available USDA data for the Eastern Corn Belt region for negotiated carcasses and for negotiated live hogs, the Iowa-Minnesota region for negotiated carcasses and negotiated live hogs, and the Western Corn Belt region for negotiated carcasses. So far the model has identified two trigger prices and after review, one that has been explained and the other remains under review.

We also monitor market activities by visiting the markets to interview participants and gather information. For example, we collect information about the procurement practices of livestock sellers, dealers, sale barns, order buyers, and packers in the cow and bull market. P&S staff visit individual cow-bull packer facilities and collect data on livestock procurement practices, such as the use of grades in buying decisions, packers' presence or absence at nearby auctions, packers' use of niche product lines, and the use of a single buyer agent to purchase on the behalf of multiple packers.

Conclusion

The P&S Act and the Packers and Stockyard's Program that enforces it, play important roles in American agriculture. The OIG report was a disturbing reflection of weaknesses that are impeding our Agency from carrying out our mission. I am fully committed to establishing the policies and creating the organizational culture that we need to promote fair business practices and competitive environments to market livestock, meat, and poultry. Only through these changes can we protect consumers and members of the livestock, meat, and poultry industries.

Thank you for the opportunity to address the Committee. I am happy to respond to your questions.

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