United States Senate Committee on Judiciary

Hearing on Beefing up Competition: Examining America's Food Supply Chain

July 28, 2021

Questions for the Record for David Smith, Associated Wholesale Grocers

<u>Senator Sasse</u>

Question 1

- *Is the domestic market for beef expanding or shrinking? What do the best projections show? Is the international market for beef expanding or contracting?*

  The U.S. cattle industry goes through cycles and we are currently in a contraction cycle. Given current trends, cattle supplies will continue to shrink in 2023 and 2024. The USDA reported that, on July 1, 2022, the total inventory of all cattle and calves was 98.8 million head, 2 million head less (down 2%) than the previous year and 4 million head less (down 4%) from the cycle peak in 2018. Drought conditions and high feed costs have all but assured that we will have fewer cattle in 2023 and 2024. Producers have been liquidating beef cows (the production base) at the fastest rate in almost 30 years. The inventory of beef cows on July 1 was 2.4% lower than the previous year. Producers are indicating that they are holding back fewer females for herd rebuilding. This means there will be an even smaller beef cow herd next January and very likely next summer. Fewer cows today mean fewer calves next spring and fewer cattle coming to slaughter in 2024 and 2025.

  If instead of questioning whether or not supplies are increasing, we question whether beef demand in the domestic market is expanding, the answer is not so simple. Prices have been higher to address issues with demand, leaving wholesale and retail beef prices for last year and this year at or near record levels. There are substantial capacity constraints in the market, labor being one of the biggest issues, yet producers are continuing to liquidate their herds.

  The USDA is currently projecting beef production in 2023 to be down 6.2% next year. Private estimates are that production will be down 4.5% to 6% in 2023 and down as much as 7% in 2024. The USDA has not published 2024 estimates but they will very likely be down as well. It should be noted that when companies like Wal-Mart take an ownership interest in companies such as Sustainable Beef LLC, a rancher-owned company based in North Platte, Nebraska, a guaranteed supply of beef is removed from the marketplace, making the overall supply tighter for all purchasers.

  In speaking to the international market, it depends on the market. European supplies are shrinking while supplies in New Zealand are steady. Brazil continues to expand, with the Brazilian cattle herd today being 17% higher than five years ago. Brazil is now by far the biggest beef supplier in the world. Australia saw a big decline in their herd in the last couple of years due to drought conditions, however, the situation in Australia appears to have improved and their herd is expected to be higher this year as well as in 2023 and 2024. It is expected that, by 2024, the Australian herd will rebound and be back to where it was in 2018. Australia's cattle industry is very cyclical with weather playing a major factor as a large portion of their cattle are finished on grass.

Demand in the international market has increased largely due to the emergence of China as a major international buyer. Although China is self-sufficient in pork production, it is not able to meet its domestic demand for beef. Currently, China is by far the largest beef buyer in the world, taking over from Japan who was the largest beef importer in the world ten years ago, when China was buying only 3% of what Japan was buying. Today, China is buying almost 4 times as much as Japan.

Question 2

- *If all capacity constraints go away over the next 6 months - so labor shortages disappear, transportation bottlenecks are non-existent, and there are no demand disruptions or regulatory shocks for bumps – would you anticipate significant change or the markets to function relatively similar to the way they do now? How would this impact retail beef prices?*

  It should be noted that in the past 14 months since the date of the original hearing before the U.S. Senate Judiciary Committee, capacity constraints, supply chain disruptions and labor shortages may have improved slightly, but these constraints are still with us. Even if capacity constraints, supply chain disruptions and labor shortages disappear in the next 6 months, independent grocers would still face significant competitive challenges compared to their larger national chain rivals. Economic discrimination against independents existed well before the supply effects of the COVID-19 pandemic unraveled and the constraints in the market during the pandemic simply magnified the problem. Dominant retail power buyers will continue to use their power to secure preferable terms from suppliers resulting in discrimination against independents with no market power. The remedy we need now and going forward is a competitive marketplace using strong enforcement of the antitrust laws.

  With respect to the cattle markets, we expect cattle prices to almost certainly increase because tighter supplies are already baked in for the next 2-3 years. However, without capacity or regulatory constraints, this change will provide incentives for growth and result in more competition among processors for cattle. The function of retail beef prices is to adjust. Tighter supplies mean prices need to be higher in order to ration out available demand. That will not change. It is our understanding that the labor situation at plants has improved, but we do not have any data to back that up.

  One way to look at this overall is with a theoretical gross margin for packers. We say theoretical because we do not know the price and cost of specific packers. However, from the USDA, we get the calculated value of beef traded at wholesale (beef cutout), the imputed value of by-products (drop credit) as well as what packers pay for cattle each week. Packer revenue is determined by cutout and by-products and packer cost is determined by what they pay for cattle. Last year at this time, the calculated gross margin was $1,370/head. Today, it is $484/head. Capacity constraints, especially the tight labor market, contributed to those outsized margins last year. Fed cattle slaughter is a bit higher today than it was last year and yet the gross margin is down. Those margins may be compressed further in the next 6 months as cattle numbers slowly decline. We say slowly because there is still a fair number of cattle in feedlots. We will see bigger declines in cattle availability in the second half of 2023 and in 2024, which will result in more capacity slack and, thus, more competition for cattle.

SENATOR CORY A. BOOKER

Mr. David Smith

1. *In your opinion, is there a connection between the growing food desert problem and grocery industry consolidation and buyer power?*

   Yes, there's a direct connection. Independent grocers tend to locate in places where larger chains don't see a great potential for profit, particularly in sparsely populated rural communities and low-income urban neighborhoods. However, it has become increasingly difficult for independents to stay afloat in these communities due in large part to economic discrimination caused by the buyer power abuses of dominant retail players. Unfortunately, independent grocers are unable to access the market on a fair and competitive basis even when they partner with a large wholesaler like AWG to capture the same economies of scale and efficiencies as our large rivals. As a result, many independent grocers have shut their doors leaving food deserts in their wake. If Congress hopes to solve the food access crisis, then it must insist that our antitrust laws are enforced to ensure that grocery markets remain competitive.

2. *Dollar stores have grown exponentially over the past few years. Communities throughout New Jersey that once had a grocery store now only have a dollar or corner store that offers ultra-processed foods and a limited assortment of fresh foods.*

   a. Does your antitrust problem explain the proliferation of dollar stores and retreat of grocery investment in low-income areas?

   Dollar stores are indeed expanding rapidly, growing from roughly 18,000 locations in 2009 to more than 34,000 today, with plans to continue expanding to more than 50,000 locations. Dollar stores have become an increasing threat to grocers in low-income and rural communities where consumers tend to be on a tighter grocery budget and need to stretch their dollars further. Dollar stores exploit the lack of antitrust enforcement by commanding exclusive smaller-quantity packaging (often known as "cheater packs") that traditional grocers cannot access due to arbitrary "channels of trade" distinctions – where a traditional "grocery store" may not be considered to be in the same channel of trade as a "discounter", so these products are simply not even made available to companies like AWG to purchase for resale to their members/customers. We compete for the same consumer dollar as the dollar store channel, yet loopholes in antitrust laws allow them to secure exclusive offerings that attract our budget-minded customers. These aggressive tactics have led to a number of grocery store closures that leave communities without a full-service supermarket. Shoppers then become overly reliant on dollar stores that provide a very limited offering of fresh and healthy foods that consumers need to maintain a healthy diet.