Regulation Of The Livestock Trade

Private regulation of the livestock trade by the Kansas City Livestock Exchange was a success.

By KC Olson

One of the most significant sidebars to the organization of livestock exchanges in the 19th century was establishment of the right of private business associations to regulate trade. The livestock market at Kansas City grew from a local concern in the1860s to national trading center in the 1880s. The volume and anonymity this brought to the business forced participants to innovate new trading methods. New trading methods, in turn, gave rise to a need for some system of administrating disputes in a fair and expeditious manner. The commission merchants were fearful of government influence in the livestock trade, therefore they elected for self-regulation over regulation by the state when the Kansas City Livestock Exchange was organized. Cattlemen, by their subsequent ambivalence toward the new system, tacitly lent support to the principals of self-regulation (Hazlett, 1987).

While a few historical precedents existed, the move toward self-regulation was bold. In the absence of strong positive government, the exchange essentially became a regulatory agency that promoted democratization of the trade rather than consolidation. Instead of following the pattern of industrial corporations that concentrated economic power into the hands of a few, the Kansas City Livestock Exchange decentralized power by encouraging widespread participation from its membership. The major functions of the Kansas City Livestock Exchange were to make rules, arbitrate disputes, and police the conduct of the commission merchants. From 1886 to 1921, it performed all the functions of a regulatory agency and demonstrated that is was possible to have regulation in a free economy without the heavy hand of government (Hazlett 1992).

In organizing a commercial exchange, the Kansas City commission merchants assumed certain rights from the government and its constituency. They assumed the right to organize their trade, to put a stop to anarchy, and to promote uniformity in business conduct. They also assumed the right to set commission rates for all livestock consigned to the Kansas City market. Furthermore, the exchange assumed the right to settle business disputes outside the normal judicial system (Hazlett 1987).

Nineteenth Century political commentator Edwin Snyder (1892) begged the question as to why the livestock industry allowed a voluntary association of less than 200 men to dictate to thousands of livestock producers the terms upon which their animals were sold. Historians later provided the answer. J. W. Hurst (1956) wrote that under a federal constitution committed to limited government, Americans routinely loaned the organized force of the community to private planners. Furthermore, the courts sustained the rights of these planners to act.

In the course of American history, state governments developed a narrowly defined view of their own power (Lurie 1979). This limited-power view of government paved the way for private associations like the Chicago Board of Trade. The state of Illinois delegated to the Chicago Board of Trade the right to regulate the grain trade through a corporate charter. The Kansas City merchants followed the Chicago example in organizing an exchange in 1886 but without applying for a corporate charter. With no stipulated authority from government, they simply assumed they had the right to regulate the livestock trade of the Southwest as an unincorporated private association (Hazlett 1987).

In retrospect, legal experts have expressed amazement at the audacity and breadth of power exercised by the Kansas City Livestock Exchange. The exchange determined who could and could not be a commission merchant; it conducted commercial courts outside the county or district courts; it fined members enormous sums of money for rule violations. Members could be summoned before the exchange board of directors and investigated upon a mere rumor of impropriety. The board even used anonymous witnesses to convict members and no attorney for the accused could appear in the commercial courtroom (Hazlett 1992).

A convenience of geography was perhaps an important reason why the exchange was able to conduct its business relatively free of government interference. The state legislature in Kansas was fairly hostile toward the Kansas City commission merchants. At times, it attempted to pass laws that imposed on the autonomy of the exchange. Unfortunately for the Topeka politicians, the exchange building was situated exactly on the Kansas-Missouri state line within the stockyards. When necessary, meetings of the exchange membership were simply moved to the Missouri side of the exchange building, making it convenient to ignore Kansas law.

The Missouri legislature rarely interfered with the operation of the exchange and reportedly even encouraged the rebellion against Topeka. In spite of the seemingly high-handed management style of the exchange, all of its activities were found to be consistent with the trade rules of the time. The courts sustained the right of the Kansas City Livestock Exchange to regulate its trade in cases brought before state supreme courts in 1889 and 1906. The Packers and Stockyards Act of 1921 ended that grant of power (Hazlett 1987).

