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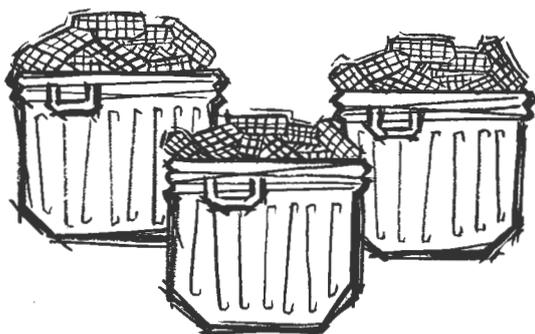
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Contract Farming "Take Over" Not Likely

Most of the current concern about the possibilities of highly specialized, contract farming or so-called vertical integration can be summed up into three major questions. Here's how the situation looks so far.

by Earl O. Heady

CONTRACT FARMING or so-called vertical integration still is a fairly new wrinkle in agriculture. It's not entirely new. Various kinds of contracts and degrees of integration have been used in agriculture for decades.

Feeding cattle and sheep on contract once was quite popular here in Iowa. And contracts for producing sweetcorn, peas and other vegetables are commonly used in communities with canning factories.

It's just within the past several years, however, that there has been widespread expressed concern over contract farming—particularly with respect to hog production. Most of this concern involves specialized production arrangements and can be summarized into three major questions:

- Will specialized production—especially of hogs under contract or independently—fit into and be most profitable on *my* farm?

- Will specialized or specialized-contract hog production take over and become the general pat-

tern of agriculture here in Iowa and the Corn Belt?

- Will the growth of specialized hog production or specialized contract arrangements force hog production out of Iowa and the Corn Belt?

We discussed the first question in two earlier articles in *Iowa Farm Science*. See "What Hog System for You?" in the November 1959 issue (reprint FS-835) and "More About Choosing a Hog System" in the February 1960 issue (reprint FS-852).

Briefly, the research reported in those two articles showed that corn production holds top billing on most Iowa farms. Corn production offers the most profitable use of resources on good Iowa cropland. Taking capital and labor *out* of corn production and putting them to work in another enterprise, on the other hand, usually lowers income. The research indicated that the specialized multiple-farrowing systems would be used, if at all, (1) on specialized hog farms where cropland and the income from it is a minor element and (2) by farm operators using such systems as a means to acquire more know-how and capital from an integrator.

In this article, let's concentrate on the last two questions. Re-

search in progress is turning up some answers. Generally, the results indicate that the answer to both questions is, "No." But let's look at each question on its own merit.

Will specialized and contract hog production take over and become the general pattern of agriculture here in Iowa and the Corn Belt?

To find the answer to this question, let's look first to the individual farm and farm operator. For farms of typical size, we find that efficient hog production usually includes 2-3 farrowings per year—fitted into a farm operation that allows labor and capital to be used in a crop program plus some feeder cattle to use any extra forage. Most specialization and contract arrangements involve multiple-farrowing systems of 4-6 farrowings a year or purchasing feeder pigs.

Our studies suggest that these methods aren't likely—in terms of profits to the individual farm operator—to supersede the more general management systems now dominant in Iowa and the Corn Belt. There are some advantages in using the same equipment and stock for specialization and as many litters as are consistent with

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the most profitable combination of livestock and crops. Beyond this point, for the farm operator with the capital and management skills, it isn't profitable and draws labor and other resources away from corn and the cropping program that goes with it.

Thus, for the farm operator with the capital and management skills, it generally isn't profitable to adopt the specialized multiple-farrowing schemes. To do so, he'd have to take labor and other resources away from corn. And this is the crop that still gives the highest return to labor and capital resources. For the farm operator in this situation, contracts providing capital for feed, hogs and equipment have no profit advantage.

