South Dakota Legislative Research Council

Issue Memorandum 94-37

JOHN MORRELL AND COMPANY INCENTIVE PACKAGE

BACKGROUND. The John Morrell and Company facility in Sioux Falls has played an important role in South Dakota's economy since 1909. With 2,800 employees at the Sioux Falls plant, Morrell is even more important to the local and regional economy, and the loss of any significant portion of that activity would have serious consequences for the community of Sioux Falls and for the state as a whole. State and local officials have been involved for the past several years in efforts to retain the Morrell plant in Sioux Falls; it was on the return trip from a meeting with John Morrell officials in Cincinnati that Governor Mickelson and seven other South Dakotans died in a plane crash in April 1993. The state's participation in the Morrell incentive package through the Legislature's passage of HB 1395 at the end of the 1994 Legislative Session was a vital element in a series of attempts to retain the plant in Sioux Falls.

ECONOMIC IMPACTS. The presence and economic well being of Morrell is important to South Dakota and to Sioux Falls, and changes in the plant's size and activities, as well as the company's long and involved labor relations history, are of more than passing interest to all South Dakotans. It is estimated that Morrell's overall economic impact is more than $1 billion annually and that the plant's economic activity is responsible for nearly 8,000 total jobs in the Sioux Falls area. The company spent more than $121 million in the local Sioux Falls area in 1992, of which $59 million went for wages and salaries. Nonlocal spending amounted to another $119 million that year. The Morrell plant, along with its affiliate in Sioux City, Iowa, accounts for 30,000 hogs slaughtered per day, fifth in the nation, or about 7.5 percent of the nation's capacity. In 1992, the company slaughtered 3.78 million hogs.

A 1992 study conducted by an economist at the University of South Dakota found that, second to agriculture, Morrell's economic impact is greater than any other private industry in the state. If the Morrell plant were to close, the state would lose $4.3 million in sales tax revenue attributable to Morrell activities, and local governments would lose $8.3 million. Approximately half of the hogs that the Morrell plant slaughters are from South Dakota, and closing the plant would force South Dakota farmers to spend more to transport their hogs to other markets. South Dakota agriculture and business interests have been striving for years to promote the processing of South Dakota agricultural products in South Dakota, which allows South Dakotans to maximize the benefits provided by their agricultural resources. This value-added approach is what the Morrell plant has been involved with for many years, and the loss of the plant would be a serious blow to South Dakota's economic development hopes.

CHANGES IN THE PACKING INDUSTRY. The packing industry has seen major changes over the past two decades, and John Morrell and Company has felt the effects of these changes. In 1980, according to an Iowa State University study, Morrell ranked second in the nation's slaughtering operations, but has fluctuated in recent years, ranking fifth in

1992. However, the packing industry has seen numerous consolidations, plant closings, and bankruptcies; of the top companies listed in 1980, only Morrell is still in existence. Today's leaders, Con Agra and IBP, were not in existence in 1980. In recent years, successful companies in the pork slaughter industry have needed to be fairly large in order to compete. Another consideration is the availability of hogs. Morrell's annual hog slaughter is more than the total number of hogs raised in the state, and states such as South Dakota and Iowa must import hogs for slaughter. Plant and facilities are another issue, with many companies investing large amounts in modern facilities in order to be competitive.

One of the basic problems with the Morrell plant in Sioux Falls is the need to upgrade the physical facility. The Sioux Falls plant is an outdated, six-story building that is not as efficient as more modern one-story facilities. Currently, parts of the processing side of the operation are fairly modern and competitive. The slaughter facility is the component of the operation that is not competitive and needs to be updated. A more efficient slaughter facility will also complement and improve operations on the processing side.

RECENT EVENTS. Events involving John Morrell and Company are always news in South Dakota, and during the late 1980s, Morrell went through a stormy period of labor disputes that attracted much public attention. In 1992, the company decided to close the beef division of the Sioux Falls plant, resulting in layoffs of 400 workers, and leaving the Sioux Falls plant dealing only with pork slaughter and processing operations. Morrell's parent company, Chiquita Brands International of Cincinnati, which lost $62 million in 1992 in its meat division, announced in 1993 that it intended to sell its Morrell operation and that Morrell would be claimed as a discontinued operation in its financial records. This decision placed the Sioux Falls plant in danger of closing if Chiquita Brands were unable to sell the facility and set in motion serious negotiations with state and community leaders to find a way to retain the Morrell plant in Sioux Falls.

