Approved February 15, 1990
Date

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT.

The meeting was called to order by Elizabeth Baker at
Chairperson

3:38 xxm./p.m. on Monday, February 5, 1990 in room 423-S of the Capitol.

All members were present except: Representatives Barkis, Kline, Russell and Foster. Excused.

Committee staff present:
Jim Wilson, Revisor
Lynne Holt, Research
Elaine Johnson, Secretary

Conferees appearing before the committee:
Representative Bruce Larkin
Dr. John W. Helmuth, Associate Professor of Economics and Assistant Director of the Center for Agricultural and Rural Development at Iowa State University
Dr. William D. Heffernan, Department of Rural Sociology, University of Missouri
Father John M. Stitz, Director, Catholic Rural Life, Archdiocese Kansas City

The meeting was called to order at 3:38 p.m. by Chairperson Baker.

Representative Baker opened the hearing on HB 2766 and recognized Representative Bruce Larkin.

Representative Larkin gave the committee a brief summary of HB 2766. He stated that this bill will allow the state to regulate laws that the federal government should but is not doing. It will bring a focus on the livestock industry in Kansas and restore or at least maintain fair competition. Representative Larkin provided the committee with Bruce W. Marion's report "Restructuring of Meat Packing Industries: Implications for Farmers and Consumers" Attachment 1 and an article on "Cattlemen astir over contract issue" Attachment 2.

Representative Larkin recognized Dr. John W. Helmuth, Associate Professor of Economics and Assistant Director of the Center for Agricultural and Rural Development at Iowa State University. He presented Dr. Helmuth's biographical sketch. Attachment 3.

Dr. Helmuth testified that American citizens have been allowing the federal government to not enforce the antitrust laws for the last ten years. Economists have documented what this loss of enforcement is costing American citizens. He feels that action is needed by farm organizations and the legislature to get federal attention. Kansas and surrounding states need to pass tougher laws. Attachment 4. Dr. Helmuth called the committee's attention to his summary "Beef Packing: Concentration and Pricing Issues". Attachment 5. Dr. Helmuth also provided the committee with additional handouts. "Antitrust Law & Economics" Attachment 6, "University of Michigan, Journal of Law Reform" Attachment 7, a letter from Edith Palmer, Senior Legal Specialist, The Library of Congress and a report "Market Share Limitation in the Antitrust Law of the Federal Republic of Germany" Attachment 8 and an article entitled "Limited number of packers keeps cattle prices low" Attachment 9.

Dr. Helmuth responded to questions from the committee.

Dr. William D. Heffernan, Department of Rural Sociology at the University of Missouri was the next conferee to testify in support of HB 2766. Dr. Heffernan supported Dr. Helmuth's testimony and called the committee's attention to his report on "Concentration of Agricultural Markets - Jan. 1990", Attachment 10.

Dr. Heffernan responded to questions from the committee.

The next conferee was Father John M. Stitz, Director, Catholic Rural Life, Archdiocese Kansas City, Kansas. Dr. Stitz stated that that his Archdiocese is affiliated with the National Catholic Rural Life Conference, which for sixty years has supported family farm agriculture. They support this bill as they see the section on immediate payment as a matter of justice and the section which will enable a producer or third party to file suit in case of price fixing as a matter of justice. Attachment 11.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT,

room 413-S, Statehouse, at 3:38 ~~a.m.~~/p.m. on Monday, February 5, 1990.

Ivan W. Wyatt, President of The Kansas Farmers Union requested that his statement be handed out to the committee members and become a part of the record. Attachment 12.

Representative Baker announced that the hearing on HB 2766 would continue on Wednesday.

The meeting was adjourned at 4:49 p.m.

Elizabeth Baker

Date: 2/5/90

GUESS REGISTER

HOUSE

Committee on Economic Development

NAME	ORGANIZATION	ADDRESS
Ed Reznicek	Farmer	Goff, KS
Joyce Bracken	Farmer	Fredonia, Ks
Lee Bracken	Farmer	Fredonia Ks
Don R. Dailors	Pork Producer	Erie, Ks
Tom Tunnell	Kans Grain & Feed Assn	Topeka Ks.
Nancy Kantola	CKFO	Topeka
John Stitz	Catholic Rural Life	R. C. Ks
J. Neil Morrissey	N.F.O.	Hoyt, Kans.
Chris Walker	NFO KANS	Mayetta
Alvin Bauman	Farmer	Sabetha, Ks.
Ray Fowler	Farmer Farm Union	Emporia Ks
Jerry Jost	Ks Rural Center	Whiting KS
Byron de Friese	Farmer	Princeton, Ks
Samuel R. Goodkins	NFO & Farmers Union	Clay Center, Ks
LeRoy Bower	Kansas NFO	R#5 Box 529 Pittsburg, Ks
Ben Harris	Kansas NFO	R2 Walnut, Ks
John Helmuth	ISU	Ames IA 50011
Mike Jensen	KPPC	Manhattan

Date: 2/5/90

GUEST REGISTER

HOUSE

Committee on Economic Development

NAME	ORGANIZATION	ADDRESS
[illegible]	Pork Prod.	Bern, Ks
Tim Stroda	KPPC	Manhattan
Kenneth McWilke	Board of Agriculture	Topeka
Ivan W. Wyatt	Ks Farmers Union	McPherson
Joe Lieber	Ks-Coop Council	Topeka
Alan Steppat	Pete McGill & Associates	Topeka
Warren Parker	Kansas Farm Bureau	Manhattan
Gina Bowman-Morrill	Farmland	Kansas City
Frank Whitsitt	Farmland	KC
Mark Ernst	Kansas Farmer	Topeka
Russell Horenkamp	Farmers Union	Baileyville Ks
[illegible] Henninghake	Farmers Union	Baileyville Ks
John Hulsing	Farmers Union	Baileyville Ks

RESTRUCTURING OF MEAT PACKING INDUSTRIES: IMPLICATIONS FOR FARMERS AND CONSUMERS

by
Bruce W. Marion[1]

Mr. Chairman, I am pleased to appear before you today. I have considerable interest in the subject of these hearings. In addition, the folks in Iowa have demonstrated considerable interest in issues of competition in the food industries -- the primary focus of my research. We at Wisconsin are particularly indebted to Congressman Neal Smith for his continued interest and support of our research. Without his support in helping us obtain funding, much of the research on which I will report today would not have been possible.

In my testimony today, I will focus first on the beef packing industry. Since we have done little research at this point on hog slaughtering and processing, my comments on pork packing will be relatively brief. Following this, I will review some of the trends in food manufacturing industries in general in order to provide a perspective of what has and is occurring in meat packing.

U.S. Meat Packing Industry: From Oligopoly to Competition to Oligopoly

During the 1960s and 1970s, the U.S. meat packing industry was frequently identified as an industry that had become more competitive over time. Product differentiation was generally minor except for processed and cured pork products. In part because of U.S.D.A. grades, brands of beef have never been successfully established. National concentration of meat packing, which was high at the turn of the century and at the time of the 1920 Consent Decree, experienced a long decline until the 1960s or early 1970s.

Until the 1960s, the "old line packers" (Swift, Armour, Wilson, Morrell) continued to lead the industry with older multi-species (e.g., hogs, beef and lambs) plants. In the 1960s, specialized beef slaughtering plants operated by "new breed" packers began to penetrate the industry by locating new plants in the Western Corn Belt and High Plains where cattle feeding was increasing. Today, plants tend to be

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[1] Professor of Agricultural Economics, University of Wisconsin-Madison. Testimony presented at hearings held by the House Agricultural Committee of the Iowa State Legislature, December 7, 1988. The assistance of my co-worker, F.E. Geithman, is gratefully acknowledged.

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specialized by species (hog or beef) and may also be specialized by function (slaughter or processing). Although pork and beef compete to some extent for consumers' meat dollars, they are in separate product markets at earlier stages in the production-marketing system. Beef packers also tend to specialize in either fed beef, which is sold as steaks, roasts and other cuts through supermarkets and restaurants, or in cows and bulls which are boned out and used in ground beef and a variety of processed meat products. Cows and bulls are mostly cull dairy animals. Plants slaughtering these animals are located in the major dairy states. Fed beef slaughterers are concentrated in the major cattle feeding states. About 70 percent of the fed cattle were produced in five states in 1985: Kansas, Texas, Nebraska, Colorado and Iowa.

National concentration of fed steer and heifer slaughter increased from 27.4 percent for the largest four packers in 1972 to 32.3 percent in 1977. Four-firm concentration then rose sharply over the following eight years to 56% by 1986 (Packers and Stockyards Administration data). As a result of three large acquisitions by Con Agra (E.A. Miller, Monfort and Swift Independent) and Excel's acquisition of Sterling Beef, all in 1987, four-firm concentration increased to about 68 percent by the end of 1987 (Exhibit 1). The industry is now dominated by three large companies, IBP, Con Agra and Excel (Cargill), which collectively slaughter over 60% of all steers and heifers in the U.S. This rate of concentration increase is unprecedented. There is no parallel in any of the industries -- food and non-food -- with which I'm familiar.

Fed cattle are slaughtered by two types of plants: 1) plants that slaughter only and sell carcass beef; 2) integrated slaughtering-fabricating plants that both slaughter and process carcasses into boxed beef. Integrated plants are largely owned by the top 20 beef packing companies.

Boxed beef has been one of the major developments in beef packing in the last 20 years. Whereas in the 1960s, nearly all beef left the packer as forequarters or hindquarters, much of it is now sold as boxed beef. Boxed beef accounted for 44 percent of fed steers and heifers slaughtered in 1979 and 77 percent in 1985 (Packers and Stockyards Administration data). The four largest sellers accounted for about 60% of boxed beef sales in 1979, 64% in 1985, and an estimated 82% after the mergers in 1987.

Boxed and carcass beef tend to be shipped from the major production/processing areas to the centers of population -- particularly the eastern U.S. The approximate continental dividing line for beef shipments to the east or west is a line from Texas to Colorado (Faminow and Sarhan, 1983).

Economies of scale exist in both beef slaughtering and processing. In the major cattle feeding areas, a specialized slaughtering plant that kills 250 thousand head per year using two shifts will realize

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most of the scale economies available. This represents about 1 percent of the U.S. fed cattle slaughter in recent years. Economies of scale appear to be greater in boxed beef processing (Cothern et al, 1978). Most of the new combination beef slaughtering-processing plants have a slaughtering capacity of 500,000 to 1 million head per year. For this and other reasons, boxed beef processing is almost solely the domain of the largest 20 packers.

Entry barriers into beef packing are relatively high because of the capital cost of a new integrated plant ($20 to $40 million), the difficulty of penetrating the boxed beef market, and the displacement effect in procurement markets of a minimum efficient scale plant. In 10 of the 13 regions examined in a study at the University of Wisconsin, a plant killing 250,000 head per year would require at least 10 percent of the total supply, and often much more than that.

De novo entry into the beef packing industry is made more difficult by present excess capacity. Since the late 1970s, per capita consumption of beef has declined significantly. Taken together with the new and expanded plants by leading packers, this has resulted in capacity surpluses in the industry. De novo entry is generally more difficult when an industry has excess capacity and declining demand.

Feedlot-packer negotiations nearly always occur at the feedlot. Whereas 39 percent of cattle were sold directly from feedlots to packers in 1960, this had increased to 90 percent by 1984 (USDA, 1986). Sellers are dependent on packer buyers coming to the feedlot, inspecting their cattle, and making an offer. A study conducted in 1979 found that packers buy 80 to 85 percent of the cattle slaughtered within 150 miles of the plant (Ward 1982). Because cattle are purchased live and the exact market value is only known after they are slaughtered, determining the value of a specific lot of cattle is an imprecise undertaking. Due to transportation costs, shrinkage in cattle weight and uncertainties concerning the price they will receive in other regions, feedlots rarely ship unsold cattle to packers outside their region.

Impact of Packer Concentration on Prices Paid to Farmers

Fed cattle are purchased in relatively small geographic markets. Thus, the structure of local and regional markets must be examined to understand the nature of competition in fed cattle procurement. Fourteen regional procurement markets were identified by the late Willard Williams (Committee on Small Business, 1979). These regions are shown in Exhibit 2. The concentration of slaughter in these regions has increased sharply, particularly since 1978. The top four slaughterers of steers and heifers in each of these regions accounted for, on average, 48 percent of regional slaughter in 1971, 56 percent in 1978 and 83 percent in 1986 (Exhibit 3). The series of mergers in 1987 very likely increased this further.

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What is the effect of increased buyer concentration on the prices paid to cattle feeders for fed steers and heifers? Economic theory leads us to expect a negative relationship between packer-buyer concentration and cattle prices if entry barriers are sufficient for monopsony power to be exercised. This expectation was confirmed by empirical research at the University of Wisconsin-Madison (Quail et al., 1986). Annual fed cattle prices in 13 regions during 1971-1980 were significantly and negatively related to the concentration of fed cattle slaughter in the regions. Holding other things constant such as packer wage rates, distance to coastal markets and the importance of large feedlots, steer prices were estimated to be 30 to 70 cents/cwt. lower in a region in which the top four packers slaughtered 80 percent of all fed cattle compared to a region in which the top four slaughtered 50 percent. For every 10 percentage point increase in the four-firm concentration ratio, cattle prices fell 10 to 23 cents/cwt.

This provides strong evidence that some monopsony power exists in the procurement of fed cattle. The extent to which prices are depressed because of ineffective competition is not great, however. Estimates are generally in the range of 1/2 to 1 percent of selling prices or roughly 20 to 50 cents per cwt. Relative to the cyclical swings in cattle prices of 20 dollars or more per cwt., the monopsony underpayment seems like "small potatoes." Still, in total dollars, a monopsony underpayment of 1/2 to 1 percent in most years represents at least $50 million annually that cattle feeders lost because of ineffective competition in cattle buying markets.

These findings are generally consistent with several other studies of livestock procurement markets. Menkhaus, St. Clair and Ahmaddaud (1981) related state level packer concentration to fed cattle prices in 12 states for 1972 and 15 states for 1977. A significant negative relationship was found in both years. The four control variables included in their models were similar to some of the control variables used in the Wisconsin study. Miller and Harris (1981) did a cross-sectional analysis of monopsony power in hog markets using state level data for only one year, 1978. Buyer concentration was negatively related to hog prices at the 10% level of significance. Ward examined the price effects of the number of buyers bidding on pens of cattle and lambs (1981; 1984). In both studies, the number of bidders had a significant positive relationship to transaction price. Schroeter (1988), using a much different approach, found evidence of monopsonistic and monopolistic price distortions in beef packing during 1951-1983. Ward reviewed 12 studies of competition in livestock markets in his recent book (Ward, 1988). He concluded:

> "On balance, market structure, whether defined by concentration or number, size, and location of buyers, seems to impact local or regional livestock prices. Available evidence suggests that number of buyers is positively associated with prices paid for livestock. Adding a buyer tends to increase price and removing a buyer tends to lower price. Increasing concentration or high

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levels of concentration seems to negatively affect fed cattle price levels when measured on a state or regional basis." (p. 168)

These results are also consistent with the broader industrial organization literature on concentration-price relationships. Professor Leonard Weiss, one of the leading scholars in the field, recently completed a review of over 70 studies of market concentration-price relationships. Weiss concluded that about 75 percent of the studies found a significant relationship between concentration and prices. Collectively these studies "give overwhelming support to the concentration-price hypothesis" (Weiss, forthcoming). Most of the studies examined monopoly power (i.e., the relationship between seller concentration and seller prices) rather than monopsony power. However, the theories of monopoly and monopsony power are essentially the same. Strong evidence that seller concentration measures the degree of monopoly power provides considerable reassurance that buyer concentration measures the degree of monopsony power.

Thus, beef packing has high and sharply increasing levels of concentration both in regional procurement markets and nationally, and high barriers to entry. Given the present structural characteristics of this industry, there is a high probability that market power exists both in buying cattle and in selling boxed beef. And, market power in beef packing is unlikely to be eroded or kept in check by new entry. While market power appears to be most likely in live cattle procurement markets, it is becoming more likely in wholesale boxed beef markets as well. If packers are successful in their current efforts to develop brands of fresh beef, they will significantly increase their pricing discretion.

Hog - Pork Packing Industry

A few comments are in order concerning the hog-pork packing industry. This industry is becoming bifurcated between hog slaughtering and pork processing. Hog slaughtering is undergoing a structural transformation similar to what occurred in beef packing. The Big 3 in beef -- IBP, Con Agra and Excel -- are also the top three slaughterers of hogs with 30 to 40 percent of the U.S. total. And, they are growing rapidly. This has largely occurred in only four or five years. Before that, none of these companies were major hog slaughterers.

The building of monster plants capable of slaughtering 2½ to 4 million hogs per year will accelerate the trend towards increasing concentration of hog slaughter. One of these plants alone will slaughter roughly 3 percent of the nation's hogs.

Although some plants reach out considerable distances to buy hogs, there are strong economic advantages in buying hogs with 100 miles or so of a plant. Shrink and transportation costs are reduced. In

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My presentation is biased towards Small & Med a Sized Family Fa[illegible] operations are the most Environmentally Socially and economically acceptable system of agriculture

Accept Sustainable practices as natural Farming Practices

addition, many of the large plants have moved to "just in time delivery" of hogs and substantially reduced their inventory of live hogs. This is much easier to manage with nearby hog producers than with distant producers.

These economic forces indicate that relative small geographic procurement areas will be sought for hogs. Indeed, some of the east coast packers that have outgrown their local supply of hogs and have had to obtain part of their supply from midwest states are reportedly moving towards more contracting of hogs in the southeastern states.

These trends toward very large hog slaughtering plants that obtain the bulk of their supply from nearby farmers will likely bring some operational efficiencies. However, they may also lead to a decline in competition for live hogs. As hog buyers shrink in numbers and become more dominant in local procurement markets, the prices paid to hog producers is likely to decline -- at least in the long run. I would expect this to affect Iowa hog producers but to have even a greater impact on hog producers in less dense hog producing areas.

Pork Processing: Of the big three slaughterers, only Con Agra has significant pork processing operations (former Armour operations). Processed pork products include bacon, ham, luncheon meat, wieners and sausages, and canned meats. Regional brands are important in many of these products. As a result, many relatively small pork processors have survived. The trend is for pork processors to reduce or phase-out their hog slaughtering activities and buy pork cuts and carcasses from the Big 3. This is true even for Oscar Mayer and Hormel, two of the major pork processors with strong brand names. Both pay substantially higher wages than the Big 3. Both plan to close their last hog slaughtering operations in 1989.

Other major factors in pork processing are Con Agra (through the acquisition of Armour), Beatrice (through its acquisition of Eckrich and Esmark/Swift) and Sara Lee (through the acquisition of 16 to 18 regional companies such as Kahns, Jimmy Dean, Hillshire and Bryans). Since pork processing has generally been more profitable than slaughtering, it may be only a matter of time before IBP and Excel enter pork processing -- probably by buying an existing well known brand. This could result in specialized pork processors relying on the Big 3 for the supply of raw products but also competing with them in the sale of processed products. Specialized pork processors would then become vulnerable to vertical price squeezes and other competitive tactics by the Big 3.

Mergers have played a major role in the restructuring of the beef and pork packing industries. While IBP has relied primarily on internal growth, Con Agra and Cargill have relied heavily on mergers to develop their strong positions. At least one and possibly three of the recent acquisitions by Con Agra and Cargill appear to have violated Section 7 of the Clayton Act. The antitrust agencies are apparently unconcerned about concentrated oligopolies in spite of compelling

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evidence from a large number of empirical studies that concentrated oligopolies have many of the performance deficiencies of monopolies: high prices, bloated costs and complacency regarding market or technological opportunities.

Broader Structural Trends in Food Manufacturing Industries

Through the late 1970s, the food processing/manufacturing industries of greatest concern to those of us who study competition were those industries with high levels of advertising-created product differentiation. These industries had strong brands, were highly concentrated, were increasing the fastest in concentration, and had high barriers to entry. The preponderance of our research summarized in a 1985 book on food manufacturing (J. Connor et al., 1985) indicated that these industries were the ones most likely to have market power and to exhibit non-competitive performance. This is still the case.

In contrast, commodity-type industries tended to be more competitively structured and gave few indications of serious competitive problems. Producer goods industries (Exhibit 5, column 2) and consumer goods industries with little product differentiation (column 3) were generally characterized by modest and stable levels of four-firm concentration. Since 1977, this pattern has changed. From 1977 to 1982, producer goods industries and low differentiation consumer goods industries jumped sharply in concentration (Exhibit 5). There were 14 census product classes in which the CR_4 increased 10 points or more from 1977 to 1982. These were:

4 in meat packing
1 in broiler processing
3 in flour milling
1 in wet corn milling
4 in cottonseed and vegetable oil mills
1 in beer

Only 2 of the 14 had high levels of advertising -- beer and flour mixes -- which is a sharp contrast to the historical pattern. Although mergers were not the only cause of increasing concentration, they played a major role in many of the above industries.

Since 1982, the structural consolidation in some industries has accelerated. A few companies such as Con Agra and Cargill have developed leading positions in several different commodity processing industries during the last decade. If Con Agra's proposed acquisition of Holly Farms is consummated, Con Agra will become the number 1 processor of broilers. Prudential Bache estimates the market shares of the largest four broiler processors would increase from about 52 to 62 percent as a result of this merger (Glaberson 1988). Thus, once again we have an industry that historically was relatively fragmented that has become concentrated rather quickly. Con Agra is also the leading slaughterer of sheep and lambs. Following the mergers of 1987, the

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four largest slaughterers of sheep and lambs accounted for about 75 percent of this market (Packers and Stockyards Administration estimate). The events of the last decade tell us that we can no longer assume that competition is effective in these commodity-type industries.

Conclusions

The substantial changes that have occurred in beef and pork packing have brought significant benefits that should not be overlooked. Boxed beef represents a substantial improvement in the marketing of beef. Without IBP, this innovation might not have been accepted. The new breed packers have introduced greater innovativeness and tighter cost controls into these industries. Lower labor costs have probably been at least partially passed on to consumers.

However, there have also been substantial costs from the changes that have occurred. Wages and fringe benefits have dropped sharply in industries characterized by unpleasant and hazardous working conditions. The lower costs of the "new breed" packers have been largely carried on the backs of packing plant workers. And, as competition in livestock procurement markets has declined, farmers have and are likely to continue to realize some erosion of the prices they receive.

Concentration is frighteningly high in beef packing, especially in many procurement markets and in the boxed beef selling market. The latter is somewhat less of a concern at this point because boxed beef is primarily sold to supermarket companies with knowledgeable buyers and sufficient size to exercise some countervailing power. If the Big 3 are successful in developing brands of fresh beef, their market power in dealing with large supermarket accounts will increase.

Given the present situation, <u>any</u> proposed merger by the Big 3 beef packing and hog slaughtering firms should be carefully examined by the antitrust agencies. However, for beef packing, merger challenges may now be a case of closing the barn door after the horse has already been stolen. Concentration in beef packing is already substantially higher than in 1920 when the Consent Decree was enacted to curb the market power of the big five meat packers. The top four packers at that time slaughtered "only" 49 percent of the U.S. cattle, although they also exercised their power through a variety of vertical arrangements (National Commission on Food Marketing, 1966). However, it may not be too late to try to maintain competition in the hog slaughtering and pork processing industries. The antitrust agencies and the Packers and Stockyard Administration should monitor these industries closely to try to prevent a replay of what happened in beef packing.

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The beef packing industry has rapidly become a shared monopoly in the sale of boxed beef and a shared monopsony in cattle procurement. Our antitrust laws are relatively impotent in dealing with shared monopolies or monopsonies. Without legislative change, there are few policy options available to restore competition to this large and important industry.

Electronic markets have frequently been proposed as a means of broadening markets and increasing competition in the purchase of livestock. These markets seem to have brought beneficial results in lambs, hogs and other commodities where they have been tested. More widespread implementation of these markets might enhance competition for hogs and fed cattle. However, the very high levels of concentration of beef packers in the major cattle feeding areas raises questions about the effectiveness of electronic markets. If the same three firms dominate beef procurements in Iowa, Nebraska, Kansas, Colorado and Texas, an electronic market might do little to enhance competition. Still, it is an option worth exploring.

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EXHIBIT 1

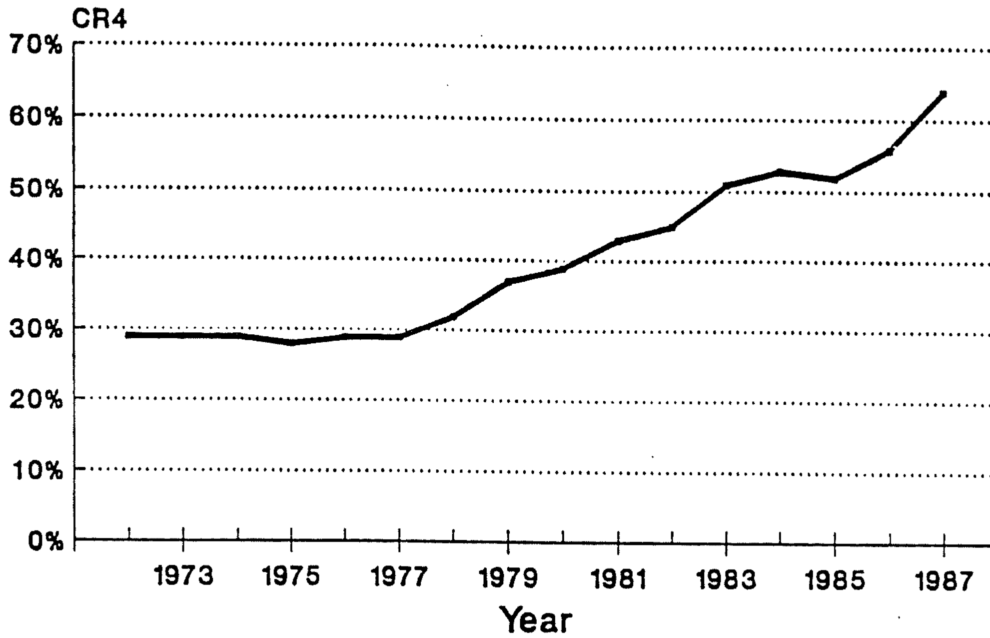

EXHIBIT 2

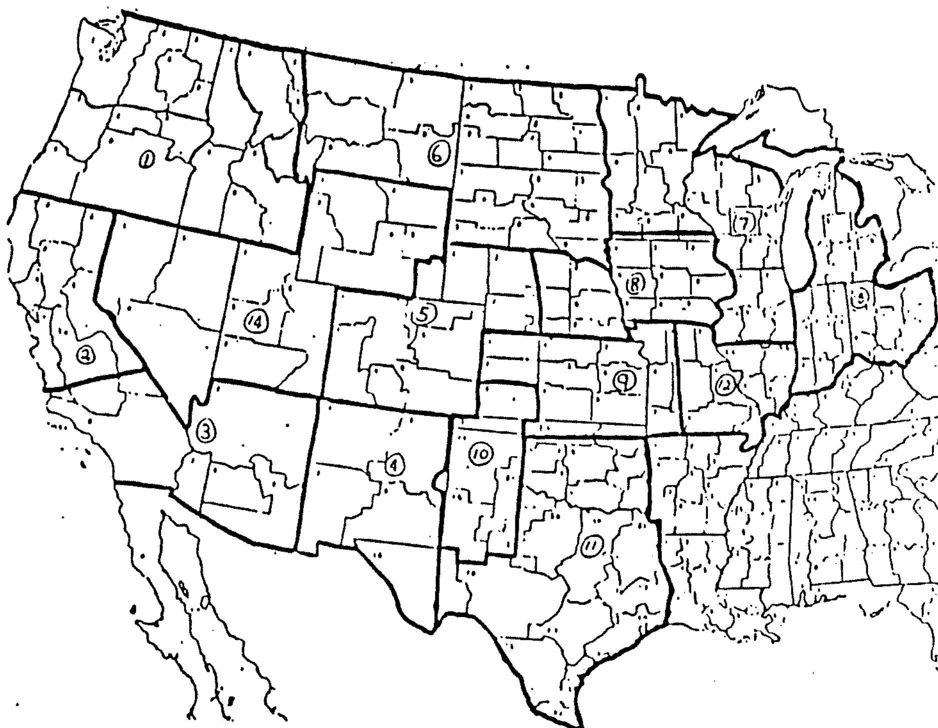

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EXHIBIT 3

Four Firm Concentration Ratios
Steer and Heifer Slaughter by Region
1971, 1978, and 1986

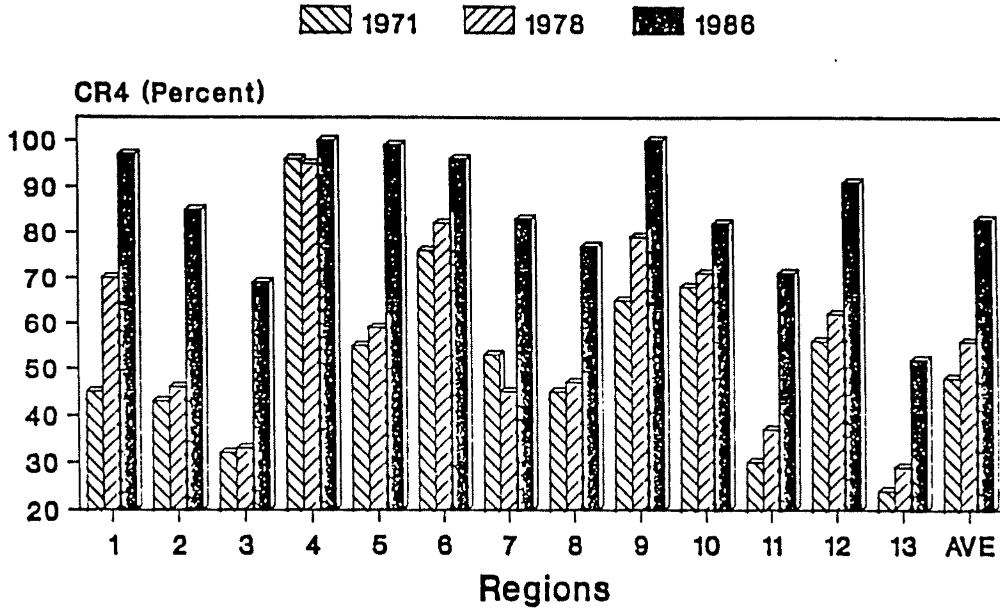

EXHIBIT 4

Average Four-Firm Concentration
of Steer and Heifer Slaughter
in 13 Regional Markets, 1971-1986

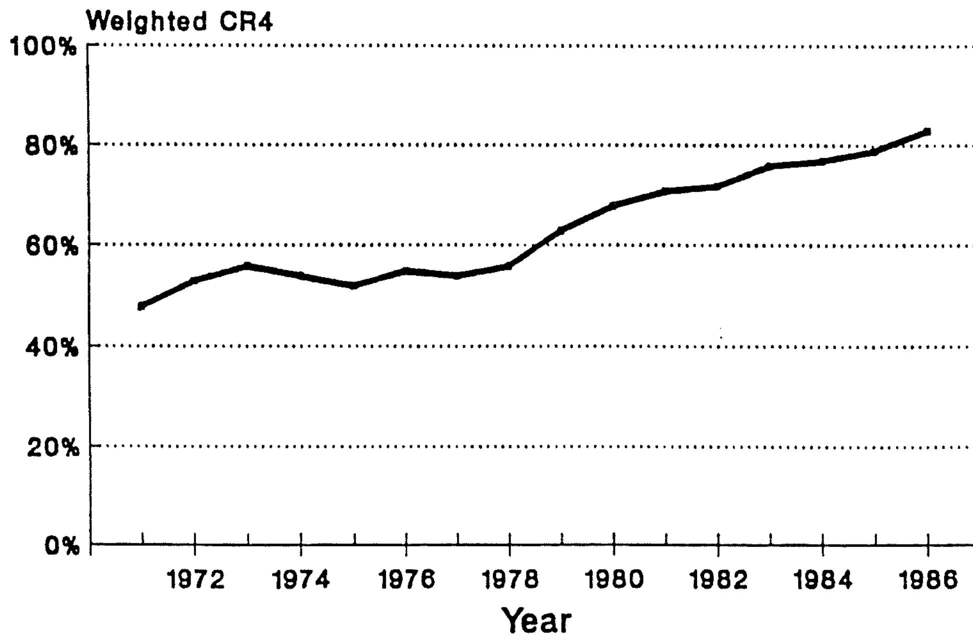

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EXHIBIT 5

Average Unweighted Four-Firm Concentration Ratios by Degree of Advertising Intensity, 65 U.S. Food and Tobacco Product Classes, 1958 to 1982.[1]

Year	(1) All Product Classes N=65	(2) Producer Goods Product Classes (A/S=0) N=18	(3) Consumer Goods Product Classes[2]: Low Advertising (A/S=0 to 1%) N=17	(4) Consumer Goods Product Classes[2]: Medium Advertising (A/S=1 to 3%) N=16	(5) Consumer Goods Product Classes[2]: High Advertising (A/S > 3%) N=14
1982	53.8%	50.2%	43.7%	58.9%	64.7%
1977	49.8	43.0	37.7	58.1	63.7
1972	48.8	42.9	37.8	56.1	61.1
1967	47.7	44.7	36.8	53.9	57.6
1963	47.1	44.8	36.1	52.1	57.7
1958	47.1	46.4	37.3	52.1	53.9
Change 1958-82	+6.7	+3.8	+6.4	+6.8	+10.8

Source: Bureau of Census, Census of Manufacturers for various years. Data tabulated by Richard T. Rogers, Department of Agricultural Economics, University of Massachusetts.