Challenging The Exchange's Power

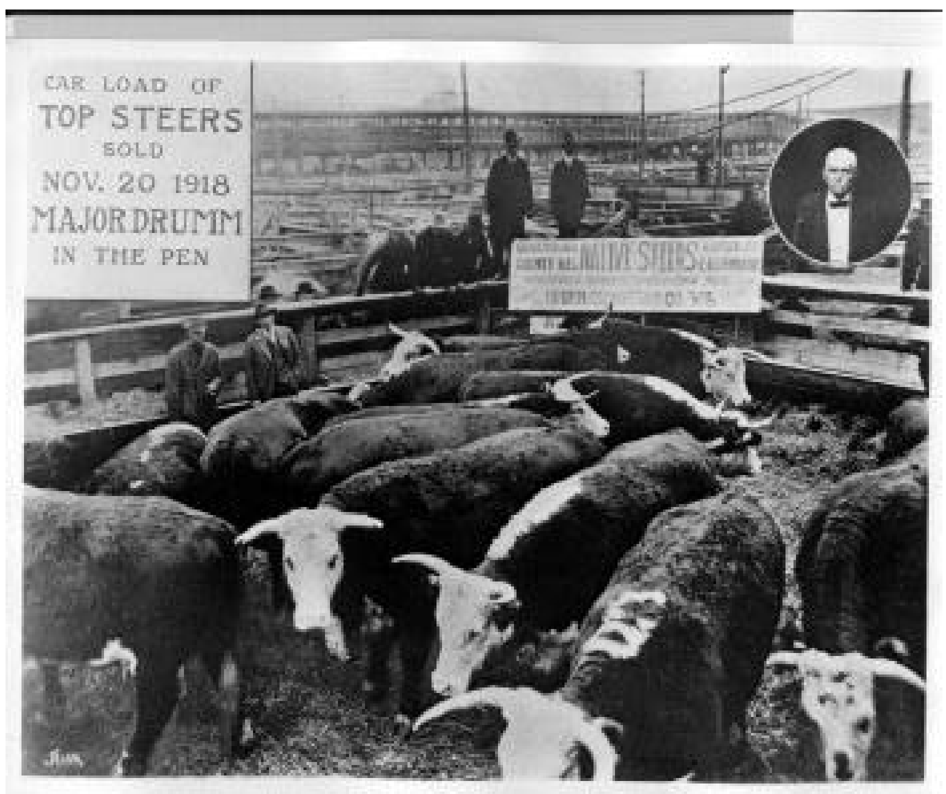
Prior to 1921, there were few serious challenges to the regulatory power of the Kansas City Livestock Exchange. Historian O.J. Hazlett (1992) nonetheless documented the events surrounding one such challenge that poignantly depicted the decisiveness and flair that was characteristic of the exchange.

By 1889, a number of individuals belonging to the free-trade faction decided that they had borne enough of the exchange's presumptions of regulation and determined to take action. They formed a new business venture, the American Livestock Commission Company (ALCC), designed to weaken and eventually destroy the commercial and political influence of the exchange. The ALCC was a thinly disguised attempt to return to the non-regulated environment that had existed prior to 1886. Its charter made it plain that the ALCC would ignore the no-rebate rules of the exchange and use the Wyandotte County (Kansas) district court and the Kansas legislature to try and force the exchange out of business. Anticipating opposition from the Kansas City exchange, the directors of the firm incorporated the ALCC in Illinois.

