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THE CASE AGAINST AN "AGRARIAN ANTITRUST POLICY"

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Those who argue in favor of a new and more expansive "Agrarian Antitrust" policy (e.g., Professors Christenson, Lauck[1], and Harl[2]) express three concerns that they believe could and should be addressed by more active antitrust enforcement in the agricultural sector. The first is the failure of current antitrust policies to adequately take into account monopsony power directed against farmers, and to block mergers that increase such monopsony power -- a failure rooted in a value judgement that antitrust should be concerned only with the welfare of consumers and should ignore the welfare of suppliers. The second is the absence of non-economic considerations such as the preservation of the family farm and less concentrated market structures at other levels, and the third is the spread of contract agriculture.

I MONOPOLY AND MONOPSONY AS A CONCERN FOR MERGER AND ANTITRUST POLICY

Several writers calling for an "Agrarian Antitrust" policy seem to believe that farmers have been short-changed or even abandoned by current antitrust policy.

They note that the major concern for farmers is, and has always been, monopsony power, i.e., when many suppliers face one buyer (monopsony) or only a small number of buyers (oligopsony), resulting in lower prices to farmers.

The argument seems to be that the agencies are concerned only with monopoly power – one or a few sellers – which results in higher prices to consumers. Somehow, the interest of suppliers has been forgotten – only consumers count.

I have three points..

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[1] See, e.g., Lauck, Jon, "Toward an Agrarian Antitrust: A New Direction for Antitrust Law" *North Dakota Law Review* 75:449, 1999.

[2] See papers listed at http://www.econ.iastate.edu/faculty/harl

First, as an economist, I agree that monopsony and monopoly are twin evils:

> Both monopoly and monopsony transfer wealth (usually from lower to higher-income individuals)

and,

> Both monopoly and monopsony result in lower output/production, less inputs purchased, higher prices to consumers, and lower prices to suppliers.

Incidentally, most normal people (i.e., non-economists) believe that since monopsony results in lower prices for inputs, it must also result in lower prices to consumers. But in fact, the reverse is true. When firms with monopsony power drive down supplier prices, they do so by restricting their purchases of those inputs. Less inputs means less output. Less output means higher prices to consumers. The gross margin of the monopsonist increases both because the price he charges for his output goes up and the prices he pays for his inputs go down.

Probably the best known current example of monopsony is in sports: the reserve clause, which prevents teams from bidding up the salaries of players. (Earlier version was known as slavery). Many fans support this, believing, erroneously, that this somehow results in lower ticket prices. Unfortunately, it only benefits the team owners.

But, second, both are opposed equally under current Agency antitrust merger policy. The Merger Guidelines, the "Bible" of antitrust policy, says:

> Market power also encompasses the ability of a single buyer (a "monopsonist"), a coordinating group of buyers, or a single buyer, not a monopolist, to depress the price paid for a product to the level that is below the competitive price and thereby depress output. The exercise of market power by buyers ("Monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines. (*Merger Guidelines*, SS 0.1).

And the Federal and State antitrust Agencies follow up on this by actively enforcing anti-monopsony policies:

As an example, BP and ARCO are by far the two largest bidders on state oil lands in Alaska – Alaska is, in effect, a two-company state. The State of Alaska was about to move to block the BP-ARCO merger on the grounds that it would create monopsony power in the market for oil leases in Alaska, resulting in lower bid prices and less state revenue from leasing. The State of Alaska -- the primary "victim" of such monopsony power – reached an agreement with BP-ARCO on terms that it believes

were highly advantageous to the State.

Now the FTC has decided to challenge the merger anyway, apparently at least partly in the belief that the State has not gone far enough in protecting its own self interest. So it's hard to argue that the Federal Agencies aren't going far enough to prevent monopsony power when they seem to be going further than even the potential victims want them to go.

Similarly, the DOJ imposed a number of conditions on the Continental Cargill merger that seem to go beyond what would have been indicated by the *Guidelines* or what most observers would have expected.

Third, many cases that look like monopoly cases, and are characterized that way, are actually monopsony cases. Take the example of two competing railroads that connect a group of farms producing a given crop with a destination where that crop is processed or consumed.