[1] These are product classes for which it was possible to make meaningful comparisons.

[2] The advertising-to-sales ratio (measured in percent) is constructed from each product class' advertising expenditures in eight measured media for 1967 and its 1967 value of shipments.

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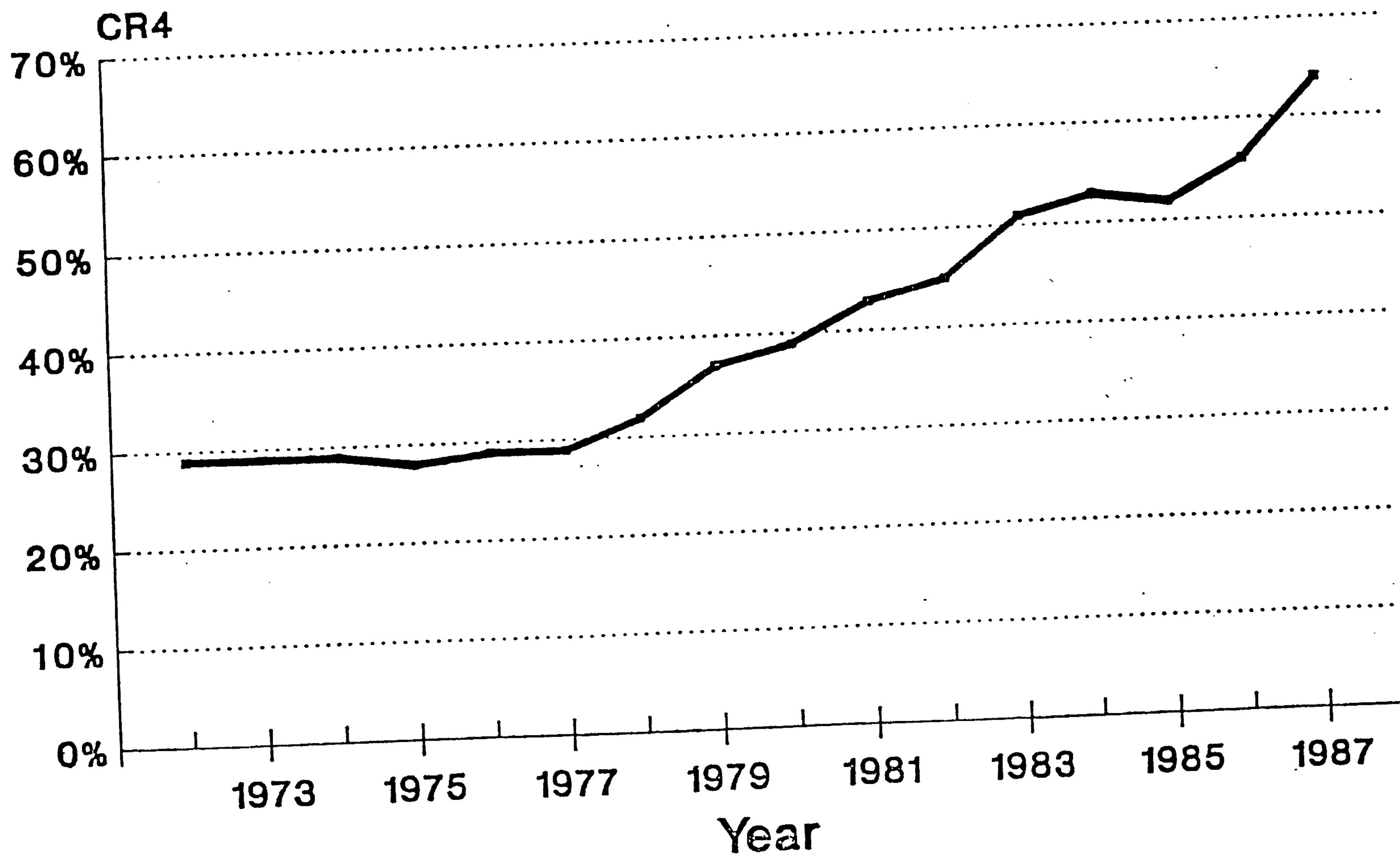
EXHIBIT 1

National Four-Firm Concentration of Steer and Heifer Slaughter 1972 - 1987



6-1-14
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EXHIBIT 2

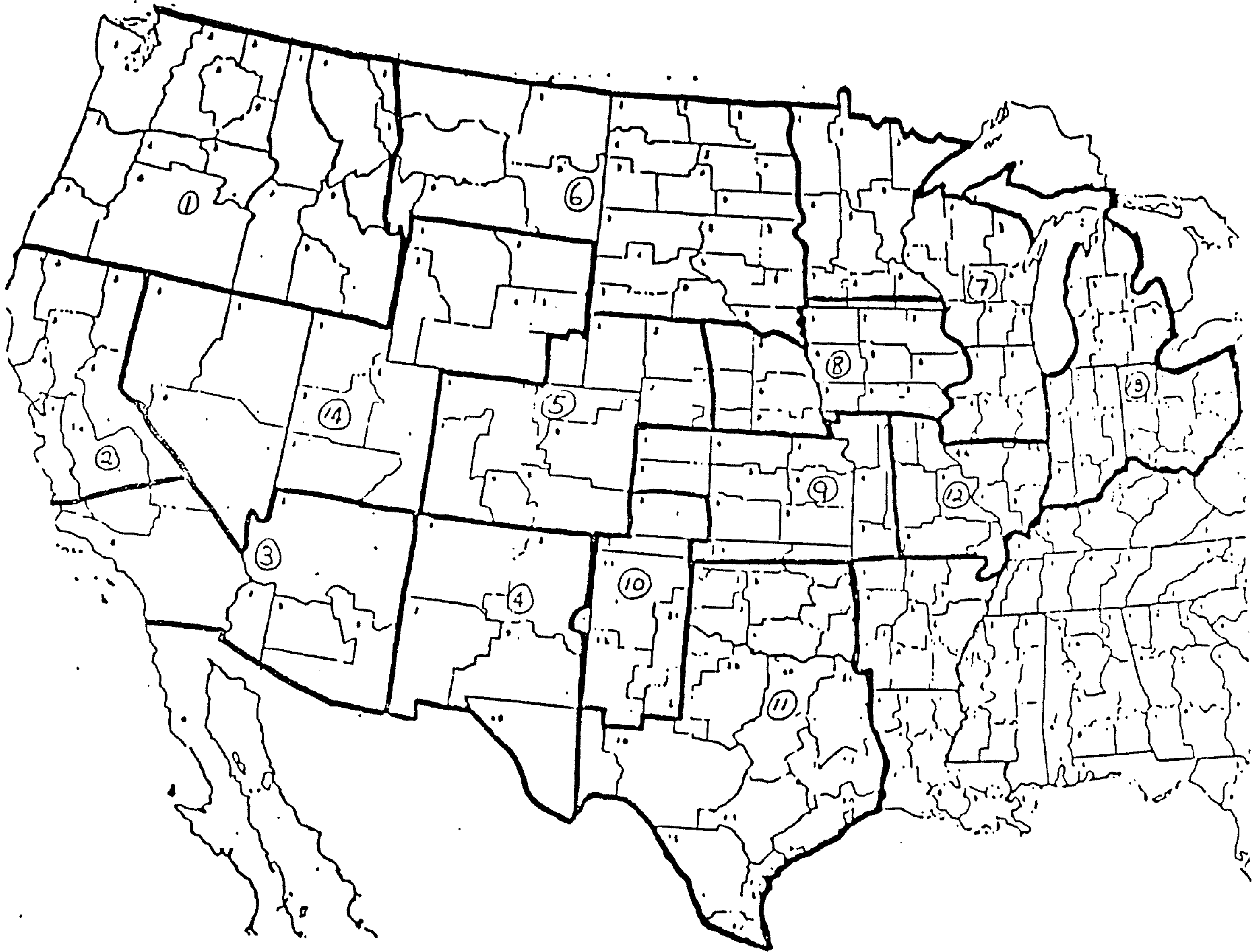

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EXHIBIT 3

Four Firm Concentration Ratios
Steer and Heifer Slaughter by Region
1971, 1978, and 1986

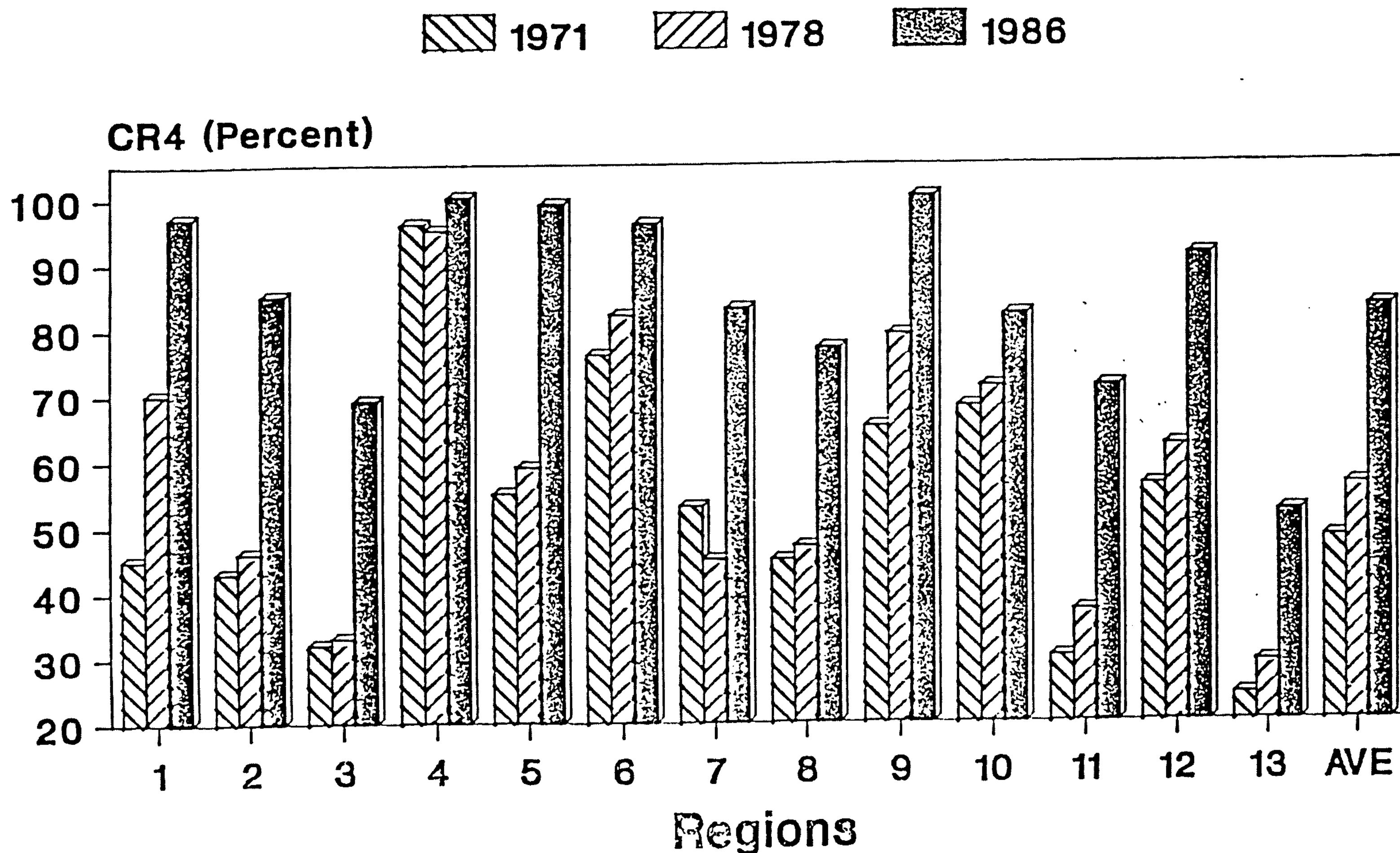
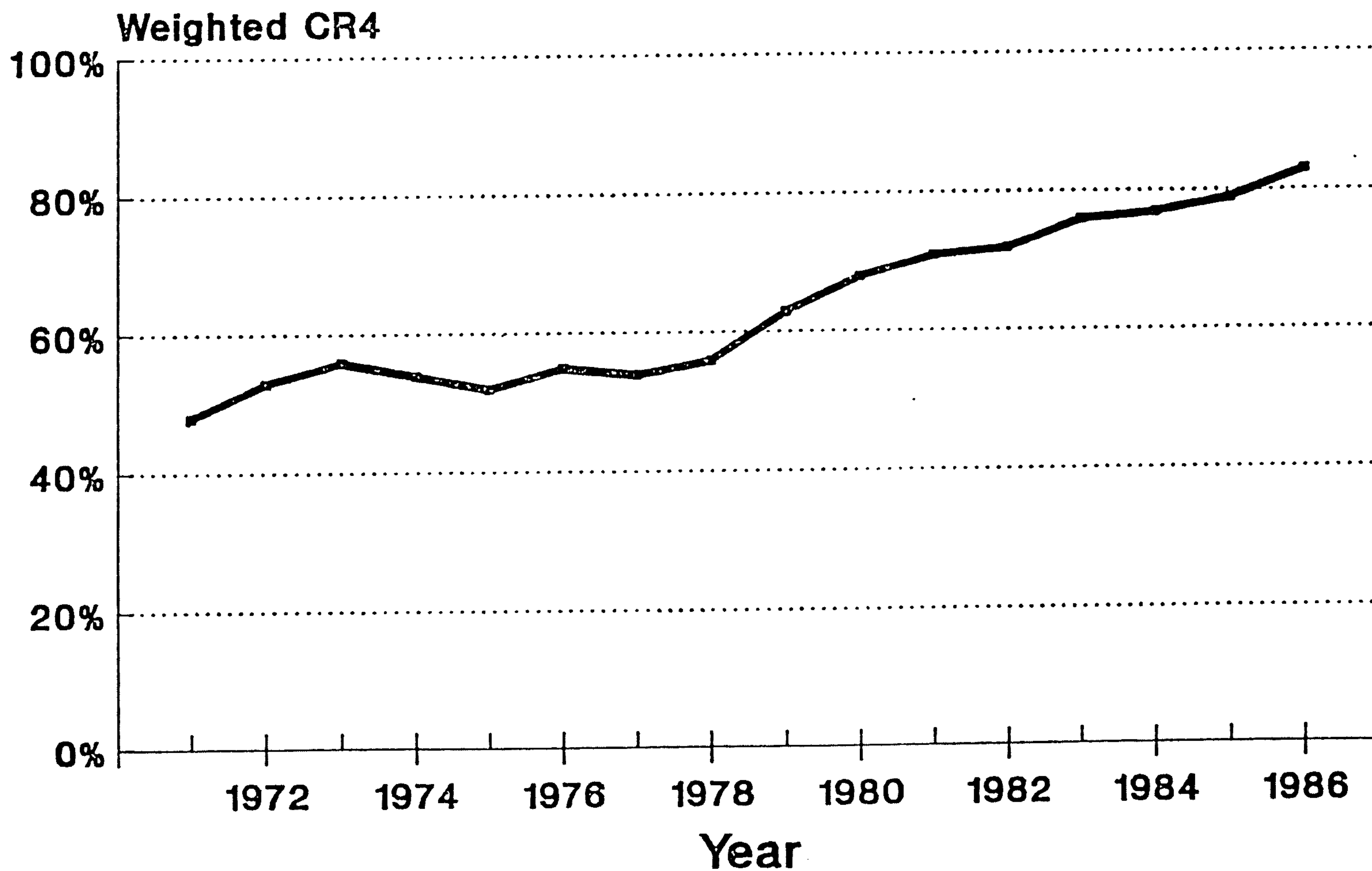


EXHIBIT 4

Average Four-Firm Concentration of Steer and Heifer Slaughter in 13 Regional Markets, 1971-1986



FARM REPORT

Cattlemen astir over contract issue

A dispute is simmering within the National Cattlemen's Association cow and calf sector over the endorsement of a task force recommendation to "take no action to alter or halt current trends toward contractual integration."

These concerns took concrete form at the NCA's annual convention in Nashville this week when the association's cow and calf council prepared a directive opposing the contractual-integration issue recommended by the concentration and integration task force.

The directive was then passed on to the marketing committee for approval but was rejected and lost all chance of becoming official association policy.

The defeat, however, did not deter some cow and calf council members from holding a news conference, during which poultry growers warned cattlemen of the risks of packer concentration and contractual integration.

David Meyer, a poultry grower from Oak City, N.C., said contract farming had left many poultry growers debt-loaded and without negotiating power. He said the poultry industry has reaped tremendous profits in the past 10 years but has not shared those profits with contract growers.

"In 1979, I made $5,000 per year per chicken house, and in 1989, I still made $5,000 per house," he said.

Under contractual integration, cattle producers would contract with packers to supply a given number of cattle at a predetermined price. Most of the poultry industry now operates that way.

The news conference was sponsored by the Western Organization of Resource Councils. Councils member Jeanne Charter thinks the cattle industry is pitching headlong toward a centrally integrated contract system and that the Cattlemen's Association is suggesting independent ranchers must move along that path.

AG BRIEFS

Wheat quality — The quality of the U.S. wheat crop declined in 1989, largely because of drought, according to a report released Tuesday by the USDA's Federal Grain Inspection Service. Soft red winter wheat accounted for the bulk of the drop. The percentage of samples that graded No. 1, by class: hard red winter, 61.4, down from 61.5 in 1988; hard red spring, 77, up from 67; soft red winter, 27.4, down from 75.9; durum, 71.2, down from 82.7; and white, 43, down from 59.

Cattle prices — Fed cattle cash prices have not yet established a top in 1990 and will challenge the January highs again in the second quarter, Topper Thorpe, general manager of Cattle-Fax, said at the Cattlemen's Association convention.

AG FUTURES

Grain and soybean futures settled moderately following a report that Soviet leader Mikhail Gorbachev might resign as Communist Party chairman.

Pork-belly futures fell sharply for the third straight day amid continuing concerns about weak demand, high slaughter rates and low cash prices. Live cattle and feeder cattle futures settled mixed.

Compiled from Eagle news services

GRAIN

KANSAS CITY BOARD OF TRADE

KANSAS CITY (AP) — Wheat futures on the Kansas City Board of Trade Tuesday:

WHEAT

5,000 bu minimum; dollars per bushel

	Open	High	Low	Settle	Chg.
Mar	3.85	3.85¾	3.80½	3.81¼	—.03¼
May	3.73	3.73½	3.68½	3.69	—.03
Jul	3.60½	3.60½	3.56¼	3.57½	—.01¾
Sep	3.65	3.65¼	3.62¼	3.62¼	—.02¼
Dec	3.76	3.76	3.72	3.72	—.04
Mar				3.76	

Mon.'s sales 10,353.
Mon.'s open int 26,853, off 1,205.

MILO

5,000 bu minimum; dollars per bushel

	Open	High	Low	Settle	Chg.
Mar	2.12½	2.12½	2.12½	2.12½	—.01¼
May				2.18½	—.01
Jul	2.22½	2.22½	2.22½	2.22½	.00

Mon.'s sales 45

	Open	High	Low	Settle	Chg.
May	2.56	2.56	2.55¼	2.55½	—.00½

Mon.'s sales 50,105.
Mon.'s open int 181,324, off 183.

OATS

5,000 bu minimum; dollars per bushel

	Open	High	Low	Settle	Chg.
Mar	1.38¾	1.38¾	1.37	1.37¼	—.01
May	1.46¼	1.46½	1.45½	1.45½	—.01
Jul	1.53½	1.53½	1.52½	1.52½	—.01
Sep	1.59	1.59	1.58½	1.59	—.00¼
Dec	1.66½	1.66½	1.66½	1.66½	—.00½

Mon.'s sales 881.
Mon.'s open int 11,449, up 54.

SOYBEANS

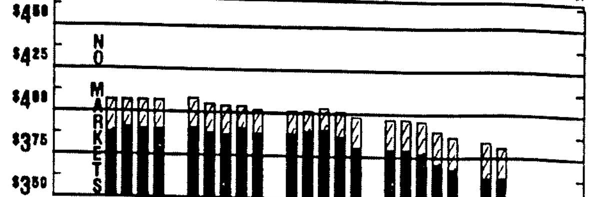
5,000 bu minimum; dollars per bushel

	Open	High	Low	Settle	Chg.
Mar	5.64	5.64½	5.57	5.58½	—.05
May	5.77	5.77	5.70¼	5.71¾	—.03¾
Jul	5.88¾	5.88¾	5.83	5.84½	—.03
Aug	5.91¾	5.92¼	5.87½	5.88¾	—.03¾
Sep	5.91¾	5.92	5.87½	5.90	—.01¾
Nov	5.97½	5.98	5.93	5.95	—.02½
Jan	6.07	6.07	6.03	6.04	—.03
Mar	6.17	6.17	6.13	6.15	—.02
May	6.20	6.22	6.20	6.22	—.02

Mon.'s sales 31,861.

Wheat

Price Per Bushel



Wichita Cash Wheat

Kansas City Board of Trade Futures (Nearby Month)

Tuesday's Grain Prices

House Eco. Devo. Committee
Attachment 2 2/5/90

Dan Cann
Raise hogs on contract

Kentucky hog producer Dan Cann, Leitchfield, anticipates his market access for finished hogs will disappear by the year 2000.

"I think the hog business will be exactly where the chicken business is now," he says. Cann and his father were forced out of broilers, then layers, by 1979. "It takes two million layers to be competitive now," Cann adds.

"The big companies put us out of business in less than three years," says Cann, "not because we couldn't produce competitively, but because without a contract we couldn't get the birds killed and marketed at a fair price."

When the 1900s conclude, Cann hog facilities and equipment will wear out in unison, he figures. He expects to be in a position to close up hog farming without major loss of capital.

"I'll be 51 then," says Cann. "Want to buy a small-town bank, wear a white shirt and tie to work."

In the meantime he expects to continue farrowing his 500 sows and finishing the pigs. Low-cost outdoor pens that were erected last fall enable the Kentuckian to limit contracting out some of his pigs.

Within the next five years, Cann expects to join what he sees as a trend toward contract hog production. Eventually, he feels, a contract will be required to obtain access to the market for hogs. Behaving on his past experience with poultry, Cann is convinced that contracts signal the slow end to individual hog operations. **—Ralph Watkins**

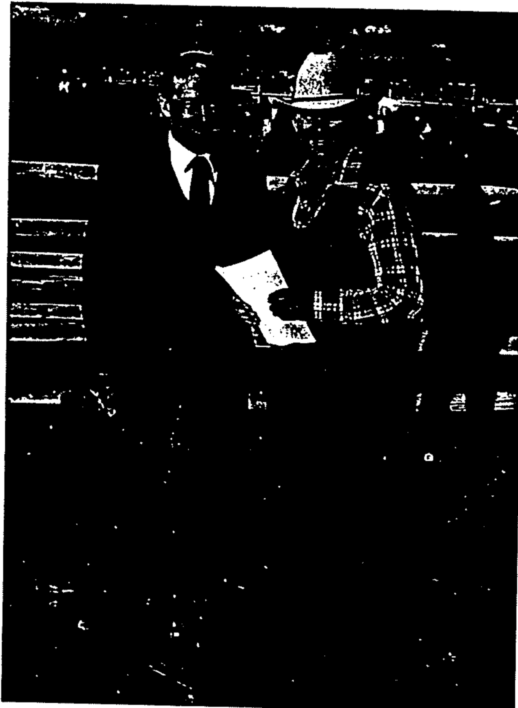


PHOTO: BRUCE MCALLISTER

WITH PACKER concentration, Bob (left) and Ron Ehrlich felt forced into switching from finishing cattle to backgrounding them 1½ years ago.

Bob and Ron Ehrlich
Packers call the shots

Second-generation cattle feeders Ron and Bob Ehrlich expect to be in agriculture for the next 10 years, but their approach will change significantly from today's operation.

Already, they've switched from finishing cattle at their commercial 20,000-head Milliken, Colo., lot to strictly preconditioning and backgrounding feeder cattle.

"We've had to in order to maintain our independence and stay competitive in view of the packer concentration," says Ron. "I don't like it, but ultimately I think you'll have to be hooked in to one of the big three packers [IBP, Con-Agra and Excel] to survive. You'll either fit into their mold or you won't be around," he adds.

Ron handles most of the cattle business. Brother Bob heads up the 4,500 irrigated acres of farmland plus works with land development.

On the horizon, the Ehrlichs believe biotechnology—even in its infant stages—holds enormous promise for them. "Biotech in general will make drastic changes in our life in the next decade," says Ron. "We're going to gear up on our highly productive land in hopes of doubling production. We'll either get rid of our poorer land or put it in grass. Hopefully biotech will have the same doubling effect on the grass, too."

Diversification will be important for these farmers in the next decade. "We're moving more into crops like [edible] beans and vegetables where we can be involved in processing and in providing a market outlet," says Ron.

Their prime location just 50 miles north of Denver allows the Ehrlichs to capitalize on development opportunities. For example, two years ago they bought and, with their own farm equipment, revamped an abandoned golf course. The cost: About one-tenth what a landscape firm charges.

With the help of Ron's son LeRon, the Ehrlichs are now making plans to renovate two more nearby golf courses. **—Greg Lamp**

4-2-2
2/5/90

Lawsuit alleges Cargill illegally terminated contract of poultry producer

By a Feedstuffs Staff Editor

Cargill, Inc., Minnetonka, Minn., and two company officials are being sued by the U.S. Department of Justice over the termination of business dealings with a poultry producer after he organized a suit charging the company with cheating farmers.

The suit, filed in federal trial court in Jacksonville, Fla., charges that the company's poultry-processing unit illegally terminated business dealings with Arthur Gaskins, president of the Northeast Florida Broilers Assn. and an independent poultry producer, after Gaskins organized a lawsuit alleging that Cargill's Jacksonville unit underweighed chickens and underpaid producers from 1980 to 1988. Through its suit, the justice department is attempting to get Gaskins reinstated to do business with Cargill.

The government department alleged in its suit that Cargill terminated business with Gaskins without good cause. "Since Cargill is the only poultry processor in the Jacksonville area, Gaskins' termination leaves him without a market for his chickens," the justice deparment was quoted as saying in a published statement.