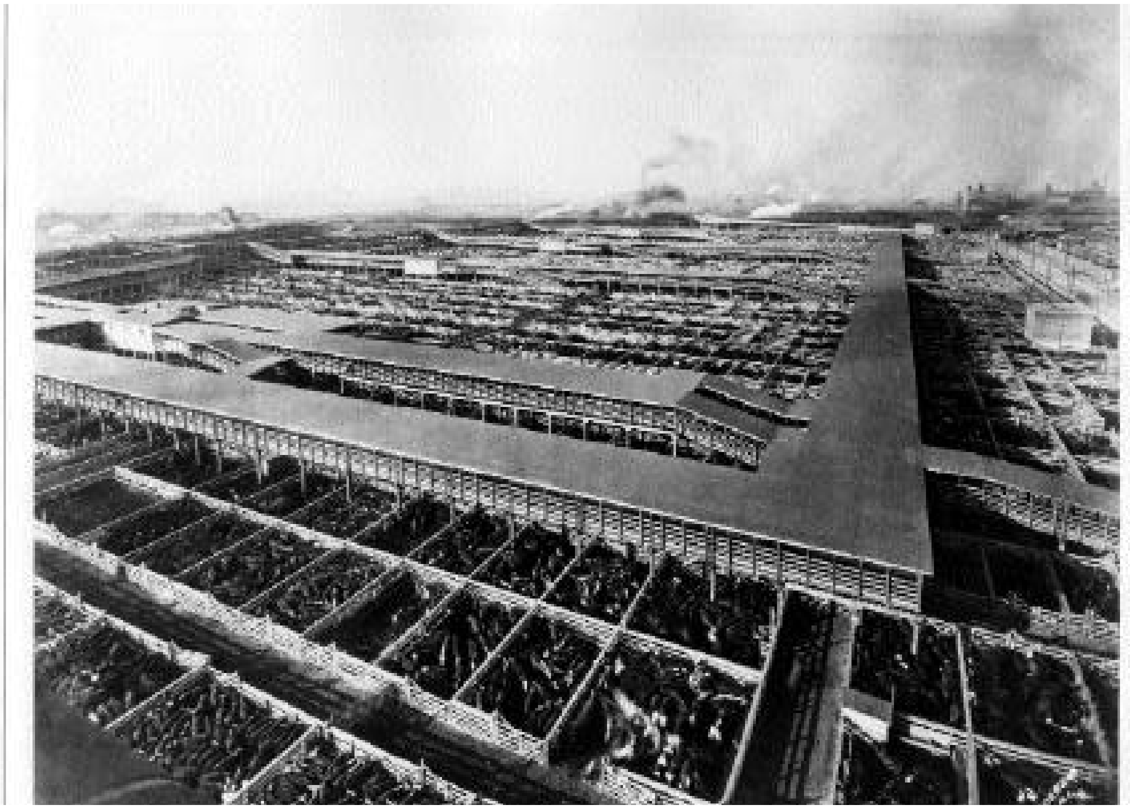
According to Hazlett (1992), most historians have interpreted the ALCC as a part of the late 19th century cooperative crusade. In fact, it attempted to portray itself as a farmer's alliance in order to appeal to the populist legislature in Topeka. The reality was that the ALCC was spawned by large cattlemen from the southwest and not agrarian crusaders, although Kansas family-farmers did later lend it support. In spite of this alliance connection, the officers and managers of the ALCC were not poor farmers; they were old-style Kansas City free traders in a new guise. W. F. Peters was the only member of the ALCC's management team who was not a large dealer in cattle; he was a commission merchant. The ALCC needed an agent, like Peters, who was already a member of the Kansas City Livestock Exchange so that it could avoid being rejected for exchange membership.

The ALCC threatened to boycott the Kansas City exchange if the commission firms and packinghouses discriminated against it. The new organization promised instead to ship their cattle to Chicago, relying on a contract with every stockholder that bound them to transact all of their business through the cooperative. By the terms of its charter, the ALCC would rebate 65% of net earnings back to consignors in proportion to the number of cattle that each marketed through ALCC. Remaining earnings were to be distributed among the stockholders in proportion to the number of shares each held.

Members of the ALCC controlled enough cattle that the Kansas City Livestock Exchange perceived them as a very real threat. If successful, the ALCC would vastly undercut the services of the exchange members and drive most of them out of business.



Cattle sold by Major Andrew Drumm at the Kansas City Stockyards on behalf of E. R. Lehmann of Eureka, Kansas. Drumm (inset) was a prominent member of the free-trade faction and a promoter of the American Livestock Commission Company. Provided by the Kansas State Historical Society - Topeka, Kansas. Reprinted with permission.



The Kansas City Stockyards, shown here at the height of its commercial prestige, closed in 1988 after 120 years of operation. Provided by the Kansas State Historical Society - Topeka, Kansas. Reprinted with permission.

Furthermore, the authority of the exchange would be undermined to the point of making it a laughing stock. The board of the Kansas City Livestock Exchange resolved to take action.

On June 11, 1890, the board notified the ALCC that charges had been filed against it for violating rules on commission rebates. Upon receipt of the charges, the ALCC sought the intervention of the Kansas legislature. Eli Titus, general manager of the ALCC, had enough influence that the legislature of 1891, which was largely controlled by the Populist Party, passed the Roe Bill. The bill declared the regulation of commissions on the sale of livestock in the state of Kansas unlawful, and thus, outlawed the Kansas City Livestock Exchange.