Suppose we examine a merger of these two railroads. Most economists – and even non-economists – would analyze this merger in terms of a "Demand for transportation". The demand curve for transportation of this commodity (say, wheat) from farmers to customers/consumers would look like Fig 1. It is downward sloping because an increase in the price of transportation (the railroad tariff) will result in a reduction in quantity -- the amount shipped.

Suppose that this merger would result in higher RR tariffs (from t_0 to t_1) and reduced shipments (from Q_0 to Q_1). Where does that higher tariff come from? The tariff is just equal to the difference between the price of the commodity at the origin and the price of the commodity at the destination. So if the tariff goes up, either the destination price goes up (higher prices to consumers) or the origin price goes down (lower prices to suppliers) or both. (See Fig 2)

Who bears the cost of the tariff increase? That depends on which end -- suppliers or consumers -- had the most alternatives. The tariff increase could be born entirely by farmers (as in Fig 3) if consumer demand is highly elastic (because consumers have many other sources for the commodity) while supply elasticity is low (because farmers have no other outlet for their crop). Or it could be born entirely by

consumers (as in Fig 4) if consumer demand is inelastic (because they have no other source of supply for the commodity) while supply elasticity is high (because farmers have many other outlets for their crop). Or the burden of the higher tariff could be shared between suppliers and consumers.(Fig 5).

The antitrust laws and current antitrust policy do not differentiate or discriminate. If the merger of two railroads would result in a higher rail tariff, antitrust enforcers do no ask how the cost would be shared between suppliers and consumers. The merger would not be approved either if all the costs were born by suppliers, or if all the costs would be born by consumers

Most of us, I believe, would oppose such discrimination on principle. It is difficult to see how such a policy could be "just" in a Rawlsian sense, i.e., to rationally support a policy that concerned itself with only the welfare of consumers or only the welfare of suppliers would require that one knew whether one was a supplier or a consumer. So the position becomes the old "where I stand depends on where I sit". Quite understandable, but not a very ethical position..

Most economists would also oppose this kind of discrimination, not because they oppose income redistribution *per se*, but because experience has shown that antitrust is a grossly inefficient and ineffective way to redistribute income. We would argue that the best approach is to use antitrust (and regulation where antitrust alone cannot create a competitive structure, i.e., where economies of scale are so large as to create a "natural monopoly") to create something as close as possible to a competitive equilibrium - to mimic what would happen under perfect competition – since that maximizes the size of the pie. We (society) can then look at the resulting income distribution, and if it is unjust, redistribute income on an individual basis in the most efficient way possible. Redistribution by occupational class is inherently unjust (why should a small business owner -- say, a dry cleaner operator Washington – be treated differently than a farmer in Iowa with the same income?). And antitrust is a grossly inefficient way to redistribute income. It is also ineffective: anyone who thinks that government actions that depart from transparency and a rule of law will favor the poor and the weak, much less the small family farm, probably hasn't spent much time in DC.

II. CONSUMER WELFARE OR TOTAL WELFARE?

The real threat to full consideration of the interests of suppliers (such as farmers) comes from those who argue for a strict "consumer surplus only" standard, as opposed to the "total welfare" standard assumed above. Under a consumer surplus standard, only the welfare of consumers *as consumers* is valued. Thus, in mergers, efficiencies are not recognized/counted/cognizable unless and to the extent that they are "passed through" to consumers in the form of lower prices. This was not the policy position in the Reagan administration, but has been the Agencies' official position recently in court (e.g., in *FTC v. Staples and Office Depot.*), and is the hallmark of the "consumer surplus"

approach to merger enforcement (e.g., see Lande[3])

Those, such as Lauck, who argue for an Agrarian Antitrust, also argue for a merger standard under which efficiencies from a merger are discounted or not even counted unless they are "passed on" to consumers. Such a "only consumer surplus counts" standard may seem appealing because ignoring efficiencies from mergers would be against the interest of "agribusinesses" such as Cargill or DuPont. But to the extent that they are successful (as they have increasingly been among lawyers -- as opposed to economists -- in the recent administration) in persuading attorney policymakers at the Agencies that the interest of one set of suppliers (i.e., the interest and welfare of shareholders in merging firms) should not be taken into account, they inevitably force the policymaker into also excluding the interest of other suppliers (e.g., farmers). Neither shareholders in Continental nor farmers are consumers *qua consumers*. Ultimately, if we continue down this road, neither farmers nor shareholders will count except as diners.