A spokesman for Cargill said his company plans to contest the justice department's suit because the termination was a contractual matter and it was in no way related to the legal action being taken by Gaskins against the company. #

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Biographical Sketch

Dr. John W. Helmuth is an Associate Professor of Economics and Assistant Director of the Center for Agricultural and Rural Development at Iowa State University. He recently served as Executive Coordinator of the 1988 World Food Conference, held in Des Monies, Iowa, June 5-9, 1988.

Prior to his position at Iowa State University Dr. Helmuth was Chief Economist for the Committee on Small Business of the U.S. House of Representatives and has held positions with the United States Department of Agriculture and Commodity Futures Trading Commission.

House Eco. Devo. Committee
Attachment 3 2/5/90

JOHN W. HELMUTH

ADDRESSES

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AREAS OF EXPERTISE

Agricultural economics, agricultural policy, futures markets, marketing, food manufacturing, applied econometrics.

PROFESSIONAL EXPERIENCE

Adjunct Associate Professor and Assistant Director, Center for Agricultural and Rural Development, Department of Economics, Iowa State University, Ames, IA, 50011, 1987 to present.

Director, Natural Resources and Conservation Policy Division, Center for Agricultural and Rural Development, Iowa State University, 1988-1990.

Executive Coordinator, 1988 World Food Conference, Des Moines, IA, 1987-1988.

Chief Economist, Committee on Small Business, U.S. House of Representatives, Washington, D.C., 20515, 1979 to 1987.

Staff Economist, U.S. Department of Agriculture, Agricultural Marketing Service, Washington, D.C., 20250, 1978 to 1979.

Staff Economist, Commodity Futures Trading Commission, Office of the Chief Economist, Washington, D.C., 20581, 1976 to 1978.

Agricultural Economist, U.S. Department of Agriculture, Economic Research Service, Washington, D.C., 20250, 1974 to 1976.

Commodity Account Executive, Hornblower & Weeks-Hemphill, Noyes, Inc., Los Angeles, CA, 90017, 1973 to 1974.

Economist, U.S. Air Force, 1970 to 1973.

EDUCATION

Doctor of Philosophy in Agricultural Economics, University of Missouri, 1970.

Master of Science in Agricultural Economics, University of Connecticut, 1969.

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Bachelor of Arts in Mathematics, University of Missouri, 1966.

ACTIVITIES AND HONORS

President, Good Shepherd Lutheran Church, Reston, VA, 1986-1987.

Chairman, Board of Elders, Good Shepherd Lutheran Church, Reston, VA, 1980-1981.

Member, Board of Directors, Reston Children's Center, 1985-1987.

Treasurer, Reston Children's Center, 1985-1987.

Volunteer, Speakers Bureau, Hospice of Northern Virginia, 1985-1987.

Member, Editorial Board of The Journal of Futures Markets.

Member, American Economics and Agricultural Economics Associations.

Curators' Award, U. of Mo., 1962-1963.

Dean's Honor List, U. of Mo., 1963-1966.

Distinguished Air Force ROTC Graduate, 1966.

Joint Service Commendation Medal, USAF.

Joint Service Commendation Medal, First Oak Leaf Cluster, USAF.

George Washington Honor Medal, Freedoms Foundation at Valley Forge.

PUBLICATIONS

Stanley R. Johnson and John W. Helmuth, et al, "Comprehensive Economic Environmental Policy Evaluation System, Documentation," Center for Agricultural and Rural Development, Department of Economics, Iowa State University, 1989.

John W. Helmuth and Stanley R. Johnson, editors, 1988 World Food Conference Proceedings Volume I: Policy Addresses (Iowa State University Press, Ames, Iowa, 1989).

John W. Helmuth and Stanley R. Johnson, editors, 1988 World Food Conference Proceedings Volume II: Issue Papers (Iowa State University Press, Ames, Iowa, 1989).

John W. Helmuth, "Background and Perspectives on the World Food Conference," Chapter 1, 1988 World Food Conference Proceedings, Volume I: Policy Addresses (Iowa State University Press, Ames, Iowa, 1989).

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Ronald D. Knutson, L. Leon Geyer, and John W. Helmuth, "Trade Practice Regulation," chapter in Federal Marketing Programs in Agriculture: Issues and Options, W.J. Armbruster, D.R. Henderson, and R.D. Knutson, Eds., (The Interstate, Danville, Illinois) 1983.

Walter J. Armbruster, John W. Helmuth, and William T. Manley, "Data Systems in the Food and Fiber Sector," Chapter in Future Frontiers in Agricultural Marketing Research, Paul Farris, Ed. (Iowa State University Press, Ames, Iowa) 1983.

John W. Helmuth, "A Report on the Systematic Downward Bias in Live Cattle Futures," The Journal of Futures Markets, Vol. 1, No. 3, (Fall 1981), pp. 346-358.

Walter J. Armbruster and John W. Helmuth, "Contract Price Reporting for Fruits and Vegetables," Agricultural Marketing Service, USDA, Agriculture Economic Report Number 467, April 1981.

John W. Helmuth, "An Assessment of the Performance of the Chicago Mercantile Exchange Live Cattle Contract as a Hedging Vehicle for Cattle Feeders," Staff Study, Committee on Small Business, U.S. House of Representatives, 96th Congress, 1st Session, 1979.

John W. Helmuth, "An Analysis of the Futures Trading Activity in Live and Feeder Cattle Contracts of Large Traders on the Chicago Mercantile Exchange," Staff Study, Committee on Small Business, U.S. House of Representatives, 96th Congress, 2nd Session, September 1980.

John R. Multop and John W. Helmuth, "Relationship Between Structure and Performance in the Steer and Heifer Slaughtering Industry," Staff Study, Committee on Small Business, U.S. House of Representatives, 96th Congress, 2nd Session, September 1980.

John W. Helmuth, "Product Market Regulation: Implications for Research," American Journal of Agricultural Economics, Vol. 61, No. 4 Part 2, (November 1979), pp. 810-817.

John W. Helmuth, Grain Pricing, Commodity Futures Trading Commission, Economic Bulletin Number 1, September 1977.

Richard G. Heifner, James L. Driscoll, John W. Helmuth, Mack N. Leath, Floyd F. Niernberger, and Bruce L. Wright, The U.S. Cash Grain Trade in 1974, Participants, Transactions, and Information Sources, Economic Research Service, USDA Agricultural Economic Report No. 386, September 1977.

Allen B. Paul, Richard G. Heifner, and John W. Helmuth, Farmers' Use of Forward Contracts and Futures Markets, U.S. Department of Agriculture, Economic Research Service, Agricultural Economic Report No. 320.

Allen B. Paul, Richard G. Heifner, and John W. Helmuth, "Selling Ahead to Save Your Shirt," The Farm Index, U.S. Department of Agriculture, July 1975.

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2/5/90

John W. Helmuth, "An Economic Analysis of the Need for Commodity Futures Account Insurance," Staff Study, Commodity Futures Trading Commission, October 19, 1976.

John W. Helmuth, "Perspective on Prices," newspaper column, The Beverly Hills Independent, 1974.

John W. Helmuth, Futures Trading Under Conditions of Uncertainty, Ph.D. Dissertation, University of Missouri, 1970.

John W. Helmuth, Trading Period Stratification as a Method of Identifying Distributions of Options for Storage Firms Participating in the Futures Markets for Maine Potatoes, Masters Thesis, University of Connecticut, 1968.

TESTIMONY

Expert witness for the CFTC: United States of America before the Commodity Futures Trading Commission (CFTC) in the Matter of Indiana Farm Bureau Cooperative Association, Inc., and Louis M. Johnston, Respondents, CFTC Docket No. 75-14.

Expert witness for the plaintiff: W.C. and Kenneth Stray, et al. vs. Hunt International Resources Corporation, et al., 78-F-450 (United States District Court, District of Colorado).

Testimony before the Committee on Small Business, U.S. House of Representatives, "Small Business Problems in the Marketing of Meat and Other Commodities," (Part 3-Concentration Trends in the Meat Industry), Hearings, May 1,2,14 and June 4, 1979, pp. 109-120.

Testimony before the House Standing Committee on Agriculture, General Assembly of Iowa, regarding Concentration in the Meat Packing Industry. Des Moines, Iowa, December 7, 1988.

Testimony before the House Standing Committee on Agriculture, General Assembly of Iowa, regarding antitrust issues in the Meat Packing Industry. Des Moines, Iowa, March 30, 1989.

Testimony before the House Standing Committee on Agriculture, General Assembly of Iowa, regarding economic modeling of environmental impacts of agricultural production practices. Des Moines, Iowa, March 30, 1989.

Fact witness for the plaintiffs: Utesch, et al vs. Thomas H. Dittmer and REFCO, C 83-4154 (United States District Court for the Northern District of Iowa, Western Division), November, 1989.

PERSONAL

Married, two children.

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2/5/90

"BEEF PACKING: CONCENTRATION AND PRICING ISSUES"
DR. JOHN W. HELMUTH
Testimony presented before the
Committee on Economic Development
House of Representatives
Kansas State Legislature
Topeka, Kansas
February 5, 1990

Thank you Madame Chairman, it is a privilege for me to appear before you today. I have submitted written copies of my testimony and request that it be made a part of the record of this hearing.

Imagine for a moment that it is early Monday morning in Topeka, Kansas. The owner of a small retail shop arrives to open for business and finds the shop has been burglarized over the weekend. The owner reports the crime to the police, takes inventory and provides a detailed list of what was stolen. After months of delay the owner is told by the police that no action has been or will be taken. This hypothetical scenario repeats itself over and over again for every robbery that occurs in the city over a ten year period.

Absurd, you say. Such a situation could never happen in Topeka or any other American city. The citizens would never stand for it. You are right, citizens would never stand for local police not enforcing the laws. Unfortunately, American citizens have been allowing the federal government to not enforce the antitrust laws for the last ten years. For all intents and purposes we have had no enforcement by the Department of Justice (DOJ), the Federal Trade Commission (FTC), or the Packers and Stockyards Administration (PSA) of the United States Department of Agriculture (USDA).

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All have not been silent, however. Dr. Willard F. Mueller, among others has written thoroughly and extensively on the issue of lack of antitrust enforcement.[1] Dr. Mueller documents the lack of federal enforcement, pointing out that during 1981-1984 the FTC proudly proclaimed that they did not open any investigations into any conglomerate or vertical mergers. The FTC, DOJ and PSA also have not challenged horizontal mergers.[2]

In the meantime economists have documented what this lack of enforcement is costing American citizens. In an award winning study of the food manufacturing industry[3] researchers found after exhaustive testing that the profits of large conglomerate firms were most highly associated with: (1) market concentration, (2) market share, and (3) product differentiation. These results suggest that since both concentration and market shares independently affected higher profits, some form of collusion exists in the highly concentrated food industries. These results suggest that the strongest motivation for firms is to get bigger and bigger, driving out competition, and gaining a larger and larger market share, while flooding the market with scores of highly advertised, senselessly differentiated products. This research -- which won the highest award of the agricultural economics profession -- shows unequivocably that the power firms gain from increasing concentration results in higher consumer prices and lower prices paid to farmers. This power cost consumers $13 billion in higher food prices in 1975 alone.

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This staggering cost is added every year, year after year.

Congressman Neal Smith of Iowa in an article in the University of Michigan Journal of Law Reform found that over the years 1973 through 1979 consumers lost $98.5 billion due to monopoly overcharges in the food manufacturing industries.[4] Over the same years total inflation in food prices amounted to $99.3 billion, so that 99 percent of the inflation was accounted for by monopoly overcharges. Were the DOJ and FTC made aware of these facts? Yes. In fact the original estimate of monopoly overcharge was done by FTC economists, Russell C. Parker and John M. Connor[5], yet their agencies took no action. Also, Congressman Smith found that based on Russell Parker's estimate for the meatpacking industry, the potential for monopoly overcharge in boxed beef ranged from $133 million to $178 million measured in 1979 dollars, or about 8 percent of the value of boxed beef shipments.[6] Again, the DOJ, FTC, and PSA took no action.

In 1986 Dr. Bruce Marion and others at the University of Wisconsin[7] found that concentration of economic power among large beef packing firms in Iowa, Nebraska, Missouri, Kansas, Colorado, and the Panhandles of Oklahoma and Texas resulted in lower prices paid to cattle producers ranging from 24¢ per hundredweight to 47¢ per hundredweight and amounting to from $42 million to $80 million over the years 1976 - 1980. The relationship these Wisconsin researchers documented shows that for every 10 point increase in market share among the large beef packers, producers are paid 10¢ per hundredweight lower prices for their cattle.

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John Connor, who is now at Purdue University found that, "To summarize, buyer concentraton appears to have had significant depressing effects on fed cattle prices."[8] Dr. Connor states, "Considerable statistical evidence and market experiments support the general finding that with up to 3 or 4 sellers or with a CR4 above 40 to 60%, supranormal profits or supranormal prices are generated."[9] Dr. Connor is indicating that with levels of concentration above 40%, we see from experience in other industries and in other time periods that firms are able to achieve monopoly profits from charging prices higher than would be charged in a competitive situation or being able to purchase inputs such as livestock for prices lower than paid in a competitive situation. In my opinion, there is no doubt that the meat packing industry, beef packing in particular, has reached this point today.

On page 74 and 75, Connor points out that the number of feedlots in the U.S. has declined from 121,000 in 1970 to 43,000 in 1988. The percent of cattle fed on feedlots feeding 1000 head or larger, has increased from 34% in 1962 to 68% in 1982.

On page 78, Connor summarizes much of the changes occurring in the livestock industry and in meat packing with the statement, "Such an increase in CR4 is completely unprecedented in this industry." He is referring to the increase in concentration occurring between 1977 and 1987 where the top four firms' percent of the market share increased from 29% to 67%. In conversations with Dr. Connor and others familiar with industry structure studies, they have indicated to me that they have seen no other industry in America at any other time period, where the concentration in economic power has increased so rapidly in such a short time period.

a-4-4
2/5/90

Dr. Connor goes on in his chapter to document the same rapid increase in the boxed beef segment of the steer and heifer slaughter market. He also finds that the significant amount of excess capacity in beef fabrication means that the possibility of new entry into this industry is very much diminished. He concludes that in a situation where entry is blocked, where you have a homogenous product with similar technologies and declining industry growth, the possibility for price collusive behavior is quite high. The implications of that, of course, are not good for producers or consumers.

With respect to buying power of meat packers in the purchase of livestock, Dr. Connor finds an average CR4 in 1971 of 50% and in 1986, a CR4 of 82%. Given the mergers that have occurred in 1987-88, he estimates that the buyer concentration (CR4) is at 90%.

Dr. Connor indicates a feasible possibility that meat packers will vertically integrate into retailing with the possible ownership of retail outlets. This is the same thing that we saw happening in the first part of the century when the beef trust did in fact own retail meat outlets and when meat packers had monopoly control over the prices charged for meat and the prices paid for livestock.

Many of those who are critical of studies of industry structure indicate that large meat packers are not necessarily bad, that large size does not necessarily indicate monopoly profits, and that such large packers are necessary to achieve economies of scale. However, Dr. Connor finds that a specialized steer and heifer packing plant with the capacity of 250,000 head per year exhausts most economies of scale. He finds boxed beef fabricating plants with a capacity of 500,000 to 1,000,000 head per year exhaust all economies of scale. He concludes then that an integrated slaughtering-fabricating facility that is achieving all economies of scale

Q-4-5
2/5/90

would need about 2 to 4% of the total U.S. fed cattle supply.[10] Given these figures, there is no economic justification for the size of companies that we observe among the top 4 meat packers.

Dr. Connor finds that barriers to entry exist in the form of excess capacity and that the capital barriers are formidable, ranging between $20 to $40 million per meat packing plant. Dr. Connor finds that neither single plant nor multi-plant economies of scale justify the high observed levels of concentration in beef packing.[11]

He also finds that there is no evidence that food industry mergers have been accompanied by post-merger efficiency increases.

He finds that the market structure conditions in meat packing lend themselves to monopsony pricing by meat packers. He finds there is a surprising consensus among the empirical studies that have examined the relationship of fed cattle prices to levels of concentration. Essentially what these studies have all found is that with increasing concentration we find lower prices paid to producers for their livestock. The range of these lower prices is somewhere 2 to 3% lower.

Dr. Connor finds that while many people will quote the low meat packer returns as a percent of sales--usually around 1% of sales, the relevant measure to look at is returns as a percent of equity. Dr. Connor finds this to be at about 16% and finds that to be significantly higher than other manufacturing industries in the United States.

Dr. Connor finds that since 1980, federal anti-trust and regulatory enforcement has been minimal. He points out the need to have strict enforcement of anti-trust laws in order to halt any new mergers. He also suggests that producers should consider cooperative action in order to counteract the current situation in meat packing.

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I would point out that Dr. Connor's chapter is very thorough and excellently done. He draws strong conclusions from the material that he reviews and from the studies that he has done. It is unfortunate that the strength of his chapter does not come through in the summary versions of the economists report to the National Cattlemen's Association task force. In essence, the summary of the economist's work waters down Dr. Connor's conclusions considerably and the task force itself in its final conclusions waters down the strength of Dr. Connor's work and in doing so, dilutes the critical need for action to correct the problems in this industry.[12]

There is no doubt that producers face significant oligopsonistic market power on the part of meat packers. Azzeddine Azzam and Emilio Pagoulatos just published a paper that measures the market power of meat packers in the red meat (beef, pork, sheep and lamb) industry over the period 1959-1982.[13] Their index for market power in the output market where meat is sold to retailers and the HRI trade is .42. Their index for market power in the input market where packers buy livestock is .68. They conclude that the U.S. meat packing industry is not a price-taker in either market over the period studied. To me, their indexes are high and they do not include the seven years since 1982. I am certain the indexes would be even higher if they looked at beef alone, and if they included data through 1989.

I would now like to provide prospective on the current structure of the meat packing industry. How did we get to the concentrated industry we have today? What are the implications for farmers? I will base my remarks on work I directed while serving as Chief Economist for the U.S.

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House Committee on Small Business during the late 1970's and early 1980's under the Chairmanship of Congressman Neal Smith.

I see the essence of the problem facing producers as follows. When a few large firms buy, slaughter and sell the meat products from most of the livestock produced by farmers, those few firms are in a position to control the price they pay for livestock, control the quality of meat produced, and control the price of the meat products they sell. Such firms are motivated to pay the lowest possible price for farmers' livestock, produce the minimum quality meat that consumers will accept, and charge the highest possible price. All such activities harm livestock producers. In such an environment livestock producers receive less than a competitive price for their animals, consumers receive a less than competitive quality product, and pay a more than competitive price. In such an environment consumers eat less meat, further harming producers because of shrinking demand. In my opinion, this is the situation we have today.

When, instead of a few large firms, we have many firms in an industry, the result is a more competitive market. Competition results in a more efficient allocation of resources and helps minimize production costs and selling prices. Competition for livestock results in higher prices paid to producers. Both producers and consumers benefit when many firms are competing for market share in an industry. But when a few large firms control an industry, any efficiency gains from economies of scale or economies of size as all the studies have shown are lost to society in the form of shared monopoly profits, together with higher product prices and lower prices paid to producers.

<u>Monopoly power</u> is reflected in control over the quantity, quality and price of meat products. <u>Monopsony power</u> is reflected in control over the

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quantity and price of livestock. Azzam and Pagoulatos' indexes indicate packers have both monopoly and even greater monopsony power.

Another way of measuring monopoly or monopsony power is to look at the percent of the market controlled by various firms. These percents are often combined in what is called a concentration ratio. For example, if the four largest firms in an industry each account for 10 percent of the sales then the four-firm concentration ratio for the industry would be 40 percent. Trends showing increasing industry concentration are of concern, as every empirical study has shown,[14] because as concentration increases, competition tends to decline and this can result in lower prices paid to farmers and higher prices paid by consumers. What is considered to be a high concentration ratio?

In hearings before the U.S. House Committee on Small Business economists testified that when the four-firm concentration ratio goes over 40 percent you start observing firms exercising monopoly power. Anything over 65 percent is considered highly concentrated.

To put these figures in perspective consider the U.S. meat industry during the first part of this century. In 1916 the five firms of Armour, Swift, Morris, Wilson and Cudahy controlled over 60 percent of the cattle slaughter. In 1917 because of public pressure President Wilson ordered the Federal Trade Commission to conduct an investigation of the meat industry. The FTC concluded that there was no longer competition in the meat packing industry with a four-firm concentration ratio of 60 percent.

In February of 1920, the Attorney General filed a petition under the Sherman Act against the "Beef Trust" seeking to dissolve their monopoly. The petition stated that the five major packers had succeeded in suppressing competition <u>both</u> in the purchase of livestock and in the sale of fresh meat. By pre-arrangement the case was not contested and a

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consent decree was entered on the same day the petition was filed. The consent decree broke the "Beef Trust."

The FTC report also resulted in Congress enacting the Packers and Stockyards Act of 1921. The primary purpose of this act was to assure fair competition and fair trade practices in livestock marketing and in the meat packing industry.

What is considered to be a high concentration ratio? In West Germany if a firm has a market share of 33 percent it is presumed to dominate the market and is regulated as a monopoly. The same is true if up to three firms have a 50 percent market share or if up to five firms have 67 percent of the market.

I mention these examples to provide perspective on the concentration ratios we see for the U.S. meat packing industry. In 1972 the top four firms in steer and heifer slaughter controlled 29 percent of the market nationwide. By 1987 this had grown to 67 percent. However, on a state-by-state basis the figures are much higher (Table 1). The top four firms held a 80 percent market share of boxed beef production in 1987. The beef industry today is clearly dominated by three very large firms, IBP, Con Agra and Excel. These three are estimated to slaughter over 60 percent of the steers and heifers.

The rate of increase in concentration in the beef industry is unprecedented. Dr. Bruce Marion, an industry structure expert at University of Wisconsin says, "There is no parallel in any of the industries--food and non-food--with which I am familiar."

I would now like to summarize the findings of the Small Business Committee staff as published in 1980--nine years ago. The Committee staff had been directed to investigate the meat industry by Chairman Neal Smith of Iowa.

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The staff concluded in 1980:

1. If trends continue, a few very large firms will come to clearly dominate the cattle slaughter business.
2. Unless something is done to stop it, the same concentration of power is likely to occur in hog slaughtering.
3. During the 1970s large packers utilized a variety of vertical integration arrangements and in some instances questionable business practices, that had a serious detrimental effect on competition in the beef industry.
4. A national advertising battle of brand name beef products between large firms could result in the demise of small and medium-sized steer and heifer slaughterers.
5. Documents obtained by the Committee revealed preferential pricing and volume discounts in apparent violation of antitrust laws. Testimony indicated these practices were part of an overall plan to increase market share.
6. The Antitrust Division of the U.S. Department of Justice and the Packers and Stockyards Administration of the U.S. Department of Agriculture have failed to meet their responsibilities for enforcing the federal antitrust laws.
7. The cattle feeding industry is becoming more and more concentrated. In 1979 the 420 largest feedlots marketed 52 percent of the fed cattle in the United States. Fifteen of the twenty-five largest cattle feeding companies were owned, controlled or affiliated with a meat company, grain company or a futures commission merchant.

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8. In 1979 a publication called "The Yellow Sheet" played the principal role in setting meat prices. Studies showed that approximately 80 percent of the beef and pork prices reported by the Yellow Sheet were not supported by records of actual transactions. The implication is that 80 percent of the Yellow Sheet prices were fictitious. Studies showed that the Yellow Sheet prices on average are based on less than 4 percent of the actual transactions.
9. In 1979 approximately 80 percent of all meat bought and sold in the United States was formula priced off the Yellow Sheet. Buyers and sellers who formula trade remove themselves from the free competitive marketplace and, in essence, allow others to negotiate the eventual price of their product. This eliminates many of the supply-demand signals that are so important to a competitive market. As the practice of formula trading became widespread, the negotiated base became smaller and smaller, thus creating the incentive for the few buyers and sellers who remained in the negotiated market to report only those transactions which personally benefited them. Such a market has little chance of reflecting true supply-demand conditions.
10. The Committee staff concluded that computerized marketing of livestock is a possible solution to many of the pricing problems in the industry. Computerized marketing encourages trading volume, helps ensure that accurate supply-demand conditions are reflected in transaction prices, enhances market access by linking more buyers and sellers and provides for more accurate and accessible market information. Computerized marketing has

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been shown in various test projects sponsored by the USDA to result in significantly higher prices paid to producers as a result of enhanced competition.

If this were 1920 instead of 1989 the current "meat packing trust" would be broken by federal enforcement of the Antitrust and Packers and Stockyards laws. If this were West Germany instead of the United States these large, dominant firms would be regulated as monopolies. But this is not 1920 and this is not West Germany.

Some people say the problems in the meat industry are problems of interstate commerce and therefore are in the jurisdiction of the Federal Government. However, in an environment where the Federal antitrust laws to this day are not being enforced, in an environment where Congress, the Justice Department, and the Federal Trade Commission and the Packers and Stockyards Administration of the USDA were told in minute detail about the problem in 1980 and did absolutely nothing about it, action by individual states and the private right of action by individual producers may be necessary to correct the problems. There is an opportunity here for individuals and states to take a vigorous leadership role. But before I go into detail about what needs to be done, let me shift to another problem area -- futures markets and cattle pricing.

Cattle futures began trading on the Chicago Mercantile Exchange in 1964. Ten years later Paul Huszar and Forrest Walters of Colorado State University presented research results on the cattle futures market to the Southern Agricultural Economics Association.[15] These researchers concluded that a statistically significant downward bias existed in cattle futures prices over the period of 1965 through 1973 and that this downward bias

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indicated consistent losses for cattle feeders trying to hedge on the futures market. They concluded that in part, the problem was caused by a lack of long hedging (that is, a lack of commercial buying) in the live cattle contract.

In the May 1981 issue of the American Journal of Agricultural Economics, Larry Martin and Philip Garcia reported on a study of the live cattle futures market.[16] Martin and Garcia were testing the proposition that live cattle futures perform the important economic function of price forecasting and provide price signals which help producers decide whether to feed cattle. Martin and Garcia pointed out that if these functions are performed then cattle futures will offer producers reasonable hedging opportunities. Martin and Garcia concluded that the live cattle futures market is generally inadequate at forecasting cattle prices. They concluded that you can tell more about what's going to happen to cattle prices by looking only at past cash prices than by using the futures at all. This means the cattle futures prices are putting inaccurate, misleading signals into the marketplace and adding to the confusion rather than performing a useful economic forecasting function. They also concluded that over the years live cattle futures have been getting worse, not better, at forecasting. They concluded that during periods of falling prices, cattle futures were biased forecasts -- thus adding confusion to the marketplace and, I would conclude, possibly exaggerating price drops. Martin and Garcia compared the cattle futures' performance during periods of relative economic stability versus periods of instability. They concluded that cattle futures were okay at forecasting when economic conditions were relatively stable, but were unable to

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forecast well when economic conditions were unstable. In other words, when the producer needs them most they perform the worst. As far as providing the producer with useful price signals which would help with cattle feeding decisions and make risk shifting possible through hedging, Martin and Garcia concluded that their analysis does not support the contention that live cattle futures perform this service.

In the summer 1983 issue of the Journal of Futures Market Ray Leuthold[17] examined the fundamental makeup of cattle futures, looking for relationships between futures trading and fundamental supply variables such as placements, cattle on feed and cattle slaughter. Leuthold again documented the hedging imbalance noted by Huszar and Walters. This preponderance of large short hedgers compared to large long hedgers in the live cattle futures has plagued the market from the beginning. With regard to hedging by meatpackers he concluded, "Obviously, packer hedging on the long side of the cattle and hog markets is not substantial, apparently because packers can pass output price risks on to consumers through the wholesale price structure."[18]

The most striking conclusion of Leuthold's study was the lack of any substantial relationship between supply variables such as placements, cattle on feed, and cattle slaughter and the futures market. Leuthold concluded, "The data indicate that futures market activity is not related to commercial cattle movements; it is more related to price regardless of whether that activity is hedging or speculation."[19] This was true for both live and feeder cattle futures.

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In the fall 1983 issue of the Journal of Futures Markets[20] G.D. Koppenhaver reported on research into the economic efficiency of the cattle futures markets. He reviewed a 1974 study by Leuthold who found that live cattle futures prices from four to eight months prior to maturity are biased predictors of cash cattle prices. Leuthold concluded, as did Martin and Garcia, that you can tell more about what's going to happen to cattle prices by looking only at past cash prices and ignoring the futures. Koppenhaver's research shows the presence of a significant long-term downward bias for live cattle futures maturing from one to six months in the future. Koppenhaver concludes that his work, "provides support for the bias detected by Leuthold and more recently by Martin and Garcia and by Helmuth."[21]

In the same issue of the Journal of Futures Markets which published the results of my research, Lennart Palme and James Graham of the Chicago Merchantile Exchange published a critique of my work.[22] Quoting Palme and Graham: "We are confident that anyone taking the time to study the Helmuth report will be dismayed by the lack of solid economic analysis and misleading conclusions presented."[23] Palme and Graham conclude the data I used do not support my findings and that I used data that were not available during the time period covered in my study.

In response to my work and the Palme-Graham critique, Darwin Pluhar of Texas A&M University conducted an analysis of both.[24] Pluhar found that my work accurately reflected the data and that a trading strategy

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based on the price drops reported in my study resulted in statistically significant positive gross profits leading to the conclusion that the live cattle futures market was weak-form inefficient. In analyzing the Palme-Graham critique Pluhar found, statistically, that there was no justification for their claim that the data I used did not support my findings or that I somehow used data not available during the time period covered in my study. Pluhar has clearly refuted the Palme-Graham critique of my work. It is interesting to note that Pluhar went to work for Cactus Feeders after he received his Masters Degree at Texas A&M.

Cattle futures have been trading for 25 years. I know of no market that has been studied more, by more different researchers, from every possible angle. The bulk of these studies keep coming up with the same results: cattle futures are an inefficient, biased market. There is clearly something wrong in the cattle futures market.

I would like to review the results of my own research on cattle futures and try to answer the question of why cattle futures are performing so poorly.