In response, the board of directors of the exchange revoked the membership of the ALCC, citing rules against seeking legal injunctions against the exchange. They also expelled all members of the exchange associated with the cooperative. The board stood firmly on the Missouri side of the exchange building and insolently declared that they would have nothing to do with the Roe Bill or with any laws enacted by the Kansas legislature. They further adopted a new rule that gave them a new disciplinary power over members: the authority to black ball. The black ball was immediately invoked against the ALCC. Previously the board could do nothing more than refuse to inspect any of the offending firm's animals at the Kansas City stockyards. Now it could prevent commission merchants, traders, packers, and railroads at the Kansas City stockyards from doing business with an offending firm by threatening a boycott. The implementation of the black ball rule against the ALCC effectively shut it out of the Kansas City market. No packer would buy its livestock and no trader would buy its animals for speculation.

In retaliation, the ALCC sought an injunction from the Illinois Supreme Court against the Kansas City Livestock Exchange to prevent the expulsion. The Illinois court ruled in favor of the exchange on October 31, 1892. The opinion of the court was that the exchange had the right to regulate their own memberships, which included expulsion. The court did, however, concede that there was a strong basis for declaring the stockyards a public market, a fact that would make private regulation impossible under federal law. Nevertheless, the court declared that until the U.S. congress specifically declared that the stockyards were public markets, the exchanges had the right to regulate the livestock trade.

The ALCC never recovered from its challenge of the Kansas City Livestock Exchange. The forces of order defeated the advocates of laissez-faire business policy with ease and the exchange regulated the commission trade in Kansas City for another 32 years without interference.

Livestock Trade in the 20th Century

The pervasive influence of the Kansas City Livestock Exchange on the national livestock economy lasted until 1918. During the early 20th century, packers began constructing private stockyards and again went into the countryside to purchase livestock directly from producers. This practice effectively bypassed the Kansas City stockyards and the regulation of the Kansas City Livestock Exchange. Merchants of the exchange were not allowed access to packer-owned stockyards to either buy or sell livestock. Additionally, competing markets in Denver, Oklahoma City, and Fort Worth began to circumvent the flow of cattle away from Kansas City (Hazlett 1987).

The development of irrigation on the Great Plains brought large-scale feed grain production to the region. Feedlots soon followed and cattle finishing began in earnest. Consequently, packers moved west to be near this new supply of finished cattle and much of the livestock industry shifted out of the Corn Belt and onto the Great Plains. By the mid-1980s, packers within a 250-mile radius of Garden City, Kansas slaughtered 4 of every 10 cattle in the U.S. (Hazlett, 1995).

The invention of the motor truck brought a second organizational revolution to the livestock trade by way of its application to livestock transport. The use of trucks encouraged the trend of selling directly to packers by increasing market flexibility of livestock producers. They were no longer bound to the railroad. The motor truck also spawned new marketing methods. As the trade continued to decentralize during the 1940s and 1950s, livestock auctions emerged on the Great Plains (Hazlett 1987). One of the first such livestock auctions was developed by Roy Sturtevant at Brookfield Missouri. As a regular customer of the stockyards at Kansas City, St. Joseph, and Chicago, Mr. Sturtevant was well acquainted with other people involved in the livestock trade. In 1930, he began to invite these people to Brookfield to bid on the livestock raised by local farmers. Later the bid process evolved into a formal auction (Dedrick 2001).

Several other events helped precipitate a general decline in the functionality of a centralized livestock trade. In the early 20th century, a flourish of cooperative livestock shipping organizations began to organize. The first cooperative shipping associations were the cattlemen's associations in the late 1860s and early 1870s. Restricted market access during these early years forced cattle raisers to cooperate with one another. They achieved a degree of success by winning concessions from the railroads on freight rates because of the large number of cattle they represented. Despite these early precedents, cooperative shipping associations only organized on a large scale after the turn of the century.

Figures from Missouri clearly illustrated the popularity of this phenomenon. In 1921, there were 275 cooperative shipping associations in the state. The Missouri Farm Management Association organized a livestock-shipping club in Boone County and saved $84 dollars on the first carload of animals sent to market. As important, the members reported, was that the local livestock speculators were forced to increase their bid prices to remain competitive. Shipping associations also enabled a higher return to the producer because livestock were sorted and graded before they were loaded onto market-bound trains. Livestock of similar grades, weights, and types brought higher prices on the market; by sorting and grading cattle themselves, producers instead of the livestock speculator could reap the associated financial benefits. The shipping organizations were short-lived, not because the farmers lost the cooperative faith but because the motor truck rendered them less competitive. Organizations that sprang up within trucking distance of the livestock markets of Kansas City, St. Joseph or St. Louis soon disbanded. Farmers preferred instead to truck their own livestock to market (Hazlett 1987).