III FARMERS AS SERFS AND THE "ALIENATION OF THE AGRICULTURAL PROLETARIAT"

Finally we come to higher values: the agrarian ideal of the family farm. In antitrust, these kind of sentiments have bee most famously reflected in Judge Hand's oft-cited dicta:

> It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of the few:" (Learned Hand, 1945).

I do not doubt that many individuals value independence and self-direction. Many people work for themselves, or in small business, or on family farms, for far less than they could earn by working on salary for a large corporation. When I and a few friends started a small consulting firm a few years ago, everyone told us that we could earn far more by joining one of the large consulting companies. They were right, and we knew it.

I greatly valued the right to make that choice for myself, but I assume that I would bear the costs. Why should anyone else pay them? To paraphrase Judge Hand, why would anyone,

> "because of its indirect social or moral effect,... prefer a system of small consulting firms..., to one in which the great mass of economists must accept the direction of the few"?

[3] Alan A. Fisher and Robert H. Lande, Efficiency Considerations in Merger Enforcement, 71 Cal. L. Rev. (1983) and other papers cited in Lauck, op. cit..

And do farmers really want their representatives to block mergers among agricultural firms if that meant lower income to farmers, just to live in a less concentrated market? Consider *Cargill v. Montfort*. There, the merger of Cargill and Spencer was challenged by a competitor, Montfort, who claimed that the efficiencies from the transaction would result in increased output by the new, more efficient firm. Cargill-Spencer would sell more beef and buy more cattle. This would result in lower beef prices to consumers, and higher cattle prices to ranchers. But higher prices for cattle would harm Montfort. The plaintiff's position was that a merger among two of his competitors should be blocked <u>because</u> it would result the plaintiff's having to pay higher prices to cattle ranchers.

Banning this merger on the principle that higher concentration in agribusiness is "bad", regardless of its economic effect, would clearly have harmed farmers. Do farmers really want an antitrust policy whose goal is to help competitors, rather than competition, consumers and suppliers? Once you invite that bear into your house, it is more likely to eat the farmers than feed them.

One noted academic advocate of an Agrarian Antitrust -- Jon Lauck - commented that

> The remarkable aspect of the case is that suppliers of cattle to the newly-merged firm did not protest the merger. (Lauck, p.504)

Such a failure to protest higher incomes would not come as a surprise to any economist, but then perhaps we lack an appreciation for the higher things in life. And then, perhaps real farmers share our values more than those who purport to represent them.

IV CONTRACTS, ANTITRUST, FREEDOM, AND THE TYRANNY OF THE COMPETITIVE MARKET

Agrarian Antitrust proponents also express concerns as to new contractual relationships between farmers and business, especially hi-tech businesses such as Monsanto and DuPont, referring to "vertical contracts" that create barriers to entry and "intellectual property abuse."

To the extent that such arrangements are in fact anticompetitive, they would violate the antitrust laws and could be expected to be treated as severely as in any other sector of the economy.

One potential source for such concerns, however, would not be covered by antitrust. Many family farms that recently entered into contracts for products such as hogs and chickens and incurred substantial sunk costs suffered from "opportunistic behavior" by the firms with whom they had contracted. They presumably still have recourse in the law, but as a contract violation. No Agrarian Antitrust, however active, wold be relevant to these cases.

But the proponents of an Agrarian Antitrust go beyond such "economic" arguments to argue, again, that

such arrangements transform the farmer or rancher "into a mere servant or agent of a corporation" (Carstensen, citing Peckham).

Almost by definition, contractual relationships involve less fiat than vertical integration -- farmers facing markets have more discretion than facing a human boss. But a competitive market can be even a tougher boss than a human one, especially when the product is a "commodity," so that one farmer's product is just like any other, every farmer is in competition with every other farmer, and only the lowest cost, lowest price producer survives.