Soon after I went to work for the House Committee on Small Business in 1979, the committee chairman, Congressman Neal Smith of Iowa, asked me a fundamental question which led to the studies I will report on today. Mr. Smith asked, "How often can farmer-feeders use the futures market to hedge?" Smith's question was motivated by persistent complaints about cattle futures from mid-western cattle feeders. In order to answer the question I gathered cost-of-feeding data from the USDA for farmer-feeders and compared these costs with cattle futures prices on the Chicago Mercantile Exchange. My study showed that during a 31 month period

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beginning January 1978 a breakeven hedge, one that would just cover costs, in live cattle futures was possible on only 28 out of 622 days (4.5% of the time) for farmer-feeders, if you assume the farmer wants to hedge the cattle during the first month in the feedlot. If you assume the farmer wants to hedge sometime during the first half of a feeding period, the hedging opportunities increase from 4.5 percent to 19 percent of the time and during the last half of the feeding period hedging was possible about 40 percent of the time.

It was while I was conducting this initial study on hedging potential that I noticed a very unusual relationship in the cattle futures prices, a relationship which was consistent with the conclusions of earlier studies that cattle futures prices were biased downward, were not efficient, and were not reflecting true supply-demand conditions. What I found was that after January 1978, every time the live cattle futures prices went above the farmer-feeder's cost they almost immediately dropped back down. I recognized that someone armed with this piece of information could trade the cattle futures market with a perfect certainty of making profits. Anyone can sell short when cattle futures go above feeding costs and buy back on the close as soon as prices drop below costs and always make a profit.

Specifically, on 36 occasions between January 1978 and November 1985, live cattle futures prices went above farmer-feeders' costs and on 36 occasions they dropped back below those cost levels within 2 1/2 days, on the average. On 12 of the 36 occasions, the price drops occurred the same day that futures went over feeding costs. On 2 occasions a trader would have had to wait 6 or 7 days before the drop occurred. On the average, the drop occurred on the second day after futures prices went above feeding costs. The gain per occurrence, on average, was $.91 per cwt. On

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These signalled drops are not isolated instances and are not reflecting minor adjustments in the spreads, but are indicative of the entire cattle futures market. Cash prices, which should reflect real supply-demand conditions, were generally unchanged or going up when the futures price drops occurred. This indicates that the predicted futures price drops are independent of cash prices and do not reflect fundamental changes in supply-demand conditions. Such artificial futures price moves increase the instability between cash and futures prices and raise serious questions about whether cattle futures are serving any economic purpose.

The next question I addressed in my research was why are these price drops occurring? To answer the question I analyzed the daily trading records of all cattle futures traders who held 50 contracts or more over the period January 1978 through April 1979. This analysis showed that grain companies, meatpackers and commercial feedlots were among the very largest traders, that they were generally trading together and that they were generally on the selling side of the market.

It showed that the officers of grain, meatpacking, commercial feedlot and brokerage firms tended to trade together in feeder cattle futures on both of the long and the short side of the market in personal accounts. These 84 people made $106 million in net profits over the 16 month period of my study. This was 68 percent of all the profits made by all 1,027 large traders in my data base.

With regard to the predictable price drops and the futures positions of large cattle traders, I concluded from my research that the short selling by grain, packing and feedlot companies and certain of their officers and brokers caused the price drops. Two vivid examples during the time period of my study highlight what happens.

On May 24 1978, the October live cattle futures contract went above the farmer-feeders' breakeven production cost level and stayed there for three days. On May 31 the live cattle futures broke and began the largest price slide of 1978. By June 22 the futures bottomed out after dropping $10 per hundred. The combined short positions of the grain, packing and feedlot companies prior to May 31 when prices broke, totaled approximately 28,000 contracts. This was the largest combined short position by these companies during the period of my study.

On October 4, 1978 the April live cattle futures went above the farmer-feeder breakeven production cost level and stayed there for four days. On October 11 the live cattle futures prices broke and began the second largest price slide of 1978. By October 25 the futures bottomed out after dropping about $5 per hundred. The combined short positions of the grain, packing and feedlot companies and certain of their officers and brokers exceeded 23,000 contracts prior to the October 11 price break. This was the second largest combined short position for these traders.

In addition to the trading behavior of these groups, I think another cause of the problems with the live cattle futures contract as pointed out by Huszar, Walters and Leuthold is the imbalance between long and short hedgers. On the average short hedging, that is selling by commercial traders, is about 3 to 4 times as large as long hedging, or buying by commercial traders. This same problem was evident in onion futures before Congress outlawed them in 1958. What this imbalance means is that the fundamental demand conditions are not adequately reflected in the market because there are so few commercial buyers. Around 90 percent of the buyers in cattle futures are speculators. This situation leads to a market that is both fundamentally and psychologically stacked in favor of

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lower, not higher prices because as the feedlots, grain and packing companies sell futures the speculators turn from buying to selling and the market inevitably drops.

Many people have asked me: Aren't the packers commercial buyers of live cattle futures? The textbooks on futures trading say they should be. Clayton Yeutter, when he was president of the Chicago Mercantile Exchange, in testimony before the USDA Meat Pricing Task Force said that packers were long hedgers. But the actual data on the futures trading of the meatpackers tell a completely different story. As a group, the meatpackers were short, they had sold futures throughout the entire period of my study. Their total short position ranged from about 2,000 contracts (76,000 cattle) to almost 10,000 contracts (380,000). Since these packers are classified by the MERC as hedgers, I can only conclude that they are selling cattle futures as hedges against cattle they are feeding or have contracted for themselves. The packers are trading the market in the same way as commercial feedlots and I might add, so are the grain companies.

Thus, when you have large amounts of short selling coming from strong commercial companies and you add on top of it the selling by certain officers of these companies, by certain officers of brokerage firms and by speculators, you find that the market drops every time.

To compare these drops in cattle prices with other commodities I looked at corn futures prices relative to farmers' production costs for the period 1976 through 1980. I found no systematic relationship between corn futures prices and production costs. One would not expect to find such a relationship. Prices were substantially above costs for extended periods and below costs for other periods. As prices moved above production costs there were no systematic drops. The corn futures market

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was operating as an efficient reflection of supply-demand fundamentals. Sometimes demand was strong relative to supply and prices moved higher. Sometimes the reverse was true. This is what you'd expect from a market that's operating properly.

I also checked cattle futures between 1972 and 1977 and found that when cost levels were reached, futures prices dropped 70 percent of the time. Thus, while this is by no means exemplary performance, it is better than the situation since January 1978 when the futures price drop occurred 100 percent of the time.

Another finding of my research has to do with the trading activities of 32 specific accounts. Before outlining these findings, let me make it clear that I am not claiming that the trading of the 32 caused the price drops. If there is any identifiable cause of the price drops it is the trading of the commercial feedlots, grain companies, meat packing companies, and certain officers of these companies and officers of certain brokerage firms.

The trading of the group of 32 is another issue. These 32 accounts--which traded both the long and short side of the market--made net profits of $110 million during the 16-month time period covered by my research. Thus, these 32 made 70 percent of the $156 million in profits made by all large traders--the $156 million which was lost by small traders in cattle futures.

This group of 32 was identified when I compared the daily trading activity of each large trader with every other large trader. The results showed that these 32 accounts made similar trades on similar dates. Also, information from public sources and CFTC large trader information showed

that many of these 32 have common business affiliations. Finally, these 32 were generally selling futures on or about the dates when the predicted price drops occurred. Thus, their trading activity certainly displays a probable awareness of these impending price drops.

My findings are in complete agreement with the earlier studies. My study showed a systematic downward bias in cattle futures prices. My findings provide hard evidence that groups trading together are definitely evident in cattle futures and I conclude this trading activity is the cause of the downward bias in cattle futures prices.

Finally, like Martin and Garcia, my findings are fully consistent with the market they describe--a market which is inadequate at price forecasting and which does not provide useful price signals to help with cattle feeding decisions or make risk shifting possible through hedging. From all of this I conclude that the live cattle futures market is not serving an economic purpose.

The NCA Task Force that I referred to earlier looked at livestock pricing issues. Chapter VI of the "Competitive Issues in the Beef Sector" was authored by Dr. Andrew Schmitz of the University of California at Berkeley and is titled, "Price Discovery in the U.S. Beef Industry." Chapter VI is embarrassingly superficial. The author cites only a small number of the many studies done on cattle pricing and seems to rely much too much on the 1987 GAO report which itself produced no new research and was severely limited in its scope. On p.121 the author states, "It is extremely difficult to do a thorough analysis of futures trading since it is essentially impossible to determine the precise nature of the actors who are hedging and speculating in beef futures markets." This statement betrays the superficial nature of the chapter in that my work for the Small Business Committee, based on daily trading records of all large

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cattle futures traders, did exactly what Schmitz says is essentially impossible. Since I know he is not unaware of my work, I can only wonder why he chose to overlook it.

The Commodity Exchange Act requires that before a futures market can operate it must be determined that the futures are not contrary to the public interest. This requirement has been interpreted by the Commodity Futures Trading Commission to mean that a particular futures contract must serve an economic purpose. When the CFTC was created in 1974 they performed what they called the "economic purpose test" on newly regulated commodities. However, this wasn't done on futures such as cattle which had previously been regulated by the Commodity Exchange Authority of the Department of Agriculture--these futures were grandfathered in. No government agency, to my knowledge, has ever taken a close look at cattle futures to see if they are really serving an economic purpose.

What, if anything, can be done to correct the problems in cattle futures? I see the following actions as necessary if cattle futures are to have any chance of operating as an unbiased, efficient market.

First, prohibit trading by the officers of firms that are themselves trading futures. This would implement into law the present policy of companies such as IBP who prohibit their employees from trading cattle futures. Several years ago an amendment to prohibit such insider trading, authored by Congressman Neal Smith, passed the House but not the Senate.

Second, we need to find some way of achieving a balance between short and long hedging in the live cattle contract. The MERC is aware of this problem and has been trying for years to get more long hedging. Unfortunately, it is my opinion, that as long as meat is formula priced so that packers, as Leuthold put it, can pass the price risk right on through the chain to the consumer or back to producers, there will continue to be

absolutely no incentive for meatpackers to use the cattle futures as long hedgers. Without substantial amounts of long hedging, I doubt that cattle futures will ever be unbiased or display the characteristics of price efficiency. But for meatpackers--who are the only group in the marketing chain that might become a substantial long hedging force--to be motivated to long hedge, you would have to completely change the way meat is priced in this country. Since this is very unlikely, I am not optimistic that improvements can ever be made.

There is one significant step that I think should be taken. Since cattle futures contracts are supposed to be a marketing tool which serve an economic purpose not contrary to the public interest and since cattle futures have an irrefutable impact on the prices paid to producers for their cattle, it should be the inalienable right of cattle producers to be able to freely express their desire as to whether cattle futures should be allowed to trade or not. Several years ago, Congressman Neal Smith introduced legislation which would require a positive vote by producers in referendum before cattle futures of any kind would be allowed to trade. To illustrate the absurdity of the current situation where producers have no say about cattle futures trading let me construct a hypothetical situation. Let's suppose that everyone here today is a member of the United Auto Workers Union and that we all work in an assembly plant in Detroit. But instead of getting an hourly wage determined by a contract with an auto company let's assume in Chicago there's a futures contract for UAW labor and that contract trades every day. And our hourly wage is determined by the price on the futures market each and every day. One day it might be $15 per hour, the next day it might be $10 per hour. We would never know from day to day. We would get paid at the end of each day at whatever rate the futures determined. All the automakers would be

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designated as hedgers by the exchange so they could trade in unlimited amounts of our labor contracts. What do you think they'd do? Would they buy the contracts and drive up our wages? Or would they sell the contracts and keep our wages down? It doesn't take an economist to answer that question. What I've just described is the most absurd, the most unfair market situation I can imagine. What I have just described amounts to total exploitation of the labor force. That is exactly the situation cattle producers face.

Let me now turn to what I see as the alternatives available to correct the problems I have discussed. I'll start with an anecdote. After I finished my Ph.D, I served with the U.S. Air Force in Vietnam as an economic advisor. In that position I learned a great deal about the agricultural economies of the far east. I learned that Vietnamese farmers were trapped in a marketing system that kept them barely above a subsistence existence. Vietnamese farmers didn't sell their products, they literally gave them to middlemen. In exchange the farmer got nothing. The middleman would move the product to market, sell it for whatever price it would bring, take their costs and profits out of the proceeds, and pay whatever taxes and bribes were necessary. The next time the middleman returned to the farm he would bring whatever residual was left from the sale back to the farmer, after everyone else had covered their costs and taken their profit. At the time I thought: this is the worst, most exploitive, consignment marketing system possible. The farmer is literally at the mercy of the middlemen.

Over the years as I have studied the marketing system for U.S. farm products I have come to realize we have the same system for pricing grain and livestock in this country. It works like this. The final price for grain or livestock is determined by what it will bring at the point of

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final sale. Middlemen know that price, either from the cash market, the forward contract market, or the futures market. They take that price, subtract their costs and profit, and that determines what they will bid for producers' product. To the degree there is competition among middlemen the higher the bid price for agricultural products. The less competition, the lower the bid price. My conclusion: American grain and livestock farmers are trapped in a "consignment" marketing system that returns the residual to them, after every other business in the system has covered their costs and taken a profit. Little wonder that there is a long run decline in the number of farmers in America. It will continue either until there are so few land owners producing grain and livestock that they have counterveiling economic power or until something is specifically done by farmers or government to stop it.

This is not a new problem. This is not a new theory. This is a description of the facts, as they now stand in American agriculture. What has changed over the last twenty years is the level of competition among middlemen. As companies merge, as companies grow larger, achieving larger and larger market shares, the level of competition grows smaller and smaller and the residual--left for the farmer-grows smaller and smaller.

What can be done? First, there are no really new solutions. This is the same problem faced by producers and government during the depression. This is the same problem that producers have always faced. I see essentially four alternatives: 1. enforce existing laws and regulations, 2. pass new state and/or federal legislation, 3. pursue civil law suits, and 4. obtain economic power through collective marketing/bargaining.

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Enforce existing laws and regulations. It is my opinion that if the antitrust, Packers and Stockyards, Commodity Exchange Act, and other agricultural laws and regulations were enforced as intended by the Congress this would go a long way toward mitigating the problems we have today in the marketing system for agricultural products. These laws were designed for that very purpose. Unfortunately they are not being vigorously enforced. They have not been vigorously enforced for at least nine years, and I see little, or no chance that they will be vigorously enforced anytime in the foreseeable future. It is a reality of our system of federal government, with three equal, independent branches, that if the executive does not, for whatever reason, want to enforce the laws passed by the Congress, they for all intents and purposes will not be enforced.

This is my somewhat pessimistic assessment of the current state of affairs in Washington. This is not to say, however, that I recommend giving up on encouraging the administration to vigorously enforce existing laws. I recommend persistence in such an effort.

Pass new federal legislation. The real bottom line is I don't think new federal legislation is necessary if existing laws were vigorously enforced. However, efforts to pass new, more specific, tougher legislation, say to adopt the West German approach to antitrust enforcement, can have two benefits. Such efforts could result in laws that are less easy to be ignored by enforcement authorities, and result in more enforcement of existing laws on the part of enforcement authorities as a response to the signal of pending, tougher laws.

Pass state laws. Tougher state antitrust and other agricultural laws such as those you have under consideration here today have an important role to play. In the vacuum created by lax federal enforcement a move on

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the part of several important agricultural states to enact tough laws, sends a powerful signal to Washington that if Washington does not act, the states will. Such activity on the part of the various states is very important and I strongly recommend it. The bills you are considering are well drafted and deserve your detailed attention.

Economists view all resources in terms of three primary factors of production: land, labor and capital. The definition of land includes all natural resources. Land and labor are primary inputs not themselves produced by the economic system. Economists use the term "capital" in a broader sense than the common usage where "capital" is taken to be synonymous with "money." Capital then is everything other than land and labor necessary for the production of goods and services in the economy--machinery, buildings, etc.

What you are dealing with is the basic question of the ownership of land, labor and capital. Since the birth of our nation, our democracy has been based on the Jeffersonian principle that ownership of the land should be broadly based among all the people. If it is not, if ownership of the land becomes concentrated in the hands of a few who also own the capital, the only primary factor of production left with broad based ownership is labor. The result of such an unfortunate process is that most family farmers would become laborers, wage earners, for those who own the land and capital.

What can you expect if you do not prohibit corporate and other outside ownership of the land? You may expect a short run drop in the price of land.

But, the facts show us as agribusiness corporations become more and more concentrated, they acquire more and more profits. The question then

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becomes in what do they invest these profits? They can re-invest in their own corporations, they can diversify, they can pay dividends, and they have many other alternatives. One particularly attractive alternative to grain and livestock agribusinesses may be ownership of land. Land is a necessary resource to their fundamental business. When land ownership is broadly based among family farmers, large agribusiness corporations do not have control of that segment of their production process--they are subject to risk as a result. Their acquisition of land can be viewed as part of a perfectly natural motivation to control the risk of their production process.

As agribusinesses become more and more concentrated the incentive to channel their monopoly profits into ownership of the land becomes greater and greater. If you forestall this investment possibility these corporations are still left with the other alternatives: re-investing in their own corporations, diversification into other industries, paying dividends, using the profits to insure the safety of the environment, etc.

Many fear the possible short run impact on land values of prohibiting corporate and foreign ownership. But if your land values are being propped up by corporate and foreign demand for you land, then you are in an undesirable situation to start with. If you forestall corporate and foreign ownership, in the long run your land values are more likely to settle at a level where young people can afford to enter family farming and make a decent living at it. In the long run you would expect your policies to attract young family farmers from other states where corporate and foreign ownership has not been prohibited.

When you took on the role of state legislators you took on the job of making tough choices. I urge you to look beyond the short run and

carefully consider the long run implications of any land ownership alternatives under consideration. In my opinion, coordinated action on the part of the several states to forestall corporate and foreign ownership of the land is absolutely necessary. Without state action there is nothing to prevent ownership of the land passing to those few who have by whatever means acquired large blocks of wealth.

Pursue Civil lawsuits. In November of 1989, cattle producers, in a civil lawsuit against REFCO and Thomas Dittmer, obtained a unanimous federal jury verdict finding REFCO and Thomas Dittmer guilty of manipulation of cattle futures prices under the Commodity Exchange Act, guilty of attempts to monopolize under the Sherman Antitrust Act, and guilty of conspiracy and fraudulent concealment under the Racketeer Influenced and Corrupt Organizations (RICO) Act. The Des Moines Register (November 11, 1989, p.1.) estimates that "an award on behalf of all cattle producers could top $200 million after a trebling of damages under the antitrust [and RICO] laws." The case was filed in 1984. It took five years to get to trial.

"Former U.S. Senator Thomas Eagleton [recently] resigned from the board of the Chicago Mercantile Exchange, accusing the world's second-largest futures market of having more concern for "fat cat" insiders than the public interest." (Des Moines Register (AP), November 8, 1989).

Several years ago Monfort sued to block the Excel takeover of Spencer. Monfort won the trial but lost on appeal.

The American Agriculture Movement is suing the Chicago Board of Trade itself, for the alleged downward manipulation of soybean futures prices and the subsequent collapse of cash prices in July of 1989.

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The FBI has had to step in and perform what is essentially a CFTC function of uncovering trading abuses in the Chicago futures pits.

Cattlemen sued the major meatpackers and retailers starting in 1975, fourteen years ago, for antitrust violations. That suit still has not gone to trial.

Civil law suits take time, money and patience,--five, ten, fifteen years and hundreds of thousands of dollars. When they are successful they can be a significant deterrent. Often the threat of a large monetary penalty may be the only thing that forestalls continued violations.

It is my opinion that you can take important and badly needed action by passing legislation that exempts your farmers from the ill conceived Illinois Brick ruling of the U.S. Supreme Court, legislation that allows producers to collect damages for indirect losses suffered because of price-fixing by processors and retailers. It is essential that states provide for the right of their citizens to bring antitrust actions against indirect purchasers of their products. The U.S. Supreme Court recently ruled that states have the right to allow lawsuits by indirect sellers under federal antitrust law. Fifteen states and the District of Columbia have passes laws allowing such lawsuits.

A state law allowing antitrust actions against indirect purchasers is important to an agricultural state such as Kansas because without it farmers cannot bring suit for damages caused by price fixing or other antitrust violations against retail food stores, secondary grain buyers, or any other party that is not the first purchaser of an agricultural product. Without such a state law the private right of action of farmers to address the full range of possible antitrust violations is for all intents and purposes severely limited.

Finally, obtain economic power through collective marketing/bargaining. The laws for collective action by producers are in place. Both Capper-Volstead and the Agricultural Marketing Agreement Act of 1937 are depression era solutions to the very same problems I have been talking about. They are very powerful laws. They have been used by dairy, fruit and vegetable producers to, in my opinion, very successfully counter the economic power of food marketers. As we find fewer and fewer producers surviving in farming, I predict we will find more and more activity among grain and livestock producers in the area of collective marketing/bargaining.

Thank you Madame Chairman for the opportunity to testify before your committee. I hope I have been able to shed some light on the issues before you.

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Table 1. Four-firm concentration ratios, steer & heifer slaughter, 23 major cattle producing states, 1978 & 1982. (Revised Reporting Year)

State	Percent of Slaughter Accounted For By Top 4 Firms		1982 Level of Concentration*
	1978	1982	
Arizona	87.3%	98.8%	Very Highly Concentrated
California	26.6	41.4	Low-Grade Concentrated
Colorado	63.8	99.2	Very Highly Concentrated
Idaho	88.1	95.9	Very Highly Concentrated
Illinois	64.9	84.8	Very Highly Concentrated
Indiana	81.9	87.7	Very Highly Concentrated
Iowa	62.0	85.0	Very Highly Concentrated
Kansas	74.3	92.4	Very Highly Concentrated
Michigan	55.5	69.5	Highly Concentrated
Minnesota	85.0	97.3	Very Highly Concentrated
Missouri	86.1	98.0	Very Highly Concentrated
Montana	98.6	97.6	Very Highly Concentrated
Nebraska	57.2	62.1	Moderately Concentrated
New Mexico	96.6	100.0	Very Highly Concentrated
North Dakota	100.0	100.0	Very Highly Concentrated
Ohio	45.6	62.4	Moderately Concentrated
Oklahoma	88.9	94.1	Very Highly Concentrated
Oregon	74.1	73.6	Highly Concentrated
Pennsylvania	79.4	86.9	Very Highly Concentrated
South Dakota	96.6	98.8	Very Highly Concentrated
Texas	65.8	81.9	Very Highly Concentrated
Washington	93.4	98.9	Very Highly Concentrated
Wisconsin	93.7	98.5	Very Highly Concentrated
Weighted Average	66.2%	81.0%	Highly Concentrated

*Classification developed by Joe S. Bain, Industrial Organization, Second Edition, John Wiley & Sons, Inc., New York.

Source: P & SA, USDA

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Four–Firm Concentration Ratios in U.S. Meatpacking

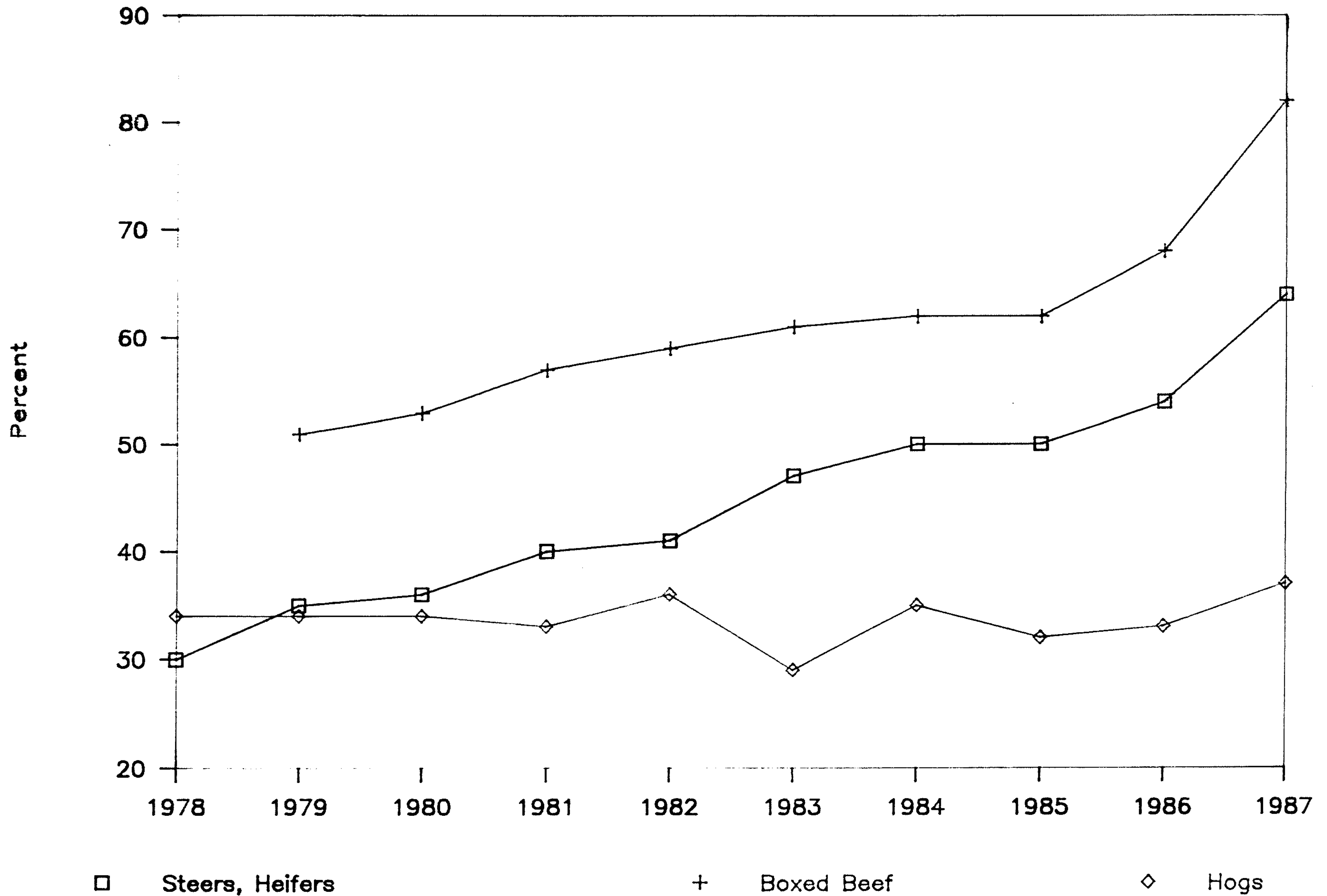
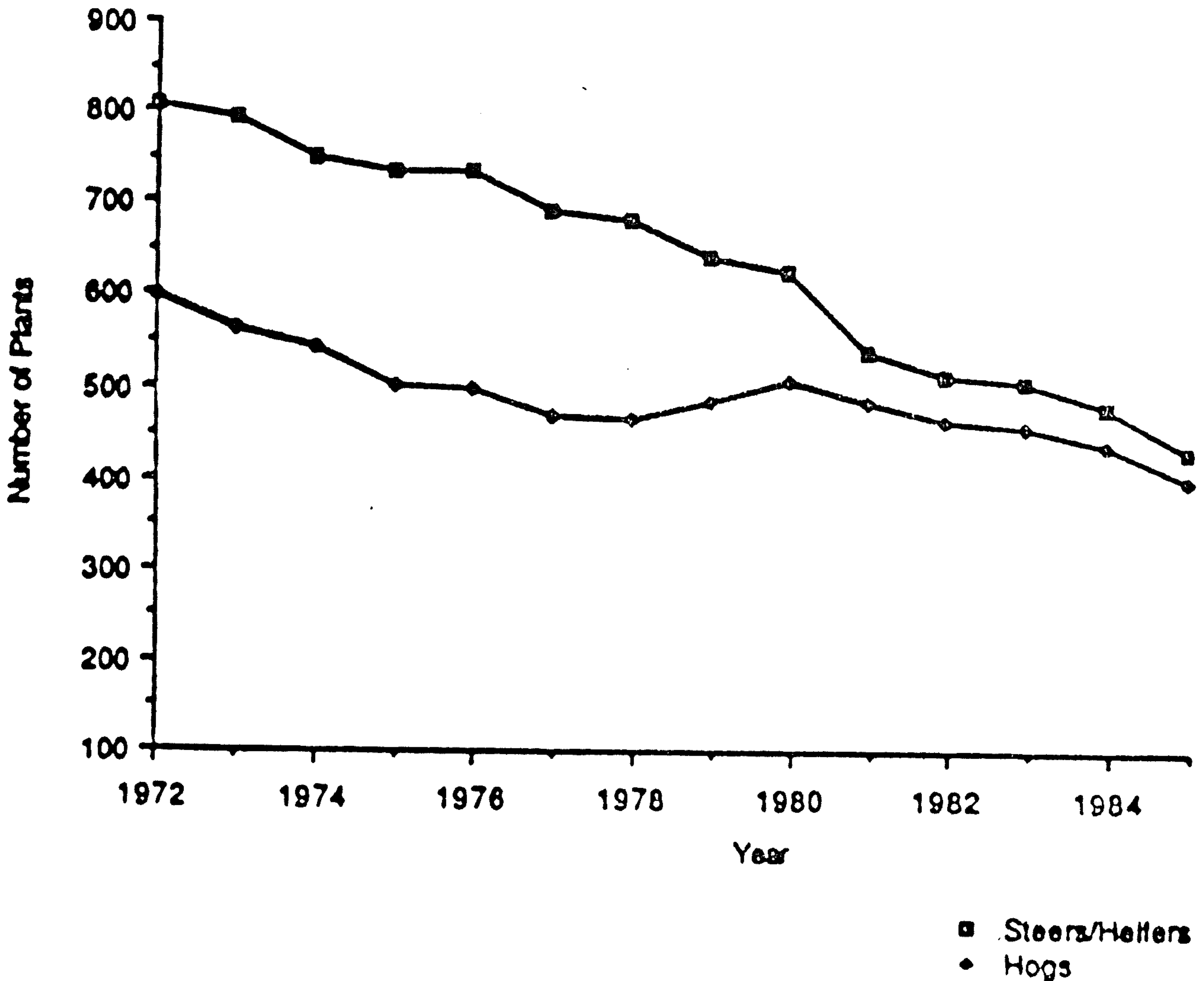


Figure 1.1. Number of Slaughtering Plants in the U.S., 1972 to 1985.