The plant's primary requirement in order to stay in operation, whether as a Morrell company separate from Chiquita Brands or as an operation purchased by another company, is that its physical facilities be modernized to increase efficiency and allow it to compete with other companies. To do this, company officials determined that they needed $30 million worth of improvements for the operation and that financial assistance from state and local governments and utility companies would be required.

One potential sticking point was continuing uncertainty over Morrell's labor situation; but in March 1994, the union and the company agreed to a five-year labor contract. Essentially, the agreement would allow production workers to remain at their current base salary level of $9 per hour, with phased-in raises to $10 per hour by 1998. A firm labor agreement was seen as a prerequisite for attracting financing for plant improvements, for attracting potential buyers for the facility, and in gaining approval by state and local government and utility officials for financial assistance for the facility. The agreement paved the way for further action in putting together a Morrell assistance package.

INCENTIVE PACKAGE. By the time the labor contract had been agreed to in March, the Legislature's regular session had been completed, except for the one-day session scheduled for March 15 to consider vetoes and other remaining business. However, legislative action was needed in order to approve the state's portion of a Morrell financial assistance package, and the rules were suspended on March 15 to introduce HB 1395, which established the Economic Development Incentive Fund and appropriated money from the fund to assist Morrell. Following a briefing by Governor Miller, HB 1395 passed the House by a vote of 49-19 and the Senate by a vote of 34-1.

The state's portion of the incentive package was authorized in HB 1395, which created the Economic Development Incentive Fund, arranged for the transfer into the fund of $7.5 million of South Dakota Building Authority funds, and authorized the use of those funds, and the proceeds earned by investing those funds, to assist "preferred development projects," such as the Morrell renovation. The state's contribution will amount to approximately $10 million over a ten-year period and will be used by Morrell to repay money to be borrowed now to upgrade its plant.

Following the Legislature's commitment, the next step was to secure assistance from local governments and Northern States Power. In May 1994 the Public Utilities Commission approved a discount in electrical rates charged by Northern States Power to Morrell. Morrell will receive a 10% discount in electrical rates for five years, followed by lesser discounts over the next five years, along with a separate 3% voltage discount. Overall, the action will save the firm about 20% per year in energy costs over the next ten years. The agreement requires Morrell to install energy efficient equipment in order to receive the discounts.

Also in May, the Sioux Falls City Commission approved additional parts of the incentive package. Morrell's annual water bill will be reduced by $45,000 if the plant meets certain water conservation measures. Morrell will receive property tax breaks of approximately $450,000, and the city will also provide tax increment district status to the Morrell plant area. In addition, the city will act as a third party to provide a $1.5 million loan from the state for Morrell, and the city will pay the state $150,000 for ten years. During the following ten years, Morrell will repay the city the $1.5 million without interest. The state will also provide a $500,000 grant to upgrade Morrell's wastewater treatment plant.

For its part of the package, Morrell must invest $30 million in improvements to the plant, maintain the quality and quantity of jobs, and agree to stay in Sioux Falls for ten years, regardless of who owns the company. Improvements to the plant would include automation of the hog slaughtering operation, modernizing workers' facilities, constructing a two-story cut and kill plant, and tearing down much of the current six-story building now in use. These changes would provide the capacity for an additional slaughter of 700,000 hogs per year, nearly a 20% increase in the annual slaughter.

REMAINING TASKS. The next step for Morrell is to obtain $30 million in loans to begin the renovation process, and the company is currently negotiating with local financial institutions to secure this funding. If successful, the company could be structured as a separate company or it could be sold by Chiquita Brands to another corporation. The incentive package would be available in either case.

The incentive package received some criticism from those who felt that the package confers too many special benefits on one particular company and that Morrell may not have been required to provide as much of the financing as it was capable of providing. However, the incentive package does provide testimony to the importance of Morrell in the state and local economy, and it could not have come about without effort and cooperation by a large variety of groups and individuals. The incentive package does not guarantee the long-term success of the Sioux Falls Morrell facility; but, if implemented, it does provide for an additional ten years of operation, and it provides a good opportunity to retain the plant, which would probably have been lost without the package.

This issue memorandum was written by Tom Magedanz, Principal Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.