On August 15, 1921, the U.S. Congress passed the Packers and Stockyards Act, which declared the major stockyards of the nation to be public markets. The American Farm Bureau and the National Farmers Union, groups that had lost confidence in the free market and wanted interference from the federal level, lobbied for this new legislation. Beginning in the 1920s, a federal bureaucracy assumed the function of a regulatory force in the stockyards. Ironically, it employed the system of operation already institutionalized by the livestock exchanges. It supervised the setting of commission rates, regulated the membership, disciplined commission merchants and traders, and conducted audits, all at taxpayer expense. The new bureaucracy innovated very little beyond what the exchange had implemented over the previous 35 years with two exceptions: they allowed the cooperative commission firms back into the stockyards and they allowed livestock traders and livestock producers direct input into the operations of the public market (Hazlett 1987, 1992).

According to O.J. Hazlett (1987), economists have generally agreed that the Packers and Stockyards Act was a failure. This assessment stems from the fact that the packers escaped regulation under the statute until 1932 through lengthy litigation in the courts. Furthermore, the motor truck eventually made federal regulation of the stockyards meaningless. As the livestock trade decentralized, the marketing of livestock bypassed the major stockyards. Still, the act brought to a close an era of private regulation in the livestock trade. The Kansas City stockyards closed in 1988 after almost 120 years of operation (Hazlett 1995).

Conclusions

Conspicuously lacking in historical accounts of our Western heritage are explanations of how and why the livestock business in the U.S. evolved as it did. A perceived lack of romance may have discouraged some from searching the livestock exchanges, stockyards and packinghouses for historical perspective. These were a symbol of industrialization in the American West and may not have fit into the idyllic image sought by historians (Hazlett 1987). There is much, however, in the accounts of these institutions to enlighten the modern-day agriculturalist.

During the 19th century, the livestock commission merchants were a new economic institution born of innovations in transportation and communication. Commission merchants marketed livestock in a faster and more efficient manner than had their predecessor, the drover. They also became a source of operating capital for ranchers in the capital poor areas of the west. In some areas that ranged as high as 90% of all funds executed. It can be concluded that 19th century ranchers in parts of the West could not have operated without the financial aid of the commission merchants (Hazlett 1995).

In particular, the rise of livestock exchanges fundamentally altered livestock marketing in the American Southwest. The Chicago and Kansas City livestock exchanges organized within two years of each other; however, the precise issues that sparked organization were different. Railroads carried livestock farther and faster than ever before to competitive urban markets. They also carried animal diseases that reached epidemic proportions by the mid-1880s. The search for a solution to the disease problem eventually prompted the organization of the Chicago Livestock Exchange. The anonymous nature of the new marketplace permitted unscrupulous buyers and sellers to flourish in the stockyards. There was no authority in the marketplace to administer the trade and correct abuses. This lack of regulation caused the organization of the Kansas City Livestock Exchange (Hazlett 1987).

The regulatory efforts of the Kansas City Livestock Exchange went far beyond the expectations of livestock producers. The exchange increased productivity by coordinating the activities of the railroads and the stockyards. It acted as a lobbying force, pressuring national government to modify its decrees. The exchange also reformed aspects of the trade little understood by outsiders. It recognized that unless market information and business hours were controlled, the activities of unscrupulous livestock commission merchants would discredit the Kansas City market. It even assumed the power to audit the books of commission merchants against their will in an effort to insure that livestock producers and traders received a correct return of funds. Finally, the exchange pioneered the concept of a surety bond to protect customers from fraud and insolvency (Hazlett 1992).

While some industries concentrated into a few large firms, the Kansas City Livestock Exchange decentralized the trade and enabled commission firms to remain small enterprises. Unlike most private associations, labor unions, and industrial corporations, the exchange did not become oligopolistic. No one interest group in the Kansas City market dominated the organization, neither the packers, nor the stockyards company, nor the large commission houses. Since the exchange effectively eliminated the domination of the larger commission houses, entrance into the trade was easier. Even traders and producers had access to the exchange. They refused to attend the initial organizational sessions but their absence did not mean they were powerless. That commission charges for cattle did not change for 36 years was testimony to their influence over the Kansas City Livestock Exchange (Hazlett 1987).

The Kansas City market reached its peak of influence in 1918 when cattle receipts totaled approximately 3 million dollars. From 1886 to 1921, the Kansas City Livestock Exchange assumed and responsibly executed regulatory power over the livestock trade of the Southwest on behalf of the government and its constituency. The Packers and Stockyards Act of 1921 ended that grant of power (Hazlett 1992).

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