Source: P & SA, USDA.

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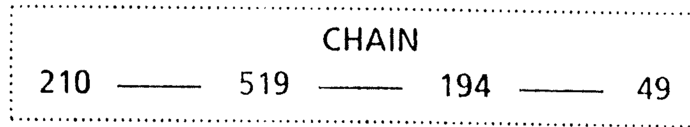
Interlocking Trading of 32 Traders

January 1978 - April 1979

Live and Feeder Cattle Futures



FEEDLOT RING

931
765
520
521
120
276
223
209
45
204
449
828
103
301
803
966
408
958
231
292
273
275
255
471
191
588
217
97701

FCM
MEAT COMPANY
RING

SPECULATIVE
RING

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Description of 32 Traders

45: Speculator
49: Officer, FCM B
103: Farmer
120: Officer, FCM A
191: Farmer
194: Speculator
204: Officer of FCM
209: Speculator, FCM A
210: Officer, FCM A
217: Officer, Meat Co.
223: Foreign Trader, Feedlot
231: Speculator
255: Speculator
273: Speculator
275: Speculator
276: Feedlot A
292: Officer, Meat Co.

301: Officer, FCM B
408: Speculator, Meat Co.
449: Commodity Pool
471: Speculator
519: Feedlot, FCM A
520: Farmer, Feedlot A
521: Farmer, Feedlot A
588: Speculator
765: Speculator, Feedlot B
803: Officer, FCM A
828: Speculator
931: Speculator, FCM A
958: Officer, FCM A
Officer, Meat Co.
966: Speculator, FCM A
97701: Grain Co, FCM A

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SUMMARY

"BEEF PACKING: CONCENTRATION AND PRICING ISSUES"

DR. JOHN W. HELMUTH

Testimony presented before the
Committee on Economic Development
House of Representatives
Kansas State Legislature
Topeka, Kansas
February 5, 1990

The basic question: How to use limited resources to meet essentially unlimited demands.

Requires planning to solve

Requires that choices be made

The question becomes: Who is best suited to make the choices?

ALTERNATIVES

Fewer and Fewer Decisionmakers			More and More Decisionmakers

Centrally Planned Economy - Socialism - Communism	Monopoly Monopsony	Oligopoly Oligopsony	Free Enterprise Free Markets Competitive Industries Competitive Markets De-centralized decisionmaking

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House Eco. Devo. Committee
Attachment 5 2/5/90

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House Eco. Dev. Committee
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[Continued, Rear Cover]

A NEW ATTACK ON ANTITRUST: THE CHICAGO CASE

Dr. Willard F. Mueller

Dr. Mueller received his Ph.D. in industrial-organization economics at Vanderbilt in 1955, taught at the University of California/Davis and the University of Wisconsin/Madison until 1961, and then spent just under a decade in Washington, first as Chief Economist of the House Small Business Committee (1961), thereafter as Director of the FTC's Bureau of Economics (with a leave of some 9 months as Executive Director of President Johnson's Cabinet Committee on Price Stability), returning to the University of Wisconsin/Madison in 1969 where he is currently William F. Vilas Research Professor of Agricultural Economics, Economics and Law, his teaching there including an antitrust seminar in the law school. He addressed the attack on antitrust from the left in an earlier piece, "The Anti-Antitrust Movement and the Case of Lester Thurow" (Review, No. 3, '81, pp. 59-92), and assesses the case from the right this time, the instant paper being based on remarks presented at the '86 Conference on Management and Public Policy Toward Business in Honor of Robert F. Lanzillotti, University of Florida.

□

Right and Left

Antitrust is under an unprecedented attack. Although support for it has waxed and waned since the passage of the Sherman Act in 1890, the current attack is unique in its breadth and success; not only have the new attackers urged

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drastic "reforms" but they have already accomplished much of their agenda. They have staffed the antitrust agencies—and to an increasing degree the federal courts—with their adherents and, unlike previous attackers, their agenda is based on a body of economic ideas that allegedly represents a new orthodoxy as to how a capitalistic market economy works. How did all this come about? How much have things really changed? How sound are the economic foundations upon which these new attackers have built their case? What does the future hold? The beginning point is to review briefly the status of antitrust before this recent attack was launched. (While antitrust is currently being attacked from both the left and right of the political and economic spectrums, this paper is addressed only to the attack from the right; I have written earlier (Mueller 1981) on the assault by some of the left, who sometimes have been unwitting handmaidens of the attackers from the right.)

Post-'50 Merger Enforcement

Until the 1980s, students of antitrust generally accepted Richard Hofstadter's (1966:116) observation that "antitrust as a legal-administrative enterprise has been solidly institutionalized in the past quarter of a century," which explained why it was that, whereas "once the United States had an antitrust movement without prosecutions, in our time there have been antitrust prosecutions without an antitrust movement." While antitrust has never accomplished as much as its staunchest advocates have hoped for, it has clearly performed better than its more ardent detractors have claimed, a fact that is nowhere clearer than in the experience with the enforcement of the Celler-Kefauver Act of 1950, which amended the Clayton Act's prohibition of certain mergers. During the 27 years following its enactment, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) [illegible]nged 1,021 mergers and acquisitions in 289 complaints ([illegible]ler 1979) and, in the 1950s, the agencies challenged

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virtually every sizable horizontal merger. In 1956, for example—the record year in opposing such mergers—the agencies challenged 48% (measured in assets) of all large (assets exceeding $10 million) acquisitions of manufacturing and mining corporations, cases that culminated in lower-court and Supreme Court decisions establishing tough legal standards for horizontal mergers that had the effect of stopping virtually all such anticompetitive mergers for a time. Students of public policy generally agree that this enforcement effort served as a powerful deterrent of horizontal mergers (Mueller 1965; Stigler 1966; Andretsch 1986). Absent this effort, there is little doubt but that today highly-concentrated industries would be the rule, not the exception.

The 1981 'Change'

During the 1960s the Supreme Court also handed down several decisions finding conglomerate mergers illegal. In 1969, Nixon's first antitrust chief, Richard W. McLaren, initiated a vigorous enforcement effort to discover the reach of the law toward conglomerate mergers (Mueller 1973) and, during 1969-1970, the antitrust agencies challenged nearly 30% (measured by assets) of all large mergers in manufacturing and mining (Mueller 1979). McLaren's heroic effort foundered, however—as Henry C. Simons might have said—on the orderly process of democratic corruption; the three *ITT* cases—the centerpiece of McLaren's assault on conglomerate mergers—were prevented from reaching the Supreme Court when President Nixon ordered that they be settled with a consent decree favorable to ITT (Mueller 1983). Those *ITT* cases aside, however, the agencies' merger effort represented an enormous enforcement push as judged by past antitrust work. Although enforcement efforts toward conglomerates flagged during the 1970s because of what Justice White (1974) characterized as the "new antitrust majority" of the Burger court, antitrust enforcement generally proceeded pretty much as usual and, indeed, the 1970s saw a number

of innovative efforts, e.g., the FTC's shared-monopoly case in the cereal industry as well as vigorous antitrust enforcement by private parties. Beginning in 1981, however, all of this changed rapidly, drastically, and largely unexpectedly.

Hopes and Fears

Unlike previous presidents—Democrats and Republicans alike—President Reagan entered office with an agenda aimed at eliminating or greatly reducing government interference in all areas of business affairs, with antitrust "reform" being near the top of his list. Regulatory policy can be altered in three ways, (1) by changing the enforcement personnel and policies of the antitrust agencies; (2) by appointing judges with a known antiregulatory bias; and (3) by repealing or amending the law through the legislative process. To date the Reagan administration has not succeeded in changing the legislative foundations of antitrust—though it has recently laid out its agenda in this area as well—but it has been successful in changing antitrust policy beyond the fondest hopes of its enemies and the greatest fears of its friends.

Agency Changes

Adam Smith and Neckties

Reagan's first step in "deregulating" antitrust was to appoint agency heads with known records of hostility to it as enforced before 1981. William F. Baxter, a brilliant laissez-faire lawyer-economist, was appointed head of the Antitrust Division and an equally zealous laissez-faire economist, Dr. James Miller III, was appointed Chairman of the FTC.[1] Prior to his appointment, Miller had worked for OMB-head David Stockman, who had led the administration's effort to wipe out the FTC's antitrust enforcement arm, the Bureau of Competition (Warner 1981). Both of these agency heads

were doctrinaire disciples of the Chicago school of economics, one which holds that the guiding and sole principle of antitrust is, or should be, the pursuit of economic allocative efficiency; in this view, all business conduct should be and can be evaluated in terms of its contribution to economic efficiency as predicted by simple, static, microeconomic models, an approach that—since the theory assumes rational decisionmakers are always motivated by a quest for greater economic efficiency—tends to resolve all disputes concerning the intent and consequences of particular practices in favor of the businessmen making them. These latter-day practitioners of Adam Smith—Miller always wore an Adam Smith tie while head of the FTC—have even greater faith in the businessman's proclivity for competition than did Smith and indeed, in the area of vertical price fixing, Baxter and Miller might have rewritten Smith's often-quoted admonition concerning businessmen's propensity to conspire to read, "manufacturers and retailers seldom meet together, even for merriment or diversion, but the conversation ends in a conspiracy to fix retail prices in order to enhance consumer welfare."

Unleashing 'Merger Mania'

The remarkable thing about Baxter and Miller is not their view of the world—Chicago-school economists have expressed these views for decades—but the fact that never before had they received such a felicitous reception from public policymakers. For example, the Stigler White House Task Force on Productivity and Competition made several rather drastic proposals to change antitrust in 1969 but they were largely ignored during the Nixon-Ford years and Nixon's antitrust chief, Richard W. McLaren, considered Stigler's arguments as theoretical nonsense not relevant to the real world. Baxter and Miller, however, did more than just advocate theories before academic audiences; commanding large legal and economic staffs—many of whom had passed the Chicago-school litmus test—they set about changing enforcement

standards and court-made law. Since in their view businessmen's decisions generally reflect the pursuit of greater efficiency, they presume that mergers seldom pose a public-policy problem, a view that is consistent with President Reagan's campaign statements in which he said that efforts to slow the conglomerate merger tide were "arbitrary, unnecessary and economically unsound."[2] Both antitrust agencies have adopted new *Merger Guidelines* that essentially give a green light to all mergers but those horizontal ones that result in very high levels of concentration; under these guidelines, most mergers found illegal by the Supreme Court during the 1960s would not even be challenged today and all this without any change in the laws enforced by the agencies. The result has been to unleash a new "merger mania" among large corporations.

'Paper Victories'

Since the Chicagoans have great faith in the "market for corporate control," they are pleased, not bothered, by the likes of Boone Pickens, Irv Jacobs, and other merger-makers who are restructuring American business for their own private gain and personal aggrandizement. Most large conglomerate mergers—while carrying a potential for anticompetitive effects (Mueller 1982)—have absolutely nothing to do with increasing economic efficiency (Greer 1986 and D.C. Mueller 1982). Nonetheless, FTC Chairman Miller (Barnett 1984:11) proudly proclaimed that during 1981-'84 the FTC did not open an investigation into a single conglomerate merger nor did either of the agencies challenge any vertical mergers. While they did challenge a number of horizontal acquisitions, these were largely paper victories that ended with consent decrees permitting the mergers after requiring some modest partial divestiture. More recently, the agencies ve even failed to challenge horizontal mergers that violate Justice Department's own *Merger Guidelines*. The FTC was tardy in challenging, for example, Pepsi Cola's attempted

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acquisition of 7-Up and Coca Cola's proposed acquisition of Dr. Pepper,[3] although both of these mergers would have clearly violated Section 7 of the Clayton Act. Indeed, the FTC didn't challenge these actions until after Royal Crown Cola had brought a private suit that had succeeded in getting a temporary restraining order blocking them and congressional leaders had threatened to introduce legislation prohibiting those mergers.

Chicago and RPM

Baxter and Miller also changed enforcement policy in the area of vertical restraints, including vertical price fixing or so-called resale price maintenance (RPM), seeking an effective repeal of the existing law through administrative actions. Not only have the agencies failed to bring any RPM cases but they have urged the courts to change their interpretation of the law in this area. To accomplish this, the Department of Justice (1985) promulgated *Vertical Restraint Guidelines* that permit much conduct that is illegal under existing law and, as in other areas of antitrust, has also filed *amicus* briefs on behalf of defendants in private antitrust suits involving RPM and other vertical restraints. These views of Baxter met with varying degrees of success before the federal courts, with one federal judge observing that, "while there may be some merit to the opinions of [Mr. Baxter], his opinions are not law. The same is true of analyses performed by academics." (The reference to "academics" is to Chicago-school economists.) In 1984, Baxter was not successful when he intervened on behalf of the Monsanto company in an RPM case before the Supreme Court.[4] While Monsanto had not even raised a free-rider defense, Baxter urged the court to declare that it would consider such defenses in future RPM cases. (The court said that, in the circumstances, it was unnecessary to reach that issue.) Despite this, if present trends continue—given the changing composition of the lower courts and prospective changes in the Supreme Court—the Chicago school

may yet carry the day on RPM.

'Shared Monopoly'

There are many other examples that reflect the Reagan administration's attitude toward antitrust. Under Miller, the Federal Trade Commission brought no vertical price fixing cases, no price discrimination cases, and no monopolization cases and in fact dismissed important monopoly and merger cases brought by prior Republican and Democratic administrations, one of the most important of these being a case charging 3 companies with having a "shared monopoly" in the prepared breakfast-cereal industry. This was a pioneer case designed to determine whether 3 firms dominating an industry could be found guilty of "monopolizing" under the law and, while it admittedly presented a novel interpretation of the monopoly law—which had previously been applied only to single-firm dominance—a majority of the Miller Commission took the unprecedented step of dismissing the case without reviewing the record.

Predation and 'Anything Goes'

In one important monopolization case, *Borden-ReaLemon*[5]—despite the fact that the prior Commission had found the company guilty of monopolizing and that decision had been approved by an appellate court[6]—the Commission requested the Supreme Court *not* to hear the case, which the Commission then settled on grounds satisfactory to the defendant.[7] Commissioner Pertschuk, dissenting from the predation standard spelled out in that consent decree, said that while the rule "may appeal to some as embodying the height of economic rationality, as a practical matter, the standard in this order would take the Commission out of the business of policing predation."[8] Similarly, the Commission dismissed an attempt-to-monopolize case involving *ITT-*

Continental in 1984 after an Administrative Law Judge had found ITT guilty and the 9th Circuit Court of Appeals had found for the plaintiff in a private action challenging ITT-Continental for many of the same practices.[9] Dissenting from that decision, Commissioner Patricia P. Bailey observed that the FTC majority had sent a signal to the business community that, in the immortal words of Cole Porter, "anything goes." She added that it "would be simpler, and surely a great saving of everybody's time, if the Commission today had simply announced that it does not believe predatory pricing exists."[10]

'One-Industry' Price Fixing?

There is only one notable exception to the Reagan Administration's soft antitrust policy, namely, horizontal price-fixing agreements. Baxter aggressively pursued price fixers and, while the prior administration had begun a probe of highway contractors, he devoted substantial resources to that effort, the result being fines of $47 million and the jailing of 127 businessmen for a cumulative total of 47 years.[11] In Baxter's view, "this is garden-variety criminal activity and incarceration of the offending executives is absolutely essential."[12] Considering his great aversion to price fixing, it is incongruous that he was unconcerned with mergers and other kinds of conduct that cause highly concentrated markets where overt price fixing may become unnecessary and is virtually impossible to detect when practiced. Surprisingly, Baxter evidently could find little price fixing outside the construction industry.

'Learning' and 'Orthodoxy'

'Heading for A Showdown'

The intellectual foundations of the policies pursued by

Baxter, Miller, and their successors are found in the so-called Chicago school of industrial-organization economics. While those ideas aren't new, they hadn't achieved much prominence in antitrust policy until the 1980s. Reagan's first FTC chairman, James C. Miller III, credits their current prominence to superior theory and empirical analysis with the result that "the ascendancy of the Chicago school now seems all but inevitable." (Barnett 1984:8.) In his view, a "new learning" about how markets work has made Chicago-school ideas the new orthodoxy. So what is this "new learning" we hear so much about these days and how does the Chicago school of industrial organization differ from the majority of economists in this field? Harold Demsetz, himself a leader in the Chicago school, identified the distinction neatly in his paper, "Two Systems of Belief About Monopoly" (Demsetz 1974:164), presented at the 1974 Airlie House (Virginia) Conference on "Industrial Concentration: The New Learning."[13] There existed, he said, two competing theories about monopoly and they were "heading for a showdown." The then-orthodox theory of the day—which Demsetz called the "self-sufficiency theory"—held that monopoly power could develop and survive "without any substantial aid from the government." The other theory—which Demsetz labeled the "interventionism theory"—saw monopoly power as "derivative of government interventions" (164-165). The Chicago-school interventionism theory believes that the only thing we have to fear—with minor exceptions—is government policy that purposely or unwittingly confers monopoly power on firms, which is in contrast to the "self-sufficiency theory" that believes public policy should be concerned with private anticompetitive industrial structures and tactics.

'Funeral Arrangements'?

Some critics of the Chicago school assert that its beliefs est more on hope than on sound theory and empirical research but, despite such casual criticism, the simple truth

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is that these theories are currently used to direct or rationalize the public-policy actions of the antitrust agencies and, increasingly, are finding their way into court decisions. Miller proclaimed in 1985—a decade after Demsetz's paper—that the new learning of the Chicago school had triumphed, that it had become the new orthodoxy; the old industrial organization theory was dead (Barnett 1984:8-10). I suggest that it is premature to make funeral arrangements for what had been the mainstream of industrial organization for at least 3 decades. What is the new evidence? Do developments in economic thought and research over the past decade support Miller's victory pronouncement? In the remainder of this paper I will review the theoretical and empirical work in the two areas where Chicago-school "beliefs" about economic affairs have had their greatest impact, market structure-performance relationships and the treatment of vertical restraints. Simply put, the Chicago school believes that (1) oligopolistic market structures are unlikely to adversely affect market performance and (2) vertical restraints, with few exceptions, improve economic welfare.

Oligopoly and Market Power

'Fatal Flaw'

Since Augustine Cournot explored the subject about 150 years ago, economists have spun a variety of insightful theories to explain the conduct and performance of oligopolists. The problem has not been an absence of theories but the paucity of reliable data to test those theories and, not surprisingly, Bain's early empirical tests—relying on crude data and statistical techniques—were quickly challenged. Despite these data problems, however, by the 1960s a consensus seemed to have emerged that market power—especially as measured by market concentration and barriers to entry—adversely affected industry performance (Weiss 1971). In his exhaustive review of the literature in 1974,

he (1974:231) concluded: "By and large the relationship holds up for Britain, Canada, and Japan, as well as in the United States. In general the data have confirmed the relationship predicted by theory, even though the data are very imperfect and almost certainly biased toward a zero relationship." But in Demsetz's view, all these studies suffered a fatal flaw, namely, that virtually all of them had measured the relationship between market structure and profits and that, whereas those conducting the studies believed they had verified a positive relationship between market structure and performance, they had unwittingly discovered a positive relationship between concentration and *efficiency*: The largest firms in an industry had higher profits because they were more efficient, not because they elevated prices.

'Official Birthdate'

Demsetz's findings, if true, had overturned several decades of empirical work and inflicted a deadly blow to what had become the orthodox view of the relationship between industrial structure and performance. The immediate influence of his assertions was surprising in view of their fragile empirical foundation. In short, Demsetz had correlated the weighted average concentration ratios of various Internal Revenue Service (IRS) industries with the profit rates of various size groupings of firms within those industries and anyone familiar with the IRS data realizes that they're fraught with problems. The problems inherent in Demsetz's use of these data clearly biased his analysis toward a finding of a zero relationship between concentration and profits (Appendix A).[14] In view of the deficiencies in his data, Demsetz's results aren't surprising; he reported that the strongest positive correlations tend to be found in the largest class size and negative correlations in the smallest class size, findings that—he believed—supported the hypoth-'s that "larger firms in concentrated industries have lower ;t because there are scale economies in these industries or

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because of some inherent superiority of the larger firms in these industries." (Demsetz 1974:178.)[15] Though not recognized as such at the time, Demsetz's 1974 piece marked the official birthdate of the new learning, which teaches that concentration promotes efficiency, not market power.[16] Interestingly, the leading nonChicago scholars attending that Airlie House conference didn't take this Demsetz study seriously.[17]

A 'Driven' Model

Peltzman undertook an ambitious test of the Demsetz hypothesis in 1977, using a more comprehensive data set and more sophisticated analysis (1977:251), his conclusion being that over a "long period changes in market structures are accompanied by increased efficiency. This efficiency gain is most pronounced where concentration is high and rising and where demand is growing." This is perhaps the most often-cited empirical work supporting the concentration-efficiency hypothesis but, as Scherer (1980:289) has observed, Peltzman's "interpretation of the results suffers from serious flaws, mostly related to his failure to look behind the numbers and ascertain how things were derived and what was actually happening in the industries analyzed." Scherer predicted that, had Peltzman examined the industries experiencing rapid concentration increases, he would have found them to be primarily consumer-goods industries. These expectations that Peltzman's model was driven by the consumer-goods industries in his sample may be tested by redoing the analysis separately for consumer and producer goods and Vita (1985) recently did just that in an analysis that used superior data and a slightly improved Peltzman model. Vita's initial analysis—based on a large sample of consumer- and producer-goods industries—seemed to confirm the Demsetz-Peltzman thesis but, when he re-ran his model separately for consumer goods and producer goods, the analysis based on producer goods did not support Peltzman's findings despite

the fact that, a priori, producer goods provide the most unequivocal test of the hypothesis.[18] On the other hand, the analysis involving consumer-goods industries did yield results similar to Peltzman's, thus confirming Scherer's expectation that Peltzman's results depended on his consumer-goods observations.

'On Its Head'

These findings are consistent with other empirical work. As Mueller and Rogers (1980 and 1985) have demonstrated, since World War II consumer-goods industries have experienced persistent increases in concentration—whereas producer-goods industries have experienced no upward trend—with the main cause for those increases being related to the advantages of large-scale in television advertising. And as Wills (1984) has shown, the leading firms in consumer-goods industries have substantially higher *prices* than do smaller sellers in these industries. Moreover, Keldon (1980) found that consumer industries with the largest advertising experienced the greatest price increases. These various pieces of evidence turn on its head the Demsetz hypothesis. Finally if—as I believe to be true—the price differences between leading firms and smaller firms are greater than the differences in their respective profit rates, the higher profits of large firms are not explained by lower costs but by higher prices.

Kill the Messenger?

Sometimes the various structure-profit studies based on FTC line-of-business (LOB) data are cited as support for the new learning. They have contributed much to our knowledge and the profession is indebted to the FTC for collecting these data for several years but it is a mistake to infer that these studies support the Chicago-school thesis merely because their findings differ in some respects from earlier

studies. One of the unique findings here is the important role played by individual-firm market shares, a phenomenon identified as being significant in an earlier FTC (1969) study and by others (Imel and Helmberger 1971; Shepherd 1972; Marion, et al. 1977). Some make much of the finding that sometimes, when market share is included in the model using FTC LOB data, there is not a statistically significant relationship between market concentration and profits—and that sometimes the relationship is negative (Ravenscraft 1983)—but these findings are by no means at odds with earlier work; as Weiss (1971) pointed out 15 years ago, the concentration-profit relationship tends to break down during periods of inflation and seldom mentioned is the fact that all of the LOB data were collected for years of substantial inflation, 1974-1977. Significantly, an analysis (Ravenscraft 1983) using LOB data for the food manufacturing industries found a significant positive relationship between profits and concentration as well as between profits and market shares, which is consistent with other structure-profit studies in these industries (Connor, et al. 1985 and Rogers 1986). This is as one would expect because these industries are less susceptible to inflation; the demand for food shifts much less over a business cycle than does demand in most other manufacturing industries. Thus the jury is still out as to what LOB data would show during non-inflationary years and, unfortunately, FTC Chairman Miller saw fit to kill off the LOB data-collection program.

Prices and 'Contestability'

The preceding demonstrates that the Demsetz concentration-efficiency hypothesis has scant empirical support but there is also a growing body of reliable evidence disproving the hypothesis entirely, namely, the studies that make a direct test of the hypothesis that market concentration—when adjusting for barriers to entry and other variables—elevates *prices* above costs. Almost without exception, these studies

have found that concentration is positively associated with price levels. Not only do they refute Chicago-school "beliefs" about the relevance of concentration but they fly in the face of another revisionist "belief," the theory of "contestable markets," an argument that market concentration does not confer market power so long as a market is "contestable," i.e., as long as there are no significant barriers to entry or exit (Baumol, Panzar and Willig 1982). If real-world markets were as readily contestable as Baumol, et al. believe, there would not be a positive relationship between the level of concentration and price in a market. The price studies, therefore, confirm Shepherd's (1985:585) observation regarding contestable-market theory: "The 'new' analysis gives no persuasive reason to shift attention away from competition within the market."

Studies In Financial Markets

Because the concentration-*price* studies examine the relationship between concentration and prices for a particular product or service sold in different geographic markets, they are not plagued with the problems common to *all* cross-industry studies[19] and, indeed, the price studies are superior to even the most reliable data (such as FTC LOB data) used in cross-industry studies. Thanks to the availability of data and the interest of Federal Reserve economists such as Stephen A. Rhoades, many of the concentration-price studies have been done in financial markets (Slater 1956; Edwards 1964; Bell and Murphy 1969; Aspinwall 1970; Jacobs 1971; Kessel 1971; Greer and Shay 1973; Heggestad and Mingo 1976; Rhoades 1977; Grady and Kyle 1979; Hester 1979; Marlow 1982). All of the studies cited here found a positive net relationship between concentration and various proxies price, e.g., checking-service charges, mortgage interest es, and bond underwriters' spreads.

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X-Inefficiency

There have been at least 5 studies of air fares since airline deregulation in 1978. Alfred E. Kahn, former Chairman of the Civil Aeronautics Board, says of them: "Every one of them concludes that how many carriers you have in a market makes a difference. If entry were a sufficient discipline, you wouldn't see different fares whether there is one carrier in the market or five." (Henderson 1986:F6.) In food retailing, 4 studies using different methods, data, and time periods found a positive relationship between concentration and price levels (Marion, Mueller, et al. 1979; Lamm 1981; Meyer 1983; Cotterill 1986), all of them showing that prices are positively associated with both market share and concentration. Moreover, a study examining both the level of profits and prices found that, in highly concentrated markets, price overcharges as a percent of sales were greater than profits as a percent of sales, thus suggesting that concentration increased costs as well as prices and profits. This study is cited by Leibenstein (1979) as an example of X-inefficiency due to market power.

'False Conclusions' and Economic Technique

Other concentration-price studies have been made in such diverse industries as life insurance (Cummins, Denenberg, and Scheel 1972); newspaper and television advertising (Landon 1971; Owen 1973; Thompson 1984); gasoline retailing (Marvel 1980); prescription drugs (FTC 1975); and microfilm (Barton and Sherman 1984), all of them finding a positive relationship between market concentration and prices. Finally, a study by Wills (1983)—using exceptionally high-quality data—examined the relationship between prices and both advertising and market share of the brands of 145 food products, the results demonstrating that prices of the leading brands were substantially higher than even the second to fourth largest brands and greater still than prices of minor

brands and retailers' private brands. This evidence likely explains why studies such as Peltzman's that combine consumer-goods industries and producer-goods industries are driven to false conclusions by the consumer-goods industries in their samples. The consistency of the price studies cited above is quite amazing and they are clearly at odds with the Demsetz hypothesis (and the findings of Peltzman), as well as the beliefs of the proponents of the theory of contestable markets. Moreover, it can't be overemphasized in evaluating these findings that the data used in most of the price studies are far superior to those in Demsetz's study and in virtually all the profit studies, including those based on FTC Line-of-Business data. This superior scientific quality of the price studies is often neglected by literature reviewers who are enamoured with econometric technique to the neglect of data quality.

The New Learning: Vertical Restraints Promote Consumer Welfare

RPM and Per Se Legality

Chicago-school models have reached their fullest flower in the area of vertical restraints, including vertical price fixing, i.e., resale price maintenance (RPM). Since 1911, the Supreme Court has held it per se illegal for a manufacturer to enter into price-fixing agreements with the distributors of its products, though for some years RPM was made an exception to the antitrust laws by a federal statute permitting the states to authorize it. In 1975—during the Ford Administration—these so-called "fair trade" laws were prohibited in favor of the historic antitrust treatment of RPM and, indeed, the repeal legislation explicitly stated that RPM was to be treated as per se illegal under the antitrust laws. Despite this legislative mandate, however, the Reagan antitrust agencies have sought more permissive treatment of all types of vertical restraints. While FTC Chairman Miller (1983)

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said his "aim is to persuade you that RPM deserves to be judged by a rule of reason," let there be no mistake about the ultimate objective of Chicago-school policymakers here: Very simply, they hope to eliminate the per se prohibitions against RPM as well as the current rule-of-reason standards applied to nonprice vertical restraints. Richard Posner (1981)—formerly of the University of Chicago Law School and currently a federal judge—states it most plainly, asserting that the appropriate legal rule for *all* vertical restraints in distribution is one which declares them per se *legal*. Bork (1978) had made a similar argument earlier.