What about the farm operator who does *not* have the funds and management ability necessary to produce pork efficiently? In this case, there is some advantage in contracts and specialized multiple farrowings—providing hog production isn't pushed so far that it pulls resources away from the more profitable crops with which hog production must be fitted.

Very few Iowa farms make top profits by producing a single crop. It usually takes more than one enterprise for the greatest returns. If a certain number of hogs are a part of this combination—but the operator lacks the managerial or financial requirements—a contract or a vertical integration system can sometimes provide the lacking resources. If only capital is missing, however, and he has the management ability and can borrow funds at usual interest rates, a contract arrangement would have an advantage only to the extent that he can get a better selling price for his hogs.

About the only other farm situation that vertical integration can benefit is the farm that produces *only* hogs. For the farm operator in this situation, extreme specialization and continuous farrowings would be the most profitable method of using his resources.

But on a profit basis, most Iowa and Corn Belt farms won't enter into (or stay in) highly specialized hog farming based on contracts and vertical integration. Again, corn production gives the

highest return to capital and labor, and multiple farrowings would draw labor and capital away from corn. And it's a crop-livestock combination fitted with and "around" corn production that almost always results in the highest returns.

Will the growth of specialization and contract hog production in other areas take hog production out of Iowa and the Corn Belt?

To answer this question, let's look again to corn. For top profits in the major corn areas, it's necessary to combine a certain number of hogs or other livestock with crop operations. Even hogs can't compete with corn in returns to labor. But this applies only to labor that can be used to produce corn. During much of the year, labor can't be used to produce corn. So it's used largely in the production of hogs in the Corn Belt. And, unless a more profitable enterprise than hogs is found, labor will continue to be used in the Corn Belt for hog production during the off-season for corn.

Hog production is closely tied to corn and other feed-grain production. Feed grains are by far the major input in hog production, with a much smaller input of prepared feeds as compared with, say, broiler production. So hog production "on location" has a relative cost advantage in the areas where corn and other feed grains are produced.

Certain regions, such as the Southeast, have a labor advantage in the form of wage rates. The Corn Belt has another kind of labor advantage: Field crop production is seasonal. Labor used for hog production doesn't have a great alternative opportunity on most Iowa and Corn Belt farms. This appears to be a greater force than low wage rates and will continue to be an important force in holding hog production in the Corn Belt.

This doesn't mean that there won't be long-run increases in pork and beef production in other areas—most likely in the Southeast and West. Increases are likely to occur in the Southeast because of long-run shifts from cotton coupled with other factors

—rising feed-grain production, lower-cost freight rates by water and a more rapid population growth than in the Midwest. Likewise, the factors encouraging increases in the West are a rapidly growing population and consumer market and a rising feed-grain production.

None of these factors, however, reflect a deterioration of the basic comparative advantage of Iowa and the Corn Belt in hog production. Part, but not all, of the forces encouraging increased feed-grain production in the Southeast and West may be the result of past and present government farm policy for cotton and wheat. A change in government farm policy might change this situation, too. A change, for example, taking the emphasis off of the shift from wheat and cotton land to surplus feed grains would re-emphasize the Corn Belt's basic advantage.

Another factor which could have a major effect on integration is whether or not the integrating firms pass on any savings to farmers. Can integrating firms process and distribute larger amounts of feeds at lower cost than other firms? Can they provide managerial services and skills at lower costs also? If so, cost economies would exist. If such gains were passed back to farmers in the form of lower costs for feed and services or in higher prices for their products, the result would likely be a long-run trend toward more integration.

This force won't exist, however, if any such economies aren't passed back to the farm operator. He'd gain nothing by integration, with the result that there'd be no lasting long-run developments in the areas of integration for hogs and cattle fattening.

Summing Up: The weight of the evidence favors a negative answer to the last two questions as well as the first. There's no absolute proof either way. But it appears that no widespread number of farmers will move into (or stay in) highly specialized arrangements unless there are very real and genuine advantages. And, so far, there's little evidence that many of these exist.