One potential escape from such bondage for commodity grain producers might be offered by specialty grains. Unlike hogs and chickens, which require substantial sunk costs which expose the farmer to opportunistic behavior by downstream firms, specialty grains require no additional investment for the farmer other than an additional bin to hold grain. Product prices for specialty grains would be higher than for commodity grains, and the product is differentiated, and the number of suppliers of each specialty far fewer than for commodity grains.

Perhaps again, what seems to the observer as servitude may in fact be freedom to the farmer.

Fig. 2

Supply (at farm) and Demand (at city) with Railroad tariff as "wedge"

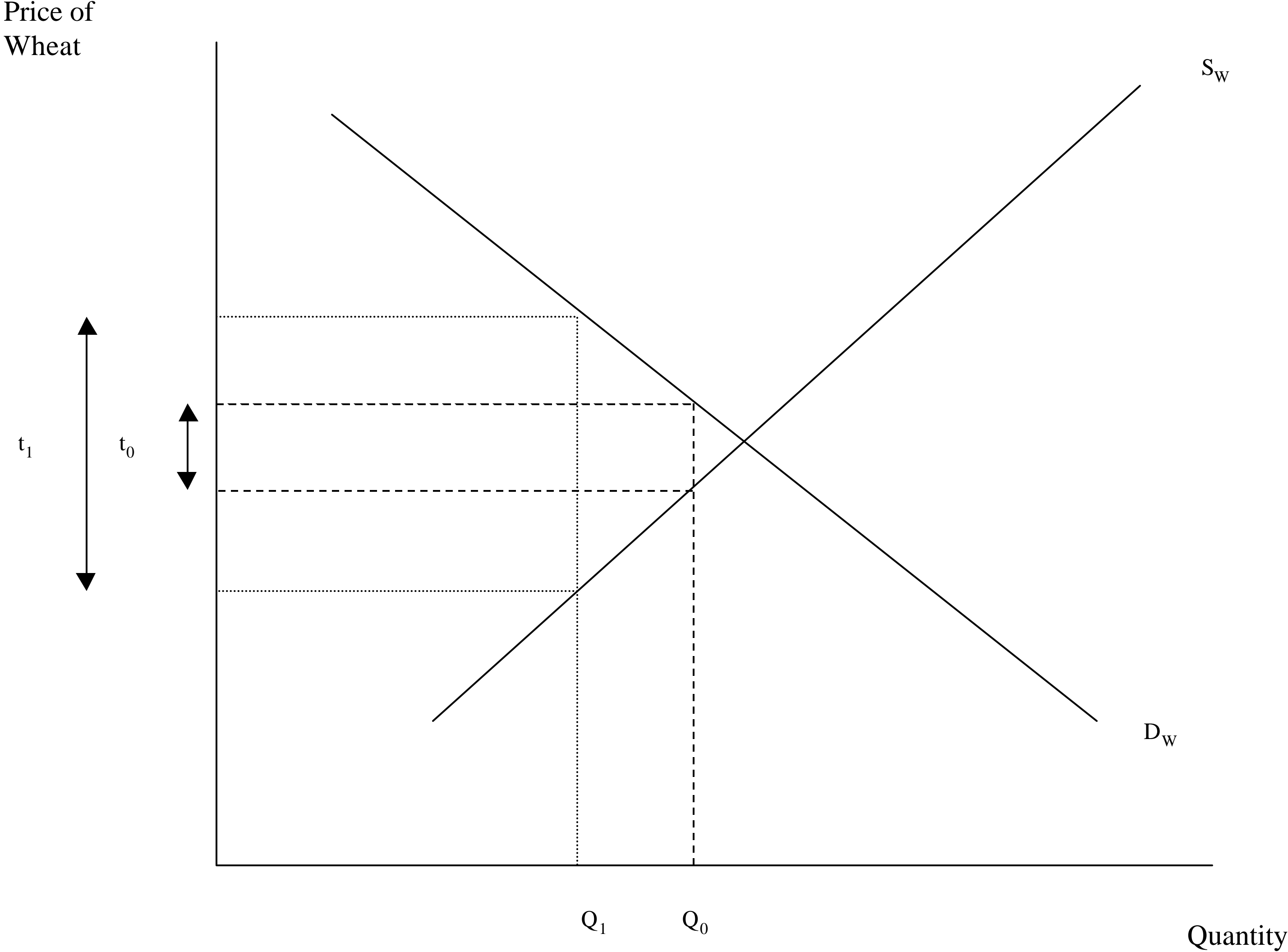

Fig. 1

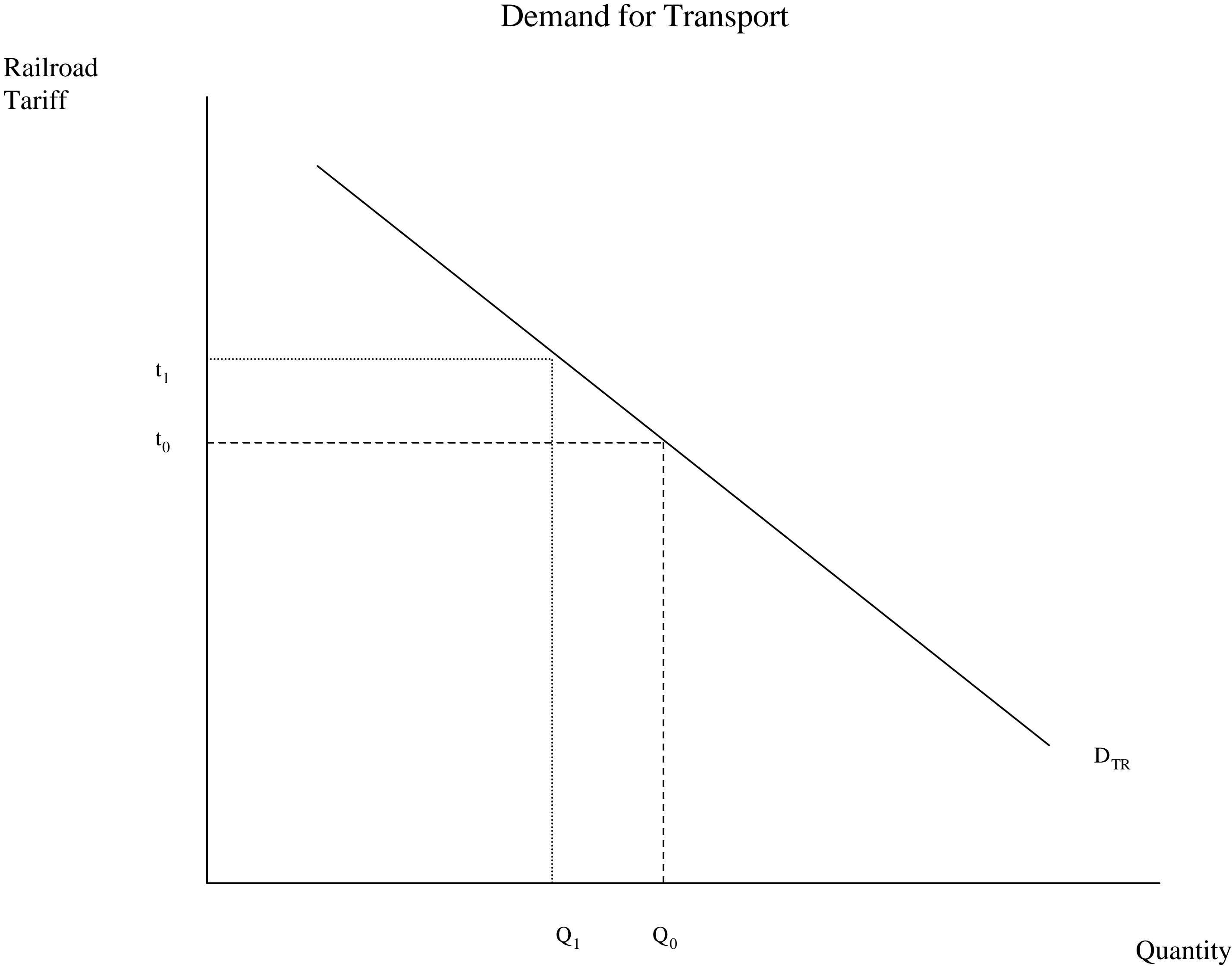

Fig. 3

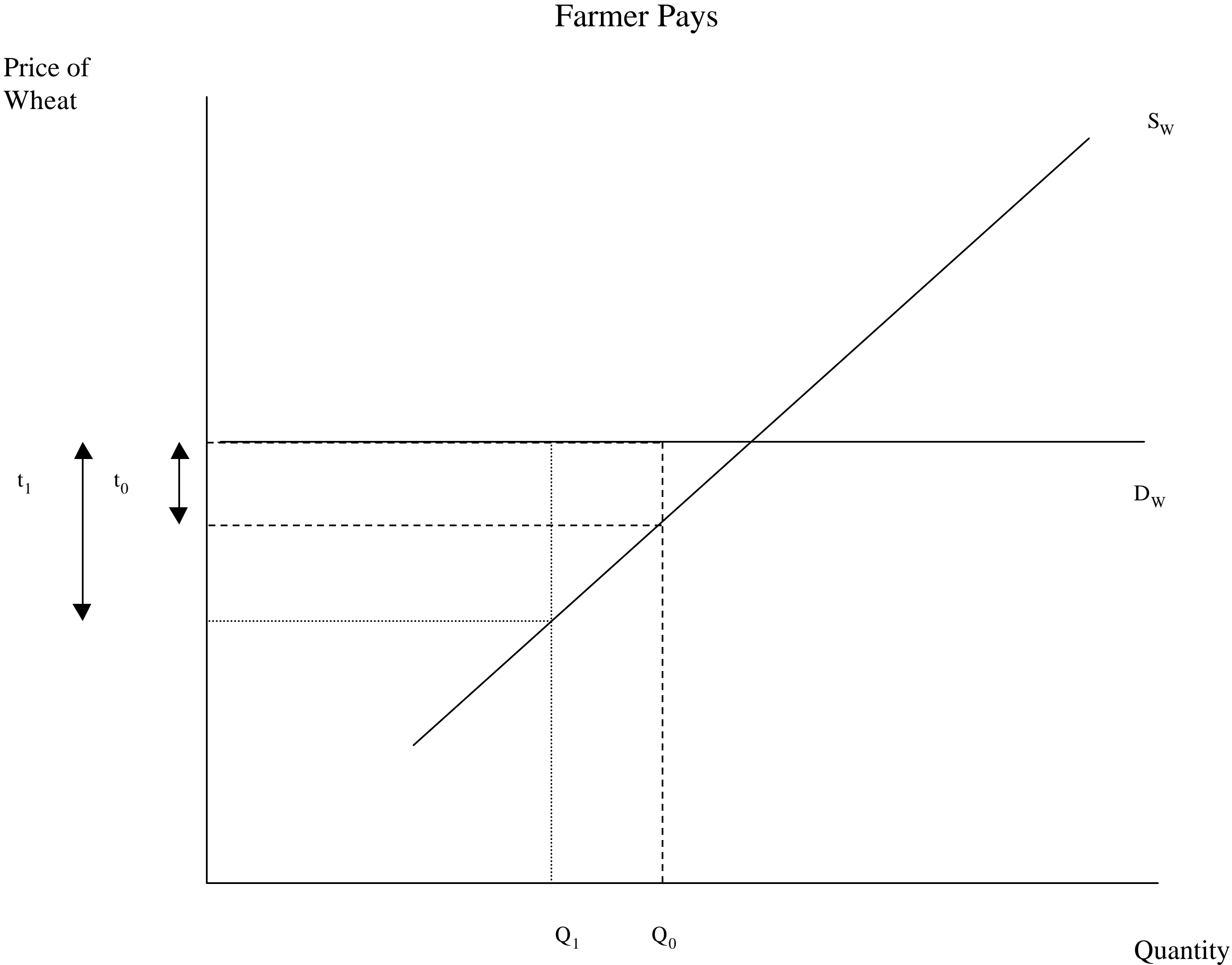

Fig. 4

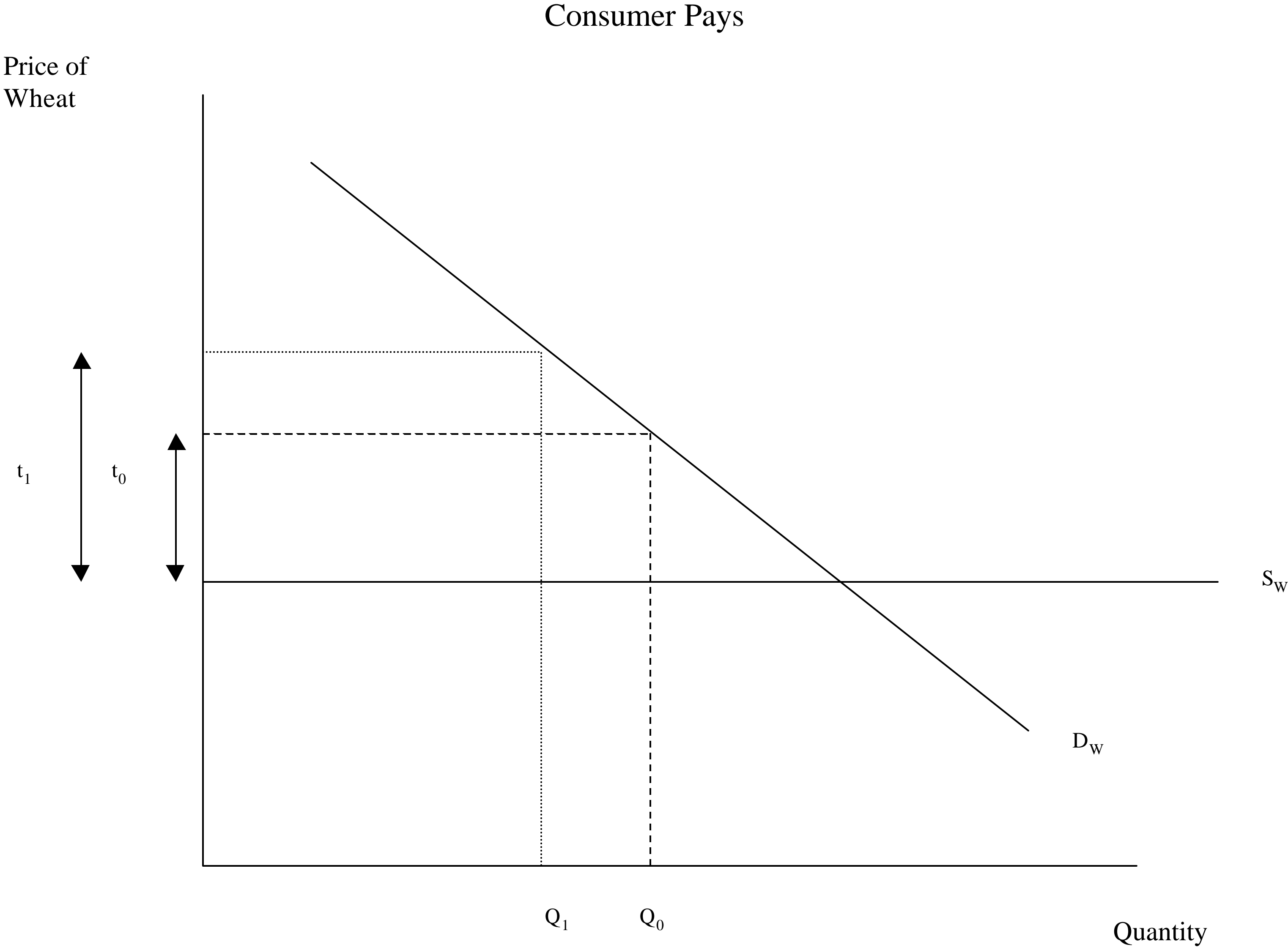

Fig. 5