The Vertical 'Output' Test

The advocates of the New Learning about vertical restraints base their case on the Chicago-school theory that a manufacturer generally would not set the retail price of his products unless he were motivated by efficiency considerations,[20] a theory that has its origins in the writings of Bowman (1955), Telser (1960), and Bork (1966). These scholars argue that a manufacturer can only induce its distributors to furnish the ideal mix of services to customers if the manufacturer guarantees those distributors an above-competitive price using RPM or other vertical restraints prohibiting intrabrand competition; absent such incentives, some distributors would get a free ride by not providing the needed services, thereby discouraging others from doing so as well. The Chicago school acknowledges that vertical restraints result in higher prices but argue that the increased services shift the demand curve to the right sufficiently to increase the manufacturer's total sales; the test of whether vertical restraints improve economic efficiency is thus not the *price* paid by consumers, says the Chicago school, but whether the restraint restricts or increases *output*, with the former being anticompetitive and the latter procompetitive (Bork 1966: 375-76).

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God and Chicago

But the problem is more complex than this, with the relevant question being whether the increased services are worth the increased prices paid by consumers. William Comanor recently demonstrated that, merely because increased services shift retail demand to the right, does not prove that economic efficiency has improved; as he (1985:991-92) puts it, "[s]ocietal gains or losses from changes in the product depend on the preference of *all* consumers, not merely those at the margin... If marginal consumers value dealer-provided service less than infra-marginal consumers do, the level of such services will be too low. By contrast, if marginal consumers value those services more highly, the level of distribution services will be excessive and the imposition of vertical restraints to promote such services would be inefficient." What Comanor has done in this seminal article is demonstrate theoretically what many observers long had intuitively felt was wrong with the Chicago-school arguments here, namely, that with restricted distribution, many consumers are forced to pay for services they don't want and hence that it's wrong to assume that, merely because vertical restraints benefit a manufacturer, they must also benefit society as a whole. Not only does the Chicago-school's new learning concerning vertical restraints rest on a flawed economic theory but it lacks empirical support as well, resting heavily as it does on the illusive concept of free riding when there is scant evidence that a serious free-rider problem is present where RPM and other vertical restraints are practiced. As someone has said, free riding is like the Loc Ness monster, much talked about but never seen or, as another wag has put it, there must be a serious free-rider problem in America or God would not have made so many Chicago-school economists.

Distributional 'Abortion'?

There is a rich body of empirical evidence demonstrating

that consumers are injured by RPM and other vertical restraints. Students of distribution have long been impressed with the broad spectrum of product-service mixes provided by different distributors in the absence of vertical restraints, with food retailing providing a homely example in which store formats range from high-margin, high-service convenience stores to low-margin, low-service warehouse stores. Similar diversity emerges whenever retailers are free to adapt their formats to unique market segments reflecting the price-service preferences of different consumers. I find it ironic in the extreme that Chicago-school economists—who yield to no one in their faith that *markets* provide the best test of what consumers want—believe that vertical price fixing is OK because the manufacturer knows better than its distributors what consumers want. The great diversity that is the hallmark of the American distribution system would not have emerged had restricted distribution been—as Posner and other Chicago-school economists would have had it—per se legal.

'Stagnant Promises'

In sum, FTC Chairman Miller was not only premature in claiming that "The New Learning" had carried the day but flat-out wrong; both the theory and the empirical work of the Chicago-school economists is seriously flawed and they have not displaced the mainstream of industrial organization or what Demsetz has labeled the "self-sufficiency theory." This "mainstream" of industrial organization—one that originated in the ideas of Chamberlin, Mason, and Bain and has been widened and deepened by the work of such current leaders in this tradition as Leonard Weiss, F. M. Scherer, William Shepherd, Alfred Kahn, Douglas Greer, and William Comanor, to name a few—flows on. The new learning has gained many true believers—some economists and many laypersons—but its main effect has been to muddy the waters of knowledge. As those waters clear, we see that

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the mainstream has not been altered significantly and that the Chicago school has merely dredged a channel of its own, one leading nowhere and filling rapidly with stagnant promises.

Revising Antitrust Through Court Appointments

Posner and 'Free Market' Law

American Presidents appoint, with confirmation by the Senate, all members of the federal judiciary and President Reagan's appointments have generally reflected his conservative views. As with his antitrust agency appointments, he has appointed several Chicago school judges to the appellate courts, the most controversial such appointee being Richard A. Posner, a former University of Chicago Law School professor appointed to the 7th Circuit Court of Appeals. Judge Posner applies economic analysis in all areas of law, antitrust, torts, contracts, family law, constitutional law, and so on. In his view, for example, a free market in private suits will solve the unlawful search-and-seizure problem (Warren 1983:76) since improper policy conduct will be deterred if enough private suits result in large jury awards. This faith in "free market" solutions to problems ignores the reality that victims of improper police conduct, for example, often don't have adequate legal counsel, that jury awards here are generally small, and that some city governments would pay much to protect a modern-day Bull Connor.

Posnerian Economics

Judge Posner's remoteness from reality was further illustrated in an antitrust decision in which he reasoned that plaintiff should not be granted discovery until an antitrust lation had been proved, not explaining just how a plaintiff

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was to prove his case without prior discovery. In dissenting from this decision, Justice Potter Stewart (a recently-retired conservative member of the Supreme Court), criticized Posner for forging "new ground, despite the absence of a factual record... and despite the existence of contrary precedent."[21] No area of law is beyond the reach of Posnerian economics. In one decision he made a cost-benefit analysis of a high-school rule prohibiting a student from playing basketball wearing a yarmulke (a cap worn by some Jews) pinned on with a bobby pin, his conclusion being that the safety costs outweighed the value of the student's religious beliefs.

Judicial 'Doublespeak'

Professor Ponsoldt (1983) of the University of Georgia Law School has accused Posner of "not remembering that he is no longer speaking as a law professor from the University of Chicago" but, despite such criticisms, he is among the leading contenders for one of the next vacancies on the Supreme Court. While President Reagan has pledged to appoint judges who practice "judicial restraint," his Chicago-school antitrust appointees are actually radical activists, prepared to upset any precedent that diverges from their view of the economic world. Judge Posner—whose activism, as noted, extends to all areas of law—has redefined judicial restraint to mean judicial activism. While acknowledging that it would be "pretty wild" to overrule *Marbury v. Madison* (the leading precedent in American constitutional law), in his view this would represent judicial restraint because "it would reduce the power of the federal courts vis-a-vis the other organs of government." (Posner 1985:210.) Such doublespeak is too much for his former colleague, Professor Philip Kurland of the University of Chicago Law School—"a pillar of old-fashioned restraint"—who notes that "judges are being appointed in the expectation that they will rewrite laws and the Constitution to the administration's liking. Reagan's judges are activists in support of conservative

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dogma." (Caplan 1986:G2.)

'Imperial Judiciary'

Ultimately—if the U.S. Senate fails to stem the tide of activist appointees to the federal courts—judges of the Chicago-school persuasion will turn antitrust law upside down. By the end of his term, President Reagan will have appointed over half of all sitting federal judges. To date, he has appointed only one member of the Supreme Court [a second appointment is currently pending in the Senate] but with 5 of its 9 members now over age 70, the composition of the court could well change dramatically by November 1988. Some have suggested that, in confirming federal judges, the Senate should scrutinize more closely those having "extra-legal" views of the judicial process. Speaking specifically of Posner, Professor Ponsoldt (1983) has said: "Judge Posner's writings and consulting had long been known for their revisionist, anti-populist critique of the existing body of antitrust legislation and Supreme Court case law... Perhaps, therefore, it should come as no surprise that Judge Posner's opinion in *Marrese* relied on his own views and ignored at least six relevant Supreme Court decisions, constituting the 50-year development of the law to the present day... [That opinion] represents the imperial judiciary in its extreme. The possibility of similar nullification, based upon ideology, should be addressed specifically by the Senate in its confirmation hearings, at least where the nominee is so publicly associated with an extralegal view of public policy."

Revising Antitrust by Legislative Action

The Chicago 'Foundation'

The changes in antitrust policy discussed above were .omplished without any legislative alterations in the

antitrust laws and, indeed, to date the Congress has shown considerable hostility to the agencies' failure to enforce existing laws and their practice of intervening on behalf of defendants in private cases. On February 19, 1986, however, the Department of Justice sent to the Congress 5 legislative proposals for "improvements in American antitrust laws"—proposals that had been fashioned by Commerce Secretary Malcolm Baldrige and Attorney General Edwin Meese III—dealing with mergers, industries affected by import competition, antitrust remedies, interlocking directorates, and the extraterritoriality of the antitrust laws. To touch on the first 3 of these, suffice it to say of the third, antitrust remedies, that it could have disastrous effects on one of the bulwarks of effective antitrust enforcement, cases brought by private plaintiffs acting as private attorneys general; having effectively squelched federal antitrust enforcement through administrative actions, this proposed statute would spike the guns of private enforcement, long the major source of enforcement in certain areas. Attorney General Edwin Meese (1986) made plain that these proposed new laws rest on the new learning of Chicago-school economists: "During the past 20 years advances in economic theory have shown that the antitrust laws should protect consumer welfare and promote economic efficiency. Unfortunately, current antitrust laws have instead been applied at times in a way that inhibits business activities that would benefit consumers." With this as a foundation, the nature and purposes of the administration's proposed antitrust "reforms" will come as no surprise to those familiar with "the new learning," one which teaches that economic concentration promotes efficiency, not market power.

Repealing the 'Incipiency' Rule

The proposed Merger Modernization Act of 1986 would make fundamental changes in the language of Section 7 of the Clayton Act. Whereas the existing law prohibits mergers

whose effects "may" substantially lessen competition, this proposed Act would require proof that "there is a significant probability" that the merger "will substantially increase the ability to exercise market power." It also incorporates the provisions of the Justice Department's *Merger Guidelines* that require consideration of a number of factors in addition to a merger's effect on competition. Together these changes would go far toward permitting all mergers except those that result in substantial market power and would effectively repeal the Celler-Kefauver Act of 1950 which amended Section 7 because the law at that time permitted the acquisition of great market power via mergers. The Celler-Kefauver Act was designed to strike at accumulations of power by merger well before they reached monopoly proportions and the legislative history of that Act made it unmistakably clear that it was directed at *incipient* monopoly, that the Sherman Act's (monopoly) standards were not to be used. This proposed Merger Act of 1986 would repeal that rule.

'Crude' and 'Refined'

The Department of Justice (1986) "analysis" of this proposed Act declares that it is "necessary to fine-tune the antitrust laws" because "the body of economic learning upon which antitrust enforcement policy and judicial doctrine regarding mergers is based has changed substantially." From whence came this new economic learning? The Justice Department puts it succinctly: "Up through the late 1960s courts lacked a sophisticated analytical framework for merger analysis. They therefore relied primarily on the size of merging firms and crude measures of concentration in the affected markets to gauge the competitive effects of mergers... Modern merger analysis, exemplified by the 1984 Department of Justice *Merger Guidelines*, is more refined and takes into full consideration foreign competition, entry conditions, and efficiencies."

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Mergers and Inefficiency

Simply put, the new body of learning underlying this new merger proposal is the Chicago-school belief that private market power is seldom a problem unless it is abetted by government, which is why the *Merger Guidelines* are little concerned unless a merger results in highly-concentrated markets. Since the market-power concepts in this proposed new merger law rest squarely on the Chicago-school's new learning, the case for that law is no stronger than the empirical foundations of this learning itself and, as discussed above, the best available empirical data regarding the relationship between concentration and performance demonstrates that these Chicago-school beliefs are no substitute for solid empirical evidence. And insofar as this proposal rests on the belief that mergers are necessary to increase efficiency, here, too, there is a growing body of evidence demonstrating that, more often than not, mergers promote inefficiency, not efficiency (D.C. Mueller 1986; Ravenscraft and Scherer 1986).

'Economists Now Recognize...'

The proposed Promoting Competition in Distressed Industries Act of 1986 is designed "to provide a new form of relief for domestic industries injured by increased imports," the new "relief" contemplated by this proposal being to give the President the authority to grant a "limited" antitrust exemption to mergers and acquisitions among members of the injured industry. The Department of Justice (1986) "analysis" gives the following rationale for that proposal: "Economists now recognize that mergers and acquisitions can create economies of scale and efficiencies. Business may, in turn, translate resulting cost savings into lower prices or better quality products or services in order to repair market share or profitability lost to imports."

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Size and Scale Economies

This proposal assumes that foreign firms outcompete American firms because the latter are not large enough to enjoy the economies of scale enjoyed by foreign businesses and this is largely nonsense. American firms unable to compete often far surpass in size their foreign rivals and are large enough to enjoy the available economies of scale. Consider, for example, two of the industries most hard-hit by imports, automobiles and steel. American automobile companies dwarf in size their foreign competitors, with the combined sales of General Motors and Ford being as great as the aggregate sales of the 3 largest automobile companies in Japan, Germany, France and Britain. General Motors, alone, has sales about as great as those of 9 Japanese automakers and even Chrysler is larger than all but 2 of the Japanese companies. Similarly, the leading American steel companies generally dwarf their foreign competitors and a recent study by the staff of the Federal Trade Commission (Frankena and Paulter 1985) found that all 8 of the largest American integrated steel companies are large enough to realize all economies of scale.

'Until the Fat Lady Sings'

True, American companies have failed to meet the competitive challenge in many industries but this has been due to a variety of complex factors unrelated to their size, including the overvalued dollar and lower foreign labor costs. These are not matters that can be changed by concentrating American business into the hands of a few huge firms since greater size does not necessarily increase efficiency. As Robert Townsend (1970:17B) has said, those who confuse bigness with efficiency are "like the poor lady who thought all she had to do to become an opera singer was to drink lots of heavy ›am." Particular big-business organizations often are cient but more often than not their current large size

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primarily reflects their innovativeness when they were still more modest-size firms. Secretary of Commerce Malcolm Baldrige, the chief administration champion of this proposal, should learn a lesson from the experience of the Japanese government officials who at one time held views identical to his here; the Japanese Ministry of International Trade and Commerce (MITI) attempted in the 1960s to consolidate Japan's 9 automobile firms into 2 large companies to better compete with the U.S. firms but the Japanese automakers refused to give up their independence and, despite being small by American standards, have thrived since then.

The Future of Antitrust

'Disturbing Specter'

How, then, can we explain the great impact of Chicago-school economics on antitrust policy? To hear former FTC Chairman Miller tell it, its success reflects the triumph of superior theory and superior empirical work by Chicago-school scholars, which is of course nonsense. On close examination, the "New Learning" is written on tablets of sand so we must look elsewhere for the reasons behind its recent ascendancy. As observed by one of Chicago's own, Professor Melvin W. Reder (1982:36) in regard to that school's two current intellectual leaders: "The Friedman-Stigler policy position was too attractive ideologically, and too successful as propaganda, for hesitant conservatives to refuse support."[22] Their ideas have triumphed, for now, because they map a course that many vested interests wish to travel but will they survive even though effectively challenged in the marketplace of ideas? The answer would be less ambiguous were economics a "hard" science but the very simplicity of these Chicago-school beliefs—abetted by their ideological fervor and attractiveness—gives them a unique ability to survive and that alone makes their future impact on antitrust policy a disturbing specter.

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APPENDIX A

Data Used in Demsetz's Analysis

The Demsetz analysis discussed in the text at notes 13-17 used data reported in the IRS *Source Book for Corporate Income Tax Returns*. In this report, IRS typically places firms in 3-digit minor industry groupings that embrace more than a single relevant economic market. This results in placing firms operating in different industries (property defined) in the same group. For example, in 1979, IRS minor industry group 371, motor vehicles and equipment, had 1,677 firms. This included automobile companies, other motor vehicle companies, and makers of all types of motor vehicle equipment. Demsetz computed a weighted average concentration ratio for IRS minor industry group 371, using Census of Manufacturers concentration ratios and value of shipments of Census industry group SIC 371. The resulting concentration ratio largely reflects concentration of the automobile industry. Demsetz assumed that this concentration ratio provided an accurate measure of concentration in each size category in IRS minor group 371. Below are the number of firms and their assets in group IRS 371 distributed in the size classes used by Demsetz:

Asset Size (000)	No. of Firms	Assets (millions)
$0-500	1,089	$ 188
500-5,000	479	660
5,000-50,000	83	1,069
50,000-100,000	8	520
100,000 and up	18	39,829
	1,677	42,266

It requires little knowledge of the motor vehicle and parts industries to appreciate the problems inherent in these data. As a starter, an observer may properly wonder, who are the 18 firms in the $100 million and over class? They obviously include much more than the four automobile companies but, more importantly, what about ıs in the other size classes? It is absurd to assume that the ȷ9 firms in the smallest class, as well as those in the other smaller

classes, sell the same products as those in the largest size class. Nor is this problem unique to the motor vehicle industry group. To varying degrees it afflicts every group used by Demsetz. For example, the soft-drink bottling industry group has 1,796 firms. Only two of these are in the $100 million and over group, these two being presumably Coca Cola and Pepsi Cola, which make and sell mainly soft-drink syrups and other products that clearly are in different relevant product and geographic markets than are the hundreds of smaller companies which consist primarily of soft-drink bottlers. Additionally, there is also a problem in the weighted-average concentration ratio that Demsetz derived using Census Bureau industry shipments data, one that arises because his procedures assume that firms in a particular IRS 3-digit minor industry group sell the same mix of products as those that comprise a Census Bureau 3-digit SIC industry group. In fact, there is often little correspondence between the two; IRS places a firm in an IRS industry group based on the firm's most important product and all large diversified corporations operate in more than one 3-digit industry group because the major product of a company like ITT may be baking, although its Continental Baking operations constituted less than 10% of its income. In that event all of ITT's sales and profits would be included in the IRS industry group including baking. As a result, there need be little correspondence between the concentration ratio derived for a 3-digit Census industry group and the average concentration ratios of the firms operating in an IRS industry group.

□

NOTES

[1] Baxter resigned as head of the Antitrust Division in December 1983; his two successors have continued his policies. Miller remained head of the FTC until September 1985 when he became head of the Office of Management and Budget. There have been no discernible changes in enforcement philosophy under their successors.

[2] "Government May Abandon Fight to Stem Conglomerate Takeovers," *Wall Street Journal*, November 14, 1980, p. 23.

[3] The *Merger Guidelines* declare that: "The Department is likely to challenge any merger in [markets with Herfindahl indexes over 1,800] that produce an increase... of more than 50 points..." The soft-drink industry

had a pre-merger Herfindahl index exceeding 2,500. Pepsi Cola's acquisition of 7-Up would increase the Herfindahl index by about 300 points and Coca Cola's acquisition of Dr. Pepper would increase the Herfindahl index by about 550 points.

[4] *Monsanto Co. v. Spray-Rite Service Corp.*, U.S. (1984).

[5] *Borden, Inc. v. Federal Trade Commission*, 674 F.2d 498 (1982).

[6] *Borden, Inc.*, 92 F.T.C. 669 (1978).

[7] "FTC's Proposed Settlement of Borden Case," 44 *Antitrust & Trade Regulation Report*, March 3, 1983 at 525.

[8] Id. at 528.

[9] *ITT Continental Baking Co.*, FTC Docket No. 9009, BNA, *Antitrust & Trade Regulation Report*, Vol. 47, No. 1177, August 9, 1984, at 283. The private suit was *William Inglis & Sons Baking Co. v. ITT-Continental*, 668 F.2d 1014 (9th Cir. 1981).

[10] *ITT Continental Baking Co.*, id., at 311.

[11] *Business Week*, August 29, 1983, p. 50.

[12] Id.

[13] The proceedings of this Conference which was held May 1 and 2, 1974, were published in Goldschmid, et al., 1974. According to one of the Conference's organizers, Professor Harvey J. Goldschmid, Columbia University Law School, the Conference was attended by "most of the nation's leading thinkers on industrial concentration." Id., at viii.

[14] Chicago-school economists seem especially fond of using these crude IRS data. Telser (1964), in a much-quoted study, used IRS data in an earlier study in which he examined the relationship between advertising and concentration and reported an "unimpressive" correlation which contradicted the findings of virtually all other researchers. Mann (1974) attributed Telser's results to his use of IRS data poorly-suited for such analyses. H.M. Mann, "Advertising, Concentration, and Profitability: The State of Knowledge and Directions for Public Policy," in Goldschmid, op. cit. at 143-144.

[15] As observed in Appendix A, the data Demsetz used were biased toward finding a zero relationship. The flaws in his data were somewhat less serious for the largest firms because their weighted concentration ratios were more likely to reflect the actual concentration of the industries in which they operated than those in which the firms in smaller size classes operated. It seems most plausible that Demsetz's observed negative correlations in small class sizes reflects the fact that small firms in IRS minor industry groups operate in more competitive market segments than do the largest firms in these groups. See the motor vehicle example in Appendix A.

Demsetz had published a piece setting forth his ideas and some of his data in 1973 but his presentation at the Airlie House Conference on the New Learning in 1974 was more complete, presented before an influential audience, and was subsequently published in a widely-read book. Supra, note 13.

[17] Leonard Weiss, who commented on the study in his presentation at the conference, pointed out some of the serious flaws in it (Weiss 1974: 225-227).

[18] There is less variation in price among sellers of producer goods than among sellers of consumer goods because the latter are differentiated.

[19] Although most cross-industry studies use data superior to those employed by Demsetz, all nonetheless have serious problems in defining meaningful product and geographic markets. For example, the geographic dispersion index often used to correct for market size is crude at best. Similarly, even adjusted Census product or industry definitions leave much to be desired (Weiss 1972). Finally, economic theory teaches that the price elasticity of demand is critical in determining the size of monopoly overcharges, yet cross-industry studies must implicitly assume that all industries have the same elasticity of demand. Price studies suffer from each of these defects to a far smaller degree than do cross-industry studies.

[20] The only exception, in their view, is where RPM facilitates collusion among manufacturers or their distributors but they believe that such collusion is rare and that, if it occurs, it should be challenged as a horizontal restraint rather than as a vertical one.

[21] *Marrese v. American Academy of Orthopaedic Surgeons*, 692 F.2d 1083 (1982).

[22] In a footnote Reder added: "In 'support' I include grants for research, conferences, and so forth. But also, and more important, I include access to conservative politicians and business leaders, and to the media." (Reder 1982:36.)

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The Monopoly Component of Inflation in Food Prices

Hon. Neal Smith, M.C.

House Eco Devo Committee
Attachment 7 2/5/90

THE MONOPOLY COMPONENT OF INFLATION IN FOOD PRICES

Honorable Neal Smith, M.C.*

Inflation is one of America's most serious problems. Since about one in every five dollars spent by Americans is for food, inflation hits us particularly hard in our food prices. The price index of food items has risen more than the overall consumer price index since the beginning of 1973.[1] During this period, producers' prices for raw farm products have not kept pace with cost increases or inflation, so the consumer food price increases have occurred after food leaves the farm.

Many supposed causes of inflation are often advanced—excess demand, excess growth of the money supply, excess government spending, government regulation, lagging productivity, excess wage demands, the high cost of imported oil, price decontrol, and monopoly power—to name a few. I would like to focus on monopoly power,[2] an increasingly important cause of inflation, that I believe has not received enough attention. In particular, I would like to focus on the increased price spread between agricultural producers and final consumers which results from the power of shared monopolies in the food manufacturing sector of the United States economy. A strong case can be made that this phenomenon is a direct result of increasing monopoly power in the food manufacturing sector. As Willard Mueller put it for the economy in general: "The crux of the matter is that market power creates an inflationary bias in our economy."[3]

Part I examines monopoly power in the food industry, paying close attention to the increased economic strength of monopolies

* Member of Congress representing the Fourth District of Iowa; Chairman of the Subcommittee on State, Justice, Commerce and Judiciary of the House Committee on Appropriations; ranking majority member and former Chairman of the House Committee on Small Business.

[1] Council of Economic Advisors, Economic Indicators 23 (1980).

[2] I define "monopoly (monopsony) power" as the ability of a firm to exercise control over the price it charges (pays) for the goods or services it produces (inputs it buys) to the extent that such prices are higher (lower) than an equilibrium point where the firm's marginal cost (value of the marginal physical product) equals marginal revenue (marginal revenue product).

[3] W. Mueller, The Social Control of Private Economic Power 7 (N.C. Project 117, Working Paper No. 44 University of Wisconsin, 1980).

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and the economic costs caused by monopoly power. Part II details the problems resulting from monopoly power in one segment of the food industry—the meatpacking industry. Part III calls upon the Congress to undertake new antitrust initiatives to reverse the food industry's trend toward increasing concentration. It cannot be said with certainty that food price inflation would totally disappear if the consumer loss due to monopoly were removed from the food manufacturing and retailing sectors. Doing away with these losses, however, would be the equivalent of a major reduction in unnecessary industry costs. Such a cost reduction, along with an industry restructuring aimed at workable competition,[4] would result in substantially lower food costs.

I. Shared Monopoly Power in the Food Industry

A. *The Costs of Shared Monopoly Power*

Pure monopoly power is seldom found in the real world, just as the theoretical ideal of pure competition is seldom, if ever, found. In reality, there are degrees of monopoly power or degrees of competition. There are many examples of domestic industries which have a few large sellers handling the majority of the product—the auto industry, the steel industry, aircraft manufacturing, food manufacturing, and the like. Economists call these industries "oligopolies." There are also examples of domestic industries where a few large buyers such as grain exporters and meat packers buy the majority of the raw product; economists call these industries "oligopsonies." A most descriptive term which I will use for all of these industries is "shared monopolies." With respect to the potential for economic abuse, the distinction between pure monopoly and shared monopoly is only one of degree and not one of substance.

1. Direct impact of shared monopoly power on inflation—The shared monopolists, via jointly beneficial mutual action, have a great deal of freedom and independence over either the selling price or the buying price of the products in question. Generally, in our society we exalt freedom and independence, both personal and economic, as long as that freedom and independence does not harm others. Via the antitrust and restraint

[4] I define "workable competition" as a situation where the price of products or inputs reflect the true cost of production in terms of foregone alternative production possibilities. *See* P. Samuelson, Economics 529 (9th ed. 1973).

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of trade laws, however, society has decided to limit the freedom and independence of monopolists because their economic actions are harmful to the rest of society.

Shared monopoly selling power[5] results in higher consumer prices since buyers have no viable alternative in terms of lower priced substitutes. Shared monopolists are motivated to charge the highest price the market will bear, and to avoid price competition at all costs. These pricing policies result in higher short-run net revenue and higher long-run net profits for the shared monopolists. Economic models show clearly that a monopolist will charge a consumer price which exceeds costs plus a competitive profit, and hold production at a level which is less than would be the case in a competitive industry. Thus, society loses in several ways: consumers pay more than necessary, a smaller amount of the product is available and because of restricted production levels there may be fewer jobs available than would be the case if the product were produced in a competitive industry. Because shared monopolists do not face stiff price competition from other firms, they are not strongly motivated to keep production costs at a minimum. Thus, unnecessary production costs are added into the price of the product, new innovative and cost-efficient production methods are not utilized and productivity may be seriously eroded. Economic theory tells us this will be the case. The reality of the American economy of the 1980's—high inflation, high unemployment, lagging productivity and stiff competition from innovative foreign producers—tells us that the results of shared monopoly power in our economy must be dealt with firmly and swiftly.

When markets are free of shared monopoly power, competition minimizes the need for the government to intervene in private decision-making to achieve the goals of price stability, full employment, and economic growth. Workable competition insures that necessary adjustments in production and consumption are rapidly and efficiently made in response to changes in demand and supply. Monopoly power, however, results in increased government regulation. One economist has estimated that for the whole economy, consumer loss to monopoly power amounts to nine percent of the gross national product—about

[5] The case of shared monopoly *buying* power has similar results except the buying prices of inputs (such as raw agricultural products) are lower than would otherwise be the case and the producers selling these inputs are harmed. Consumers do not benefit from these lower input prices because the monopsonists do not pass on the lower prices, rather they reap higher profits.

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$200 billion in 1979.[6] With such amounts at stake, the underlying reasons for our antitrust laws should be clear.

2. *Indirect impact of shared monopoly power on inflation*—Besides the direct impact of shared monopoly power on inflation, there is a potent indirect effect on inflation which comes from an upward price and wage spiral.[7] This happens because of the interaction of shared monopoly power in industries with strong labor organizations. The problem is caused when labor attempts to share in the high profits of shared monopoly industries as new wage settlements are being drawn.[8] Collective bargaining is the process we use to divide returns between capital and labor, and profit levels have a direct impact on both wage settlements and dividends. If high shared monopoly profits are partially passed on in wage settlements that are larger than justified on a comparative basis with services rendered, those increases cause further problems as they "spill-over" into other industries. Wage negotiations in a monopolistic industry are not entirely independent of settlements in other industries because there is some labor mobility and in a time of low unemployment, the less profitable, more competitive industry must pay higher wages, whether it can afford it or not, or lose its good employees. When spill-over causes high wage increases to be achieved in more competitive industries the result is "cost-push" inflation.

In the key shared monopoly industries, the high wage settlements are often welcomed by management as excuses for raising prices not only to pass on the higher wage costs but to add more in order to boost profit rates. When this is done, more fuel is added to the inflation fire and the stage is set for a new round of wage and price increases as part of a never-ending spiral.

Traditional government anti-inflation policies using monetary and fiscal tools are frustrated because shared monopoly industries have the power to raise prices even when they face declining demand. They raise prices in order to make up for the higher unit costs associated with falling rates of output. Traditional anti-inflation policy dampens demand with cuts in government spending, increased taxes, high interest rates, and tight money. Unfortunately, the battle lines of shared monopoly-caused inflation can march right through all but the most severe of these government policies.

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[6] F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 408 (1970).

[7] STAFF OF THE CABINET COMM. ON PRICE STABILITY, INDUSTRIAL STRUCTURE AND COMPETITION POLICY (1969).

[8] Parsley, *Labor Union Effects on Wage Gains: A Survey of Recent Literature*, 18 J. ECON. LIT. 1 (1980).

