

# Government regulation and quality in the US beef market <sup>☆</sup>

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## Abstract

We show how government regulation played a critical role in shaping the beef industry over the past century. Technological developments in the late 19th century led to a highly concentrated meat-packing industry and fostered a national market for beef in the US, and the development of a national market for beef led to regulations to ensure quality uniformity, especially USDA grading. We explain the problems with beef quality created by USDA grading using tools from information economics. Because USDA's fairly coarse grading system failed to measure significant aspects of beef quality, beef production suffered from the multi-tasking problem, which led producers to focus on producing larger quantities of beef while ignoring quality issues. We show that producing high quality beef requires either ex ante input controls or ex post sorting. In turn, we show how newly developed programs such as USDA quality certification and branding are incentivizing production of higher beef quality and dealing with information problems arising under USDA grading. We conclude with the implications of the regulatory history for current regulation of beef markets.

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## Introduction

Between 1976 and 1998, the beef's share of meat consumption declined from 48% to 32% as total beef consumption stagnated while poultry and pork consumption rose

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(Fig. 1). In turn, real beef prices fell by approximately 35%, and beef cattle inventories fell from 45 million head to 33 million head. In this period, the industry underwent widespread structural changes in attempts to reverse the tide of falling demand, including the consolidation of the ranching, cattle-feeding and meatpacking sectors and the passage of the Beef Promotion and Research Act of 1985 which introduced generic advertising of beef at the national level. Recently, the relative price of beef has risen sharply, leading some to argue that demand for beef is increasing (although there have been several supply shocks as well). We argue here that federal regulation of beef production has played a critical role in shaping the structure of the industry from the ranch through the feedlot and the supermarket. In turn, new production and marketing institutions have arisen to address both information and incentive problems in beef production. These institutions have contributed to increases in beef demand.

Federal regulations of the beef industry arose in order to regulate market power and to use government sanctions to bolster economic returns to various links in the beef supply chain, e.g. to foster rent-seeking. The development of USDA grades in the early 20th century created a classic moral hazard problem in which producers were compensated for producing larger cattle, but not for quality improvements. In response to declining beef quality, a number of marketing innovations have arisen to raise beef quality, including contracting, value-based pricing, and USDA quality certification programs. These innovations addressed the belief that poor quality, specifically a lack of tenderness and palatability, contributed significantly to beef's decline, while acting within the established USDA grading program. As the new innovations have taken hold to raise quality and to allow for the creation of branded products, demand has risen accordingly.

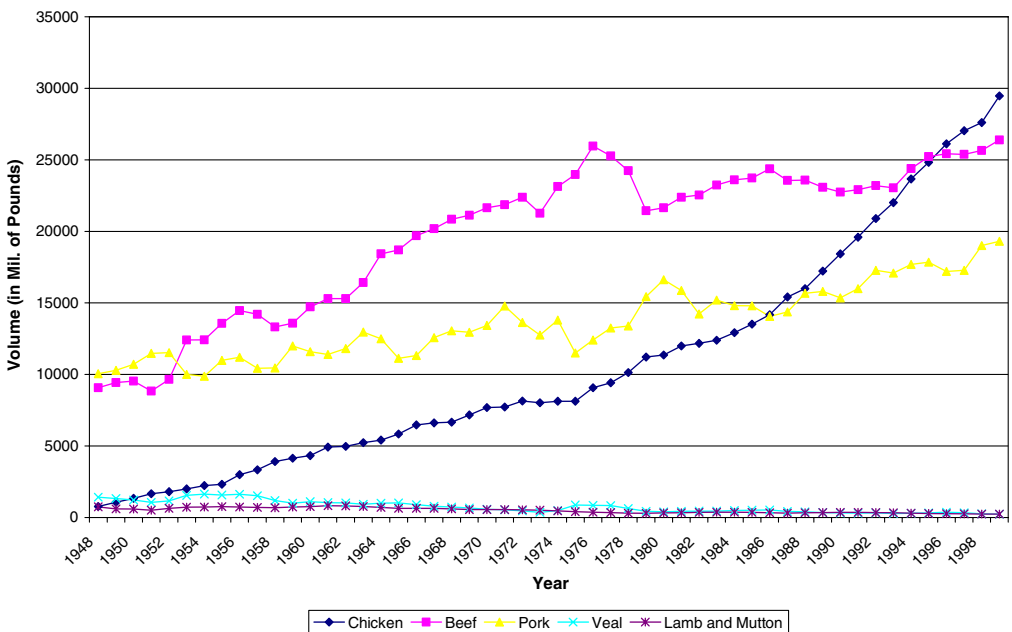


Fig. 1. US production of meats in millions of pounds, 1948–1999. Source: USDA, Agricultural Statistics, 1948–2000.

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