These problems of shared monopoly power create an intense squeeze on the farmers of this country. In the purchase of machinery, tractors, trucks, tires, plows, herbicides, and many other products, farmers face some of the most concentrated United States manufacturing industries. For the energy and petroleum based chemicals that are so vital to farm efficiency, farmers are at the mercy of the OPEC oil monopoly and the shared monopoly in United States petroleum product refining. When the farmer sells his products, he faces food processing industries whose degree of shared monopoly power on average, significantly exceeds that of other manufacturing industries. In such a setting, the farmer loses on both sides. The exercise of oligopsony buying power over the price paid to farmers keeps commodity prices low at the farm, and the exercise of oligopoly selling power by farm suppliers means that farmers must pay high prices for their supplies. If major new antitrust steps are not taken soon, the small business, family farm in this nation is doomed for reasons unrelated to efficiency or the ability to produce.

B. *The Concentrated Food Industry*

The losses due to monopoly power in the food industry have a staggering impact upon all Americans. The consumer loss due to monopoly in food manufacturing alone represents about 9.5 percent of the industry's payroll and material costs, eight percent of the value of shipments, twenty-six percent of the value added, and $290 per United States family per year. When the overcharge due to monopoly power in food retailing, which has been estimated to be $942 million, is added to the loss to monopoly power in food manufacturing, the cost is $307 per United States family per year.[9] The farmers in the United States have certainly felt this impact as well. On the average over the years 1973 through 1979, the consumer loss due to monopoly in food manufacturing represented fifty-two percent of the net farm income of all farmers.

[9] Parker & Connor, *Estimates of Consumer Loss Due to Monopoly in the U.S. Food-Manufacturing Industries*, 61 AM. J. AG. ECON. 626 (1979) [hereinafter cited as Parker & Connor]. *See also The Profit and Price Performance of Leading Food Chains 1970-74, Hearings Before the Joint Comm. in Economics*, 95th Cong., 1st Sess. (1977) (statement of Bruce W. Marion and Willard F. Mueller) [hereinafter cited as *Joint Econ. Comm. Hearings*]. Comparisons on a per family basis are calculated using 57.2 million U.S. families as reported by BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT (1979).

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The economic power of shared monopolies in both food manufacturing and food retailing has increased dramatically since World War II.[10] In 1947, there were over 40,000 firms in food manufacturing and about 350,000 firms in food retailing. There are now less than 20,000 firms in food manufacturing and about 155,000 firms in food retailing.

After World War II, firms were leaving the food manufacturing sector at an annual rate of about one percent—that rate of exit has now tripled to three percent. Similarly, the average annual rate of decline in the number of food retailers from 1947 to 1958 reached 2.8 percent. This time period covers the era of the "supermarket revolution" when thousands of small grocery stores went out of business. The current rate of exit from food retailing is even higher, now standing at 3.2 percent per year. Other economic indicators reflect the same alarming trend. The percent of food manufacturing assets held by the fifty largest companies has jumped from forty-two percent in 1947 to sixty-four percent in 1978, and the USDA estimates that it could rise to one hundred percent by the year 2000. This estimate means that almost 20,000 firms could drop out of food manufacturing by the year 2000. It has been estimated that these trends have already resulted in concentration powerful enough to elevate wholesale food prices an average of ten percent.[11] At the retail level, the percent of national sales held by the twenty largest retail chains has jumped from twenty-seven percent in 1947, to thirty-seven percent in 1975. Concentration of sales in individual metropolitan area grocery retailing markets has also grown from forty-five percent in 1947 to fifty-three percent in 1972.[12]

It is clear from these statistics that there are still a large number of independent firms in the food manufacturing and retailing sectors. The clear trends toward fewer and bigger firms, however, must be viewed with increasing concern. Most importantly, attention to the relative size of firms within the food manufacturing sector reveals a significant decrease in the number of firms engaged in direct competition in the production of many specific product lines. The relative size of the largest firms, moreover, clearly shows potential for the abuse of shared monopoly power.

The overcharge to consumers due to monopoly power in food

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[10] *See* Table 1 in Appendix, *infra*.

[11] J. Connor, The U.S. Food and Tobacco Manufacturing Industries: Market Structure, Structural Change, and Economic Performance (Economics, Statistics and Cooperatives Service, U.S. Dep't of Agriculture, Ag. Econ. Rep. No. 451, 1980).

[12] *See* Table 1 in Appendix, *infra*.

retailing was estimated to be $662 million in 1974.[13] Inflated by the consumer price index for food, the estimate for 1979 is $942 million lost by consumers because of monopoly overcharges[14] at the retail level. Estimates for the food manufacturing sector recently appeared in an article by Russell Parker of the Federal Trade Commission and John Connor of the United States Department of Agriculture.[15] This article presented some truly startling research results. The average of the Parker-Connor estimates for one year, 1975, is $13 billion lost by consumers due to monopoly power in the United States food manufacturing sector of our economy.[16] This estimate, moreover, does not include monopoly overcharges paid by farmers for machinery and other inputs or monopoly overcharges in food wholesaling and retailing, or in any of the industries that provide inputs and supplies to food marketing firms.

How does this $13 billion annual figure compare with the amount consumers lose due to inflation in wholesale food prices? Over the years 1973 through 1979, the annual increases in wholesale food prices from all causes of inflation totaled $99.3 billion.[17] Over the same period, consumers lost $98.5 billion due to monopoly at the food manufacturing level.[18] In other words, the loss due to monopoly power was ninety-nine percent as large as the increase in food costs due to all causes of inflation. It is no wonder that Parker and Connor concluded:

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[13] *See Joint Econ. Comm. Hearings, supra* note 9, at 4.

[14] The terms "monopoly overcharge," "consumer overcharge," "consumer loss due to monopoly," and "monopoly loss due to market power" are often used interchangeably. As Parker and Connor point out, the term "consumer overcharge . . . is properly used to mean only the income transfer from consumers to the monopolist." *See* Parker & Connor, *supra* note 9. Total loss due to monopoly power encompasses not only this income transfer, but also what economists call "X-inefficiency" due to excess costs incurred by monopolists and deadweight social welfare loss due to monopoly underproduction. Loss due to monopoly can also be viewed as a loss of what economists call "consumer surplus." I use the term "*monopoly overcharge*" in a general sense to refer to the broadest of these concepts, with the understanding that specific estimates most likely underestimate the totality of such loss.

[15] *See* Parker & Connor, *supra* note 9.

[16] "Three independent methodological approaches and data sets are used to estimate the consumer loss due to monopoly in the U.S. food manufacturing industries for 1975. They include estimates (a) built up from previously estimated components of consumer loss, (b) derived from a regression analysis of the relationship of market structure to industry price-cost margins, and (c) derived from regression analysis of the market structure determinants of national brand-private label price differences. All three estimates converge to the $12 to $14 billion range. Virtually all of the consumer loss is attributed to income transfers; 3% to 6% is due to allocative inefficiency." *Id.* at 626.

[17] *See* Table 2 in Appendix, *infra*.

[18] *Id.*

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> There are significant implications of our monopoly loss estimate for public policy. The annual loss to consumers in food manufacturing alone is 250 times the combined antitrust budgets of both U.S. antitrust agencies and several thousand times that part of federal antitrust expenditures [for food].[19]

The food manufacturing sector ranked fourth among the twenty major industry groups in our economy based on 1977 value added. Food manufacturing, furthermore, ranked first in 1977 value of shipments.[20] Obviously, this is one of the largest sectors of our economy. But in this sector, only fifty firms out of about 20,000 firms accounted for sixty-four percent of food manufacturers' assets in 1978, up from forty-two percent in 1947. "Concentration of profits, sales promotion activities, and the holding of leading positions by these fifty firms is substantially higher, ranging upward to ninety percent."[21]

II. AN EXAMPLE OF SHARED MONOPOLY POWER IN FOOD MANUFACTURING: THE MEATPACKING INDUSTRY

Sixty years ago there were major monopolistic problems in the meat industry with meat being sold under manufacturer's national brand names. As part of the actions taken to re-establish competition in the industry, a 1920 consent decree[22] was entered which prohibited the "big five" packers from engaging in retailing and certain nonslaughter activities. The consent decree and the widespread acceptance of federal grade labeling—which helped insure non-brand-name, generic sales of fresh meat—were major contributors toward a return to workable competition in the meat industry. These measures helped to insure ease of entry into meatpacking which resulted in a dramatic decline in industry concentration.

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[19] Parker & Connor, *supra* note 9, at 637.

[20] *See* BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, 1977 CENSUS OF MANUFACTURERS, Standard Industrial Classification (SIC) 20: Food and Kindred Products (1979).

[21] Parker & Connor, *supra* note 9, at 627.

[22] United States v. Swift and Co., Equity No. 37623. (D.C. Feb. 27, 1920). *See* United States v. Swift and Co., 286 U.S. 106 (1932) for a summary of a complaint and relief obtained. For a history of the Consent Decree, see United States v. Swift and Co., 189 F. Supp. 885 (N.D. Ill. 1960).

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A. *The Struggle of Small Businesses in the Meatpacking Industry*

I have a special concern about the problem of shared monopolies because the economic power of shared monopolies has been derived at the expense of the thousands of small businesses in this nation. When an industry is composed of thousands of small businesses, where no one business can exercise power over buying or selling prices, we have a situation that goes a long way toward approximating the ideal of pure competition. Unfortunately, American economic history demonstrates that more often than not small businesses either grow into giants or are driven out of business by larger businesses—this represents the paradox of development in our free enterprise system. While firms are fighting for territory in an industry, consumers seem to benefit. Once an industry is controlled by a few large firms, however, the efficiency gains from economies of scale are lost to society in the form of shared monopoly costs and profits.

Within the broad problem of shared monopoly power in food manufacturing, the House Committee on Small Business has focused on the problem in the meat industry. The ongoing Committee investigation has included two major studies of meat industry structure, a study of futures trading, and a computer analysis of pricing behavior. Some of the results of this investigation are discussed below.

1. *Increasing concentration*—Nationally, the top four firms slaughtering steers and heifers[23] accounted for about thirty-two percent of the total slaughter in 1978. This is not a particularly high level of industry concentration. One should keep in mind, however, that moving live animals great distances is very costly both in shrink, *i.e.*, animal weight loss due to stress and limited access to feed and water, and transportation. Thus, concentration levels in local marketing areas are of much greater importance than national concentration levels, which are more relevant with non-perishable products. In a special study prepared for the Small Business Committee, the USDA reported that in the twenty-three states that accounted for over ninety-six per-

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[23] Slaughter of cattle is generally divided into two major categories: 1) steers and heifers, which account for about seventy-five percent of all cattle slaughter and end up as cuts of fresh meat at the retail level and 2) cows and bulls, which account for about twenty-five percent of all cattle slaughter and end up in hamburger or other processed meat products. *See* ECONOMICS, STATISTICS, AND COOPERATIVES SERVICE, U.S. DEP'T OF AGRICULTURE, LIVESTOCK AND MEAT STATISTICS, STATISTICAL BULLETIN NO. 522, 81 (1978 SUPP.).

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cent of the total fed cattle marketings in 1978, the top four firms in each state had over sixty-six percent of the steer and heifer slaughter.[24] This sixty-six percent figure is a statistically significant increase over the fifty-six percent concentration level in 1969.

It is generally accepted that shared monopoly effects begin appearing in an industry when four-firm concentration ratios go above forty percent. When the four-firm concentration ratio reaches sixty percent, the industry is considered to be quite monopolistic.[25] What has happened in the steer and heifer slaughtering industry over the last decade is that the large firms have concentrated at the source of the animals, driving out the competition—a classic case of oligopsony buying power.

We have not yet observed, however, in all cattle producing areas, the final result of oligopsony buying power—lower prices paid to producers for live animals. The industry is still in the final transition to shared monopoly. What has occurred is that large packers move into an area and pay higher prices for live animals than the existing competition. Thus, the large "new generation" packers are able to operate their plants at or near capacity throughout the cattle cycle while existing packers go bankrupt in the face of cost increases. During the initial stage of this type of industry structural change, cattle producers may not perceive the problem because, in the short run, some are receiving higher prices for their animals. Cattle producers fail to realize that in five or ten years there will be so few small and medium size packers left in the business that the price of live animals will be determined totally by what the remaining oligopsonists want to pay. When the crunch comes producers, unfortunately, will bear the burden.

2. *Conglomerate control*—Thirteen of the twenty-five largest cattle feeders in this country are now owned or controlled by either meatpacking companies or grain companies. These thirteen cattle feeders already represent a one-time capacity of two million head or about twenty percent of the total national feed lot capacity.

The wave of conglomerate takeovers and vertical integration in the grain-livestock-meatpacking complex is a telling sign of the monopoly profits to be made by those with economic power.

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[24] *See* Table 3 in Appendix, *infra.*

[25] *Small Business Problems in the Marketing of Meat and Other Commodities (Part 7—Monopoly Effects on Producers and Consumers): Hearings before the Subcomm. on SBA and SBIC Authority and General Small Business Problems of the House Comm. on Small Business*, 96th Cong., 2d Sess. 114 (1980) (testimony of Russell Parker).

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The medium sized packer has little chance to survive when the vast resources of international conglomerates are brought to bear to subsidize giant meatpackers. These conglomerates furnish capital and sell grain at favorable prices to conglomerate feed lots who in turn sell fed animals at favorable prices to the conglomerate packer. Instances of conglomerate control are rising. For example, Cargill, Inc., a privately-held company, is the world's largest grain merchandizer with fiscal 1979 sales estimated at $12.6 billion.[26] Cargill in turn owns Caprock Industries, America's largest cattle feeder and MBPXL, America's second largest boxed beef producer and third largest steer and heifer slaughterer in 1978. A further example is Continental Grain, among the world's top five grain merchandizers and also among America's top ten cattle feeders. Esmark, on the other hand, a conglomerate which owns Swift (America's second largest steer and heifer slaughter in 1978) has retreated from the slaughter business as have Armour (owned by Greyhound) and Wilson (owned by LTV).

A recent USDA study reported:

> . . . cattle feeding has shifted to very large commercial feedlot operations using: (1) highly specialized skills and technology and (2) industrialized approaches to management, financing, and marketing. Large commercial feedlots have developed so rapidly that . . . more than half of all fed cattle are now fed in 422 feedlots, each of which averages over 30,000 head marketed a year, and . . . half of the cattle are fed in 131,500 smaller feedlots, each of which averages only 90 head marketed annually. . . .[27]

The three largest groups trading in live cattle futures are grain companies, meatpacking companies and commercial feedlots. These groups accounted for up to thirty percent of the total short open interest in cattle futures during the period January 1978 through April 1979, and held enough cattle to potentially control up to one hundred percent of the short open interest. These figures are significant because control of short positions in cattle futures can have a substantially depressing effect on cattle prices throughout the country.

3. *Declining competition and employment*—As concentration has increased in cattle slaughter, the USDA reports a signif-

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[26] BUSINESS WEEK, Apr. 16, 1979, at 68.

[27] L. Schertz, *et al.*, ANOTHER REVOLUTION IN U.S. FARMING? (U.S. Dep't of Ag., Ag. Econ. Rep. No. 441, 1979).

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icant decline in slaughter plants.[28] From 1969 through 1977, 270 firms each purchasing more than $500,000 worth of livestock per year left the steer and heifer slaughter business.[29] This is an average drop of about four percent of the firms each year, amounting to thirty percent over eight years. During 1978, moreover, at least twenty-two major plants discontinued steer and heifer slaughtering.

Meatpacking traditionally has been an industry where small businesses can effectively compete. In 1978, for example, of the 622 steer and heifer firms buying more than $500,000 worth of livestock per year, 602 slaughtered less than 300,000 head per year. The remaining top twenty firms, however, slaughtered over sixty-two percent of the national total with individual slaughter totals ranging from 300,000 to over 4,000,000 head per year. The majority of firms which can be expected to go out of the steer and heifer slaughter business, if present trends are left unchecked, will almost certainly come from the group of 602 small and medium sized firms and/or those firms operating in only one location.

The economic vitality of an industry depends on the vigorous competition supplied by new, innovative firms. The giant packers of today were such firms ten or twenty years ago. But when a few firms become large and industry concentration reaches high levels, barriers are placed in the path of new firms trying to enter the industry. Thus, the competition from new entrants is stifled, existing small and medium firms fail, and concentration becomes worse. As these trends grow, efficient medium sized firms become acutely aware that they could be eliminated and become reluctant to risk further investments to update or expand their capacity. Present economic trends—inflation, record high interest rates, the recent low point in the cattle cycle, and increasing concentration—have combined to cause a crisis situation for all but the giant firms in the meatpacking industry.

4. *Price spreads*—Other economic indicators tell the same story. The USDA recently reported that the farm-to-retail price spreads for choice beef and pork were seven cents and five cents per pound greater than justified by costs during March-April 1979.[30] Since the farm-to-retail spread measures the difference

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[28] U.S. DEP'T OF AGRICULTURE, CONCENTRATION IN THE MEAT PACKING INDUSTRY 6 (1979).

[29] USDA does not have reliable data on the smallest livestock slaughters. Firms slaughtering $500,000 or more worth of livestock (approximately 1,000 head) per year are required to report to USDA.

[30] *See* ECONOMICS, STATISTICS, AND COOPERATIVES SERVICE, U.S. DEP'T OF AGRICULTURE,

between the retail price and the payment to producers for their animals, these spreads are an indication of the excessive returns to the middle sector. The USDA, furthermore, recently reported that the middle spread for all food had widened nearly twelve percent in 1979, the largest increase in five years.

5. *Impact on farmers*— Increasing concentration in meatpacking means farmers have fewer buyers for their animals and are more and more at the mercy of the remaining large buyers. Large commercial feedlots may have eight to ten buyers or a financial tie or contract with a major packer, but the farmer/feeder may have as few as one or two buyers who will negotiate for delivery to a point that does not involve unbearable transportation cost and shrink. Studies of livestock buying practices document the power to depress farm prices concentrated in the hands of a few buyers.[31] Unfortunately, it is only a matter of time until this power is used against all farmers in cattle producing areas.

B. *Future Trends in the Meatpacking Industry: The Advent of Boxed Beef*

Not since the major antitrust intervention in the 1920's have advertised manufacturer's national brands been used to sell beef in retail food stores. Until relatively recent years, beef moved from slaughterers to retailers in carcass form. Most carcasses were broken at or near the retail outlets and sold generically. A significant proportion of all carcasses are now broken into primals and/or subprimals and vacuum packed by the slaughterers. This boxed beef is now shipped directly to retailers, cutting out the costs associated with shipping unnecessary bone and fat and eliminating the costs of breaking near retail outlets. Retailers then cut the boxed beef into individual portions.

The idea of boxed beef is not new and was used to some extent in the 1950's. During the last decade, however, it has spread rapidly with about fifty percent of all fed beef currently being shipped in the box. Major efficiencies have been associated with the boxed beef revolution, but a USDA study shows:

> . . . that cost savings from boxed beef may have been overrated. Stores which fabricate carcass beef into consumer cuts at central warehouses can save as much as 15

AN EXAMINATION OF PRICE SPREADS FOR BEEF AND PORK, (1979).

[31] U.S. DEP'T OF AGRICULTURE, *supra* note 28, at 20-22.

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> percent in retailing costs. On the average, boxed beef costs the same as if a retailer cut a carcass to primals and subprimals at his regional warehouse. However, as retailers and packers are further apart, 1,000 miles instead of 125, boxed beef becomes more attractive.[32]

There is a marketing danger with boxed beef. Once retailers convert to boxed beef, laying off meat cutters skilled at breaking carcasses and closing down local breaking facilities, they become locked into boxed beef. Buying carcasses as an alternative to boxed beef is no longer feasible. Thus, carcass beef is no longer a substitute for boxed beef to retailers. Those who hold shared monopoly power over boxed beef production, therefore, are now the ones who can extract shared monopoly prices.

At this point in time, all the major boxed beef firms have not started product differentiation[33] via national advertising, a phenomenon associated with increasing concentration. The second largest boxed beef firm, however, the Cargill-owned MBPXL, is marketing branded "portion-controlled" fresh beef under the brand name "Excel." MBPXL provides retailers with local newspaper and radio advertising materials, and has embarked

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[32] L. Duewer & T. Crawford, *summary* to Alternative Retail Beef-Handling Systems, (Economic Research Service, U.S. Dep't of Agriculture Rep. ERS-661, 1977).

[33] Parker and Connor, in estimating the consumer loss due to monopoly, relied upon the observation that when a firm grows big and achieves some degree of market power, it tends to spend more and more on advertising to insulate its product from the competition of other firms by creating perceived differences in the mind of the consumer. Obviously, a particular product is no better than any other product simply because of advertising. If the consumer thinks the advertised product is better, however, then the seller has power to increase the product price above the competitive level. This technique of trying to create perceived differences which in reality do not exist, is referred to as *product differentiation from advertising. See* Mueller & Rogers, *The Role of Advertising in Changing Concentration of Manufacturing Industries,* 62 Rev. Econ. Statistics 89, 90 (1980). "Advertising-created product differentiation is a major source of market power for an individual firm and of industry entry barriers. Because the payoff from successful product differentiation is large, firms have a strong incentive to engage in the level of advertising necessary to achieve the optimal degree of differentiation." *Id.*

Once large scale advertising takes hold of an industry, a major barrier is placed in the path of new small businesses trying to start up and in the path of existing small businesses trying to survive. Quite simply, small businesses cannot afford such large scale advertising expenditures. "IRS data indicate that in 1975 total U.S. advertising expenditures . . . by food manufacturers were $4.1 billion . . . ." Parker & Connor, *supra* note 9, at 627. However, ". . . the bulk of promotional activities currently used for food products . . . are largely self-cancelling and simply add to distribution costs." *Id.*

One of the most cut-throat battles in any retailing industry occurs over shelf space in retail food stores. Thus the firm that spends more on advertising can demand more shelf space for its product and more shelf space means more sales. The small or medium sized manufacturer faces nearly insurmountable odds in the battle for shelf space. *Id.* at 634.

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on an intensive advertising campaign with television, radio and newspaper ads in certain test markets.[34] This meatpacker is taking charge of everything from killing the animals to consumer packaging the meat for retail display. Branded, portion-controlled meats are coming to the retail store just like boxes of breakfast cereal, requiring no further processing. Dominant firms in the production and distribution of portion-controlled meat, aided by the merchandizing power which emanates from a nationally advertised brand name, are positioning themselves to take control of beef retailing and to force retailers to display their products or even to take control and operate retail meat shops in supermarkets.

National brand advertising is already established in poultry, pork products and processed meats. Once portion-control is fully achieved in beef, an advertising battle among giant packers will ensue which will end the medium sized packer's role in steer and heifer slaughter—unless we do something to prevent this.

The United Brands Company "Chiquita" brand banana has shown that nationally advertised brand names can be successful in most any fresh product. United Brands Company even tried to promote a "Chiquita" brand lettuce, attempting to raise the price of lettuce thirty to fifty percent through national advertising. The attempt in lettuce was forestalled, at least in part, by Federal Trade Commission action.[35] Thus, the sixty year history of unbranded fresh beef by no means insures that nationally advertised, brand-name fresh beef will not be attempted in the near future.

Sixty years ago, before the 1920 consent decree against the "big five" packers, fresh meat was being sold under national brand names. Nationally advertised, brand-name, portion-controlled beef is on its way again. If these shared monopoly trends are not forestalled, it is only a matter of time before a few boxed beef packers will totally control the market.

C. *Detailed Breakdown of Loss Estimates*

A detailed look at the results of the Parker-Connor estimate leaves little doubt regarding the extent of the shared monopoly problem. The percent of national sales controlled by the four

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[34] *The National Provisioner*, January 3, 1981, p.8.

[35] *See* In the Matter of United Brands Co., Docket No. 8835 (1974) (Thompson, Comm., concurring), *reprinted in* Scanlon, *Brand Advertising and the FTC: "Catching the Seed, Ignoring the Weed,"* 7 ANTITRUST L. AND ECON. 21 (1974).

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largest firms (four-firm concentration ratio) for the forty-three industries within the food manufacturing sector range as high as ninety percent.[36]

The 1975 Parker-Connor estimate for meatpacking shows a monopoly overcharge from zero to $7 million.[37] This estimate is based on minimal advertising levels and a national four-firm concentration ratio of twenty-two percent. When the boxed beef four-firm concentration ratio is used, along with advertising expenditures commensurate with manufacturer national brand names, the estimate increases dramatically.

Russell Parker of the FTC made a special estimate of consumer loss due to monopoly power in the boxed beef segment of the meatpacking industry that is comparable to the overall 1975 Parker-Connor estimates. He assumed that boxed beef was an industry with the same advertising characteristics as broilers and hams. Parker used 1975 data on boxed beef production and market shares gathered by the USDA. In 1975, the top four firms had sixty-one percent of the boxed beef production. Poultry and ham advertising rates were used in order to explore the consequences of boxed beef producers moving to portion-control and starting advertising campaigns to differentiate their products, based upon the 1975 level of shared monopoly power of boxed beef producers. Parker assumed that if national advertising of brand name beef occurs, expenditures would be the same percent of value of shipments as occurred in broilers and hams during 1975. Understanding that individual segment estimates within the food manufacturing sector are subject to greater error than the estimates for the entire sector, Parker concluded that the shared monopoly overcharge would be 4.9 percent of the value of all boxed beef shipments and 8.2 percent of the value of manufacturer brand boxed beef shipments. In dollar terms, these estimates indicate that in 1975 the consumer loss due to shared monopoly overcharge could have ranged from $107 million to $143 million.[38] Inflating these estimates to 1979 dollars

[36] For the sector as a whole, the ". . . food industry concentration ratio was 52 percent, indicating a significant degree of oligopoly and potential for competitive problems." Parker & Connor, *supra* note 9, at 627. In dollar terms, the largest consumer loss in 1975 occurred in processed meats, fluid milk, breakfast cereals, bread, cookies, crackers, refined cane sugar, soybean oil, shortening, margarine, beer, soft drinks, flavoring extracts, syrups, roasted coffee and other prepared food. *See also* R. PARKER & J. CONNOR, ESTIMATES OF CONSUMER LOSS DUE TO MONOPOLY IN THE U.S. FOOD-MANUFACTURING INDUSTRIES, (NC-117, Working Paper No. 19, Dep't of Ag. Econ., Univ. of Wisconsin, 1978) 59, 61 [hereinafter cited as R. PARKER & J. CONNOR, (NC-117)].

[37] R. PARKER & J. CONNOR, (NC-117), *supra* note 36, at 59, 61.

[38] *See* Table 4 in Appendix, *infra*.

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gives a range of $133 million to $178 million potential loss to shared monopoly overcharge in advertised, portion-controlled boxed beef—a truly startling conclusion.

III. The Urgent Need for New Directions and Bold Initiatives

Antitrust law is founded on economic principles of preserving competitive markets and on a social policy that small businesses should be preserved regardless of the economic results.[39] New antitrust initiatives, founded on these same economic and social considerations, must be undertaken: to reverse the ever increasing shared monopoly power in food manufacturing; to return this sector of our economy back to workable competition among efficient smaller and medium sized businesses; and to make the entire system more market sensitive so that periodic surpluses result in the kind of reduced consumer prices which move the product.

Recent press reports[40] claim our ninety year old set of antitrust laws and enforcement policies lack validity in today's economic environment. These types of reports, while conceding that outright monopoly is socially unjustifiable, claim that in many cases the economies of scale gained in industries with shared monopolies outweigh any adverse social costs. Accordingly, such reports call for a major relaxation of antitrust efforts.

I interpret our current economic environment in an entirely different light. I believe that basic economy theory, which has evolved from Adam Smith to the present day, accurately predicts the consequences of shared monopoly power. Shared monopolies vehemently resist price competition, resulting in a major structural contribution to our current inflation problem throughout the economy. Shared monopolies also restrict output which results in a smaller supply, thereby keeping prices higher than would otherwise be the case and acting as an underlying structural force contributing to our unemployment problem. In addition, rather than lowering prices to move their product, shared monopolies place the burden of a recession on their employees by cutting output and laying off workers in an effort to

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[39] United States v. Aluminum Co. of America, 148 F.2d 416, 427-29 (2d Cir. 1945); Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962).
[40] Business Week, Jan. 12, 1981, at 90.

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maintain their shared monopoly profit margins.[41] Shared monopoly power, furthermore, creates an environment where cost-push inflationary wage gains spill over to the rest of the economy. Unquestionably, shared monopolies construct barriers to the entry of new firms, thus stifling price competition and innovation. These actions result in outmoded production techniques and lagging productivity. And finally, this combination of shared monopoly created circumstances in our domestic economy—higher prices, restricted output, barriers to entry, stifled innovation, lagging productivity—invites competition from innovative, productive foreign firms and results in our chronic balance of payments problem.

Parker and Connor concluded from their research that to correct the problem of shared monopoly power, industry restructuring may be necessary. They in turn suggested divestiture and compulsory licensing of major trademarks as possible remedies.[42] Such approaches may be necessary in industries such as steel and automobiles where there are no small firms left. Another approach (which I have proposed for the meatpacking industry) involves two components: first, to define the rules of conduct in advance for actors in the marketplace and second, to specify firm size limitations before undesirable concentrations of shared monopoly power are allowed to develop. This two-prong approach would eliminate the need to break-up shared monopolies via divestiture. Businessmen would have a clear statement of how far they can go in extending their control over the market.[43] For meatpacking, the principal elements of this two-prong approach would prohibit vertical integration by proscribing meat retailing by firms which exceed a fixed share (for example, five percent) of the national slaughter of steers and heifers, cows and bulls, or hogs; insure a competitive market structure by limiting a packer's slaughter in any one year to a fixed share (for example, twenty-five percent) of the national slaughter of the appropriate classifications of livestock; and protect small businesses by prohibiting the unreasonable use of economic power or pricing practices intended to eliminate or impair the marketing ability of small business meatpacking concerns.[44]

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[41] Current labor union policies to maximize per hour wages and benefits rather than to maximize the number of members employed also contribute to this problem.

[42] Parker & Connor, *supra* note 9, at 637-38.

[43] *See* H.R. Rep. No. 7197, 96th Cong., 2d Sess. (1980) and H.R. Rep. No. 5733, 96th Cong., 1st Sess. (1979).

[44] Small business meatpacking concern is defined as any packer which has less than a five percent share of the national slaughter of steers and heifers, cows and bulls, or hogs.

The imposition of limits on individual firm size or market shares may be criticized by some on the grounds that it would discourage the development and adoption of cost-reducing technology. Such limits, it may also be argued, impede aggressive competition and protect individual competitors rather than the competitive process. When an industry, however, is composed of a large number of small or medium sized businesses where no one business can exert power over buying or selling prices, we have a situation that begins to approximate the ideal of pure competition.

In free competitive markets, unlike in a concentrated industry, decentralized decision-making allows for more rapid changes and flexible responses to changing economic conditions.[45] Currently, firms can and do take advantage of new technologies in the meat industry at firm sizes far smaller than the maximum firm size limits proposed. For example, slaughter houses and breaking plants with less than one percent of the national production can and do employ all the latest technology. Because the proposed market share limitations are so much larger than any company could practically slaughter at any one or several locations, a market share limiting approach would in no way stifle innovation; in fact, more decentralized decision-making should encourage it.

Similarly, the integrity of the competitive process would not be impaired by market share limitations. This approach neither limits the number of firms in an industry nor restricts the entry of new firms or the expansion of smaller existing firms.[46] In fact, in an environment where it was known with certainty that no one firm could grow beyond a certain size, innovation and investment in new plant and equipment by small and medium sized firms would be encouraged because unfair competition from industry giants would not exist.

Market share limitations would impact on aggregate market behavior and affect the size of firms or the independence of individual business decisions only if the firms reached a size which approached the limit. The social benefits to be derived from decentralized and independent decision-making in an industry

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H.R. Rep. No. 7197, *supra* note 43, at Section 3.

[45] Scitovsky, *Can Capitalism Survive?—An Old Question in a New Setting*, 70 Am. Econ. Rev. 1 (1980); Hayek, *The Use of Knowledge in Society*, 35 Am. Econ. Rev. 519 (1945).

[46] The spread of product differentiation, especially if fortified by large scale advertising or promotional expenditures, has a far greater potential to operate as a barrier to new entry than market share limitations.

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which does not limit the entry of new firms or the expansion of smaller existing firms far outweighs the social loss resulting from the imposition of fixed market share limits.

The costs of our present antitrust system may not be justifiable. It has been estimated that American Telephone and Telegraph Company has spent from $350 million to $500 million in its antitrust battle with the Justice Department, and International Business Machines Corporation is expected to spend as much as $1 billion in its battle with the Justice Department.[47] Such expenditures as well as enforcement expenditures by the Justice Department would be unnecessary under a market share limitation approach. Also, the government welfare program for shared monopolists such as Chrysler would be unnecessary. In an environment controlled by the market share limitation approach, the failure of any one firm would not produce the ripple effects that the bankruptcy of a firm the size of Chrysler could have in today's shared monopoly business world.

CONCLUSION

Unfortunately, as the studies now show, the meat industry is returning to a state of concentrated shared monopoly power. Once again, the industry is returning to highly advertised, needlessly differentiated national brand marketing of fresh meat. The names of the actors have changed but the script is the same. As these shared monopoly practices occur, increased efficiencies resulting from boxing and portion-control are not passed back to the producer or on to the consumer, but rather they are wasted on needless advertising and shared monopoly profits—causing losses to both farmers and consumers.

For the benefit of both livestock producers and consumers, further concentration of shared monopoly power in meatpacking should be prohibited. It is not yet too late to keep the meatpacking industry from turning into the biggest shared monopoly of the 1980's, but time is running out. The need for a market share limitation approach is clear in the meatpacking industry. This antitrust approach, furthermore, should be carefully considered for other segments of our economy.

[47] *See* BUSINESS WEEK, Jan. 12, 1981, at 90.

a-7-21

APPENDIX

Table 1
Number of Companies and Concentration in Food Manufacturing and Retailing 1947-1977

Food Manufacturing					Food Retailing			
Census Years	Number of Companies	Average Annual Percentage Decline of Number of Companies from Previous Census Year	Percent of Food Manufacturing Assets Held by 50 Largest Companies	Average 4-Firm Share of Sales in Food and Kindred Products Industries	Number of Companies	Average Annual Percentage Decline from Previous Census	Percent of National Sales by 20 Largest Chains	Average 4-Firm Share of Sales in Metropolitan Areas
1947	41,147	NA	41.6 (1950)	NA	350,000 estimate 1948	NA	26.9	45.4 (1954)
1958	36,546	- .9	45.8	47	238,000 est.	-2.8%	34.1	49.3
1967	27,706	-2.5	52.7 (1969)	50	187,293	-1.9	34.4	50.9
1972-1978*	23,326 (1972)	-3.0	63.7 (1978)	52 (1972)	155,235 (1972)	-3.2	37.0 (1975)	52.9 (1972)

* Data only available for year indicated in each column.

SOURCE: Federal Trade Commission.

Table 2
Comparison of the Annual Costs to Consumers of Monopoly in Food Manufacturing and Food Price Inflation, 1973-1979

Year	(1) Value of Shipments from Food and Kindred Product Manufacturing Plants[1]	(2) Consumer Loss Due to Monopoly in Food Manufacturing[2]	(3) Annual Percent Change in the Average Wholesale Price for Food Products[3]	(4) Annual Dollars Increase in Consumer's Food Costs Due to Wholesale Price Increases[4]
	$ Billions	$ Billions	Percent	$ Billions
1973	$135.5	$10.3	22.5%	$25.9
1974	160.6	12.2	13.0	17.6
1975	171.0	13.0	5.5	8.8
1976	180.9	13.7	-2.5	-4.3
1977	193.1	14.7	6.6	11.9
1978	218.4	16.6	11.9	23.0
1979	237.4	18.0	7.5	16.4
		TOTAL $98.5		TOTAL $99.3[5]

[1] Value of shipments of food and kindred products manufacturing plants, *1977 Census of Manufacturers, Industry Series (MC 77-1-20)*, U.S. Department of Commerce, 1979. 1978 and 1979 amounts are estimates derived by multiplying the 1977 census total value of shipments by the average annual deflated growth rate of value of shipments between 1972 and 1977 (1.2 percent) and the percentage increase in the Bureau of Labor Statistics producer price index for finished food products (the wholesale price index).

[2] The dollar amounts are equal to 7.6% of value of shiments shown in Column 1. 7.6% is the ratio of the dollar amount of consumer loss estimated by Parker and Connor for 1975 ($13 billion) expressed as a percent of 1975 total food industry value of shipments. This method of extending the Parker-Connor estimate to other years assumes the ratio of consumer loss to value of shipments stays constant. The 7.6% is not the total possible consumer loss due to monopoly included in consumer food purchases. Not included are monopoly loss amounts in wholesaling or retailing of food products or monopoly overcharges by farm input supply industries.

[3] Annual percent change (from December to December, unadjusted) in producer prices for finished goods (foods). Source: Department of Labor, Bureau of Labor Statistics. These inflation (deflation) rates apply to food and kindred product prices as charged by the manufacturer to the retailer. Since the Parker-Connor's estimate does not include possible consumer loss due to monopoly at the retail level, inflation (deflation) rates for consumer food prices were not used.

[4] These values represent the dollar changes in value of shipments (Column 1) which are due to inflation (deflation). Assuming these inflation charges are passed on by retailers on a dollar for dollar basis, the total of Column 4, $99.3 billion, can be considered as an estimate of the total "consumer loss due to inflation" over the 1973 through 1979 period. Percentages were taken of the previous year's value of shipments. Value of shipments in 1972 total $115 billion.

[5] Part of the price increase represents an increase in the dollar amount of the monopoly loss between 1973 and 1979. Subtracting the increase in the annual monopoly loss (7.7 billion) leaves a total due to non-monopoly price increase of $91.6 billion.

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Table 3
Four-Firm Concentration Ratios, Steers and Heifers, By State[1]

State[2]	Percent of Slaughter Accounted for by Top 4 Firms			1978 Level of Concentration[3]
	1969	1977	1978	
Arizona	83.7%	85.9	87.6	Very Highly Concentrated
California	20.5	22.7	26.5	Unconcentrated
Colorado	63.3	65.4	63.8	Moderately Concentrated
Iowa	53.4	57.2	61.9	Moderately Concentrated
Idaho	77.3	86.0	89.0	Very Highly Concentrated
Illinois	63.1	72.0	70.2	Highly Concentrated
Indiana	64.3	78.9	82.1	Very Highly Concentrated
Kansas	54.3	74.0	74.7	Highly Concentrated
Nebraska	51.1	50.2	57.8	Moderately Concentrated
Michigan	53.4	59.4	56.0	Moderately Concentrated
Minnesota	59.7	84.2	84.7	Very Highly Concentrated
Missouri	67.9	80.5	85.9	Very Highly Concentrated
Montana	92.9	100.0	100.0	Very Highly Concentrated
New Mexico	95.9	95.3	96.7	Very Highly Concentrated
N. Dakota	100.0	99.0	100.0	Very Highly Concentrated
Ohio	40.9	44.6	44.7	Low-Grade Concentration
Oklahoma	72.9	86.6	89.0	Very Highly Concentrated
Oregon	62.0	74.2	73.9	Highly Concentrated
Pennsylvania	73.6	73.8	79.3	Very Concentrated
S. Dakota	91.3	94.4	96.6	Very Highly Concentrated
Texas	43.2	64.6	65.2	Highly Concentrated
Washington	66.5	87.1	91.6	Very Highly Concentrated
Wisconsin	79.6	84.7	89.3	Very Highly Concentrated
23 State Total	55.9	63.2	66.3	Highly Concentrated

[1] SOURCE: "Concentration in the Meat Packing Industry," P&S, AMS, USDA, in Hearings Before the Subcommittee on SBA and SBIC Authority and General Small Business Problems of the Committee on Small Business, House of Representatives, 96th Congress, 2nd Session, "Small Business Problems in the Marketing of Meat and Other Commodities," (Part 7—Monopoly Effects on Producers and Consumers). Washington, D.C., April 29, May 5 and 9, 1980.

[2] These 23 states accounted for over 96% of the total fed cattle marketings in 1977.

[3] Classification developed by Joe S. Bain and reported by USDA, *Ibid.*, p. 9.

Table 4
Overcharge Estimates for Boxed Beef, 1975

1972 SIC Code	Industry	% of National Sales Controlled by Four Largest Firms (CR_4)	% Overcharge from: National Brand-Private Label Model[1]	% Overcharge from: Price-Cost Equation (3)[2]	Dollar Overcharge from: National Brand-Private Label Model	Dollar Overcharge from: Price-Cost Equation (3)
		Percent	Percent		Millions of Dollars	
2011	Meatpacking	22 (1972)	0	0	$ 7	$ 0
	Boxed Beef With Advertising[3] (Special Estimate)	61 (1975)	8.2	4.9	143	107

[1] Percent overcharge applies only to the value of consumer product sales shipped under manufacturer brands.

[2] Percent overcharge applies to the value of all product shipped by food manufacturers, including producer goods. The denominator includes both manufacturer brand and private label sales of consumer products.

[3] Boxed beef estimates are based on the following variable values: CR_4=61, ADS4=.75% (same as for broilers and hams), Size=$2.2 billion (derived from USDA estimates of 1975 boxed beef production), and Firms=50 (estimated from USDA survey of boxed beef firms). All other variables in the equations are held constant. It is assumed that net imports of boxed beef are zero and that all boxed beef is sold for final consumption, i.e. producer sales are zero.

SOURCE: R. Parker & J. Connor, (NC-117), *supra* note 36, at 59, 61.

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LAW LIBRARY
EUROPEAN LAW DIVISION

Attention: Mr. John Helmuth

Dear Mr. Mitchell:

In response to your inquiry on market share limitations in West German antitrust law, I have prepared the enclosed report entitled Market Share Limitations in the Antitrust Law of the Federal Republic of Germany.

The regrettable delay in responding to your inquiry was caused by our recent move to the Madison Building. Should you have any further questions, please let me know.

Sincerely yours,

Edith Palmer

Edith Palmer
Senior Legal Specialist

Enclosure

Honorable Parren J. Mitchell
Chairman, Small Business Committee
House of Representatives
Washington, D.C. 20515

House Eco. Devo. Committee
Attachment 8
2/5/90

MARKET SHARE LIMITATION IN THE ANTITRUST LAW

OF THE FEDERAL REPUBLIC OF GERMANY

I. Overview

In the antitrust laws of the Federal Republic of Germany, the market share of an enterprise is an important criterion for two purposes:

1. to establish whether an enterprise has a market-dominating position--such enterprises are not prohibited from existing in that form, but they are subject to special abuse control by the Cartel Authority;[1] and
2. to impose merger control--mergers may be prohibited if they create or increase market domination.[2]

From 1973 until the spring of 1980, the same concept of market domination (which to a great extent is based on market shares) was used both for purposes of determining the imposition of abuse control and for merger control. However, a major reform of the Antitrust Statute of 1980 has brought more stringent criteria to determine market domination for purposes of merger control. These are aimed at controlling mergers of very large enterprises and at controlling vertical mergers of very large

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1/ Sec. 22, Gesetz gegen Wettbewerbsbeschränkungen [GWB] vom 7. Juli 1957, in the version of 4. April 1974, Bundesgesetzblatt [BGBl., official law gazette of the Federal Republic of Germany], I, p. 869, as last amended by Viertes Gesetz zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen vom 26. April 1980, BGBl., I, 458.

2/ Sec. 24, GWB; a detailed and up-to-date overview of German antitrust law is contained in the Common Market Reporter, Doing Business in Europe 23, 501-23, 521 (Chicago, Commerce Clearing House, 1978-) which is included as Appendix I.

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enterprises by which these seek to gain entry into markets where small or medium sized firms are predominant.[3/] For the latter, even a market share of 5% raises the presumption of market domination, and they have been characterized in the antitrust literature as amounting almost to an outright merger prohibition.[4/] In summary, the law as presently in effect, provides for abuse control and merger control as follows.

II. Abuse Control

For the purposes of abuse control, an enterprise is considered as market-dominating if it has a monopoly over a market involving certain types of goods or services, or if it is one of several enterprises that together form an oligopoly in a particular market. The market share of an enterprise or of several enterprises is an important criterion for establishing if such a condition exists. Other criteria that will be considered in this context are financial power, access to resources and markets, interlocking relationships with other enterprises, and factual and legal barriers detaining other enterprises from operating in the specific market.

3/ It is noteworthy that German antitrust law, at the time of its creation in 1957, was very lenient in comparison to U.S. antitrust law and has become more stringent both in the wording of the law and also in its application by the Cartel Authority, particularly with respect to merger control. See, T. Schnorr, "Trust-Busting with a German Accent: The Control of Corporate Merger and Acquisition Activities Under Increasingly Aggressive West German Law," 19 Virginia Journal of International Law 595 (1979), included as Appendix II.

4/ K. Schmidt, "Vierte Kartellrechtsnovelle zwischen Effektivitäts- und Legitimationsproblemen," 12 Zeitschrift für Rechtspolitik 42 (1979).

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A presumption for market dominance exists if one enterprise has a market share of at least one-third, provided its sales volume in the preceeding business year exceeded 250 million Deutsche Mark (DM); furthermore, a presumption of market dominance exists if two or three enterprises together have a market share of at least 50%, and if five or fewer enterprises together have a market share of at least two-thirds, provided the involved enterprises had a sales volume in the preceeding business year of at least 100 billion DM.

In all these instances, the presumption is not only rebuttable but the Cartel Authority must consider circumstances favorable to the enterprise *ex officio*.

Enterprises that are market-dominating within the meaning of these provisions are subject to special abuse control. The Cartel Authority may prohibit abusive conduct by these enterprises and void contracts involving the same. Particular examples of abuse are the hampering of competition of other enterprises without any justification, the setting of prices and conditions that deviate from those achievable in similar competitive markets, and the setting of less favorable prices and conditions as compared to those set by the enterprise itself in a market where it is not dominant.[5/]

II. Merger Control

Mergers may be prohibited by the Cartel Authority if they create or strengthen a market-dominating position. However, such mergers may be permitted

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5/ *Supra* note 1.

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by the Cartel Authority if the involved enterprises prove that the merger will be beneficial to competition. Furthermore, such mergers may be permitted by the Federal Minister of Finance if they are in the public interest or if their detriments are outbalanced by advantages for the economy as a whole.

Certain types of mergers must be reported to the Cartel Authority shortly upon completion, whereas for others (primarily those of very large enterprises) a pre-merger notification is required. Post-merger notification is mandatory if one of the involved enterprises has a market share of 20%, or if the merger would create or increase such a market share, and also if during the preceeding business year the participating enterprises together had at least 10,000 employees or a joint sales volume of at least 500 million DM.[6/] Pre-merger notification is required if one of the participating enterprises had a sales volume of at least 2 billion DM during the preceeding business year, if at least two of the participating enterprises each had a sales volume of at least 1 billion DM during the preceeding business year, or if the merger requires a governmental act of authorization by the Federal Goverment or the lander (constituent states of the Federal Republic).[7/] In either instance, the Cartel Authority only has a short period of time to prohibit the merger or order a dissolution. Planned mergers may be prohibited

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6/ Secs. 23, 24, GWB.

7/ Sec. 24 a, GWB.

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within four months from the time of giving notice, and completed mergers may be prohibited within one year of such notice.

Market domination is presumed by two sets of criteria:

1. those also applicable to abuse control (as outlined above); and
2. by the more stringent criteria introduced in the 1980 amendment that are superimposed on those already existing before.[8/]

The new criteria introduced by the 1980 amendment are as follows:

1. Market domination is presumed if an enterprise with an annual sales volume of at least 2 billion DM[9/] merges with another enterprise that operates in a market in which small or medium-sized enterprises together have a market share of two-thirds and the enterprises participating in the merger together have a market share of at least 5%. Market domination also is presumed if the large (2 billion sales volume) enterprises merge with an enterprise that is market-dominating in one or several markets in which the total sales volume amounted to at least 150 million DM during the preceeding calendar year.

2. Furthermore, market domination is presumed for mergers where the participating enterprises jointly had a sales volume of at least 12

8/ Sec. 23 a, GWB.

9/ The sixty largest German industrial enterprises fall into this category. Supra note 4.

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billion DM during the preceeding business year and at least 2 of the participating enterprises each had a sales volume of 1 billion DM.

3. The presumption for market domination in an oligopolistic situation remains the same as for abuse control, i.e., a market share of 50% achieved by two or three enterprises, and one of two-thirds shared by 5 or fewer enterprises creates a presumption of market dominance; however, the burden of proof has now been reversed, and the enterprises involved in the merger have to prove that even after the merger they will continue to behave competitively and that the merger should, therefore, be permitted.

Prepared by Dr. Edith Palmer
Senior Legal Specialist
European Law Division
Law Library, Library of Congress
February 1981

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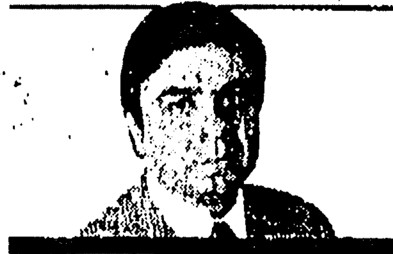
Hughes is our choice.

Limited number of packers keeps cattle prices low

10-19-86
Des Moines Register

2c

GEORGE ANTHAN



RESEARCHERS AT the Department of Agricultural Economics at the University of Wisconsin, have confirmed Iowa Congressman Neal Smith's longtime contention that in many areas of the country the limited competition in live cattle markets means lower prices.

The evidence as to the adverse competitive effects of packer concentration in key producing areas of the country, the independent Wisconsin study states, is so strong that the federal government should challenge any attempts by the few remaining firms to increase their control through mergers.

For more than a decade, Smith has been warning that control of the meat-packing industry by fewer and fewer companies is resulting in diminished competition for live cattle, and in lower prices being paid to producers.

Smith and Dr. John Helmuth of the House Small Business Committee staff, several years ago produced landmark studies showing the sharp increases in concentration in the packing industry, especially the control by a few firms of the boxed-beef business, in which carcasses are cut up at the plant, sealed in vacuum bags and shipped in boxes to supermarkets. In regions of the country where two-thirds of the cattle are processed, including the upper Midwest, the study indicates that if there had been more packing-industry competition in the 1976-80 period, producers could have received from 24 cents to 47 cents a hundredweight more for their cattle. Total annual returns to feeders in these areas would have been from $42 million to some $83 million more.

The Wisconsin study shows that in Iowa, southern Minnesota and eastern Nebraska, one of the top cattle-producing regions of the country, four firms in 1980 controlled 67 percent of the procurement market. The study also states, there now are three dominant cattle-processing companies in the U.S.: IBP, a subsidiary of Occidental Petroleum; Excel, a subsidiary of Cargill Inc., and Swift Independent. The research indicates that for each additional 10 percent of the cattle-processing market share controlled by the four largest packers within a region, cattle producers there can expect a 10-cent-per-hundredweight cut in prices received.

"With very high levels of concentration," the Wisconsin team stated, "packers are expected to tacitly or explicitly collude in an effort to jointly maximize profits."

And prices paid for cattle were even lower in areas where a few big packers deal with smaller farmer-feeders, the study indicates. In areas where the companies must deal with giant feed lots, the prices they pay for cattle tend to be higher.

Big feedlots are in a much stronger bargaining position in negotiating with packer-buyers because they often have professional market-intelligence services on which to rely, and because they sell cattle regularly instead of the occasional sales of the smaller farmer-feeders.

And although larger beef-processing plants are generally believed to be more efficient, apparently this doesn't lead to higher cattle prices in regions where these big plants are located. For example, the Wisconsin study states that the presence in regional markets of IBP, one of the biggest and most efficient packing firms, "had a significant negative effect on live-cattle prices during 1971-78."

Since large, efficient plants generally have lower costs per head slaughtered, they can pay a higher price for cattle, if necessary, than smaller plants. But, states the Wisconsin report, whether they do pay higher prices for cattle depends on the extent to which there is effective competition between large plants in a given area. A single big plant in a region with many smaller plants may find that it can get maximum profits by paying the same prices as the smaller plants, the researchers said.

Also, as Congressman Smith has emphasized, this single big plant with small-plant competition might choose to pay higher prices, at least for a while, and drive its competitors out of business. When they're gone, says Smith, this large plant then can begin paying lower prices for cattle. The areas where one or two big packing companies have more dominant positions tend to have the lowest cattle prices, the report states.

The Center for Rural Affairs, a public-interest group at Walthill, Neb., agrees with Smith that the big losers in the increasingly concentrated meat-packing industry are the small and medium-sized family livestock operations, most of them located in the upper Midwest. Thus, says the center, the Reagan administration's "relaxed efforts to enforce the anti-trust laws in recent years ... is bad news for family farmers."

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Attachment 9 2/5/90

CONCENTRATION OF AGRICULTURAL MARKETS - Jan. 1990

by William D. Heffernan and Douglas H. Constance
Dept. of Rural Sociology, Univ. of Missouri
Columbia, Mo. 65211 314-882-4563

BROILERS (CR4=45%)

	Wkly Prod.
1. Tyson Foods (Holly Farms)	78.30
2. ConAgra	32.70
3. Gold Kist	26.62
4. Perdue Farms	24.77
5. Pilgrim's Pride	16.70
6. Continental Grain (Wayne)	14.42
21. Cargill	4.50

1986	1988	1989
35%	38%	45%

Source: Broiler Industry, 12/89:50-52.

TURKEYS (CR4=31.2%)

1. Philip Morris (Louis Rich)
2. Beatrice/KKR (Swift/Eckrich)
3. ConAgra
4. Norbest
5. Cargill
6. Hormel (Jenni-O)

1986*	1987	1988
29%	30.5%	31.2%

Source: *Turkey World, 12/87; Turkey World, 11/12/1989:16.

EGGS (CR5=18.5%)

1. Cal-Maine Foods, Inc.
2. Rose Acre Farms, Inc.
3. Milton G. Waldbaum Co.
4. Croton Egg Farms
5. Seaboard Food and Ise Farms, Inc.

1986(CR5)*	1989(CR5)	1989(CR4)
14.4%	18.5%	16.2%

Source: * Egg Industry, 12/87:20; Egg Industry, 11-12/1989:20.

BEEF SLAUGHTER (CR4=69%)

	Capacity/Day	Plants
1. IBP	30,164	10
2. ConAgra (w/ E.A. Miller, Armour, SIPCO, Monfort)	23,100	8
3. Cargill (Excel, w/Sterling, Spencer)	20,000	6
4. Beef America	5,000	5
5. National Beef	4,800	1

Source: Meat & Poultry, 1/89:19; * Meat and Poultry, 7/88:14; ** N.C.A. 10/89:10.

1972*	1989**
29% Fed Cattle	69% Fed Cattle 87% Boxed Beef

CATTLE FEEDLOTS

	Sales (Mil.)	State
1. Cactus Feeders	250	Tex.
2. ConAgra (Monfort)	212.6	Colo.
3. J.R. Simplot Co.	197	Idaho
4. Cargill (Caprock)	177	Minn.
5. Continental Grain	152	ILL.

1988*
1.4% of the feedlots fed 71% of the cattle

Source: Successful Farming, 1/87:9;* N.C.A., Task Force Report, 10/25/89:10.

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PORK SLAUGHTER (CR4=45%)

1. IBP
2. ConAgra (w/ SIPCO, Armour)
3. Morrell
4. Cargill (Excel)

1977*	1987*	1989
34%	31%	45%

Source:* V.J. Rhodes, Missouri Pork Industry, 1988; Hog Farm Management 9/89:8.

PORK PRODUCTION

	Sales (mil)	State
1. Murphy Farms, Inc.	70	N.C.
2. Tyson Foods	57.2	Ark.
3. Cargill	38.5	Minn.
4. National Farms	35.75	Mo.

Source: Successful Farming, 1/87:9.

MULTIPLE ELEVATOR COMPANIES (CR4=24%)

1. Cargill
2. Conti. Grain
3. Bunge
4. ADM
5. ConAgra
6. Pillsbury

\# of Facilities = 39%
Capacity in Bushels = 24%
% of Port Facilities = 59%

Source: 1989 Grain Guide - Milling & Baking News.

FLOUR MILLING (CR4=61%)

	# of Mills	Total Capacity (cwts)
1. ConAgra	31	266,000
2. ADM (inc, Dixie-Portland)	27	229,700
3. Cargill	15	151,400
4. Grand Met. (Pillsbury)	8	119,700
Industry Totals:	208	1,187,318

1977*	1982*	1989
38%	48%	61%

Source:*Census of Manufacturing, 1982; Milling and Baking News, Milling Directory for 1990.

SOYBEAN MILLING (CR4=61%)

	Plants	States*
1. ADM	19	12
2. Cargill	16	12
3. Bunge	8	5
4. Ag. Processors	6	3
5. Ferruzzi (Central Soya)	7	4

1977**	1982**
54%	61%

1987(CR2)
ADM/Cargill > 55%

Source: M&B News, 7/13/87:1-2; * Feedstuffs 2/27/89:20; ** Census of Manufacturing, 1982.

WET CORN MILLING (CR4=74%)

	# of Plants	1977*	1982*
1. ADM	4	63%	74%
2. Cargill	4		
3. Tate and Lyle, PLC (A.E. Staley)	4		
4. CPC	3		

Source: Milling and Baking News, Milling Directory for 1990; * Census of Manufacturing, 1982.

ETHANOL PRODUCTION (CR4=73%)

	Capacity (1000 gal)	1987(CR1)	1987(CR4)
1. ADM	500,000		
2. Pekin Energy	70,000	52%	73%
3. South Point Ethanol	60,000		
4. New Energy Co. of Indiana	60,000		
5. Tate and Lyle, PLC (A.E. Staley)	40,000		
Total U.S. Production	953,050		

Source: Milling and Baking News, 12/15/87:27-28.

DRY CORN MILLING (CR4=57%)

	Plants	24hr. Grind	1982(CR4)*
1. Bunge (Lauhoff Grain)	2	120,000	
2. Illinois Cereal Mills	2	95,000	
3. ADM (Krause Milling)	2	70,000	57%
4. ConAgra (Lincoln Grain)	3	52,000	
5. Quaker Oats	3	45,000	
	Total	445,000	

Source: Corn: Chemistry and Technology, 1989:352;* Census of Manufacturing, 1982.

A. Since 1981 we have documented 200 mergers, buy outs or acquisitions.

B. Major focus is shifting to international concentration.

October 1986 - Purina Mills Division purchased by B.P. Nutrition (British Petroleum)
August 1987 - Hillsdown Holdings of U.K buys Maple Leaf Mills for $271 million
September 1987 - Central Soya purchased by Ferruzzi, Italy for $370 million
September 1987 - Borden Milk buys pastamaker Albadoro of Italy
September 1987 - Italgrani buys remaining interest in New England Milling Company
February 1988 - Cargill in cotton seed crushing joint venture in China
February 1988 - Ferruzzi buys edible oil interest of Lesieur of France for $261 million

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March 1988 - Nestle buys pastamaker Buitoni of Italy for $1.28 billion
April 1988 - ADM and RJR Nabisco in joint venture with USSR
June 1988 - Nabisco in breadstuffs joint venture in China
June 1988 - A.E. Staley purchased by Tate and Lyle, England for $1.3 billion
September 1988 - Ocrim of Italy in wheat milling joint ventures in China, USSR, Philippines, and Taiwan
August 1988 - British Nutrition subsidiary, Purina Mills buys pork processing plant in Indiana
October 1988 - Amstar Sugar purchased by Tate and Lyle for $305 million
October 1988 - Wilson purchased by Doskocil of U.S., but in September 1988 International Fish and Meat (a French firm) made an offer.
November 1988 - Ferruzzi subsidiary, Central Soya, to build pork processing plant in Indiana
December 1988 - Pillsbury (Burger King, Green Giant, Hagen Daas, Totinos Pizza and Steak and Ale Restaurants) purchased by Grand Metropolitan of England
January 1989 - Grand Metropolitan buys Spanish soft-drink firm, Sileno
February 1989 - Mitsubishi of Japan buys several businesses from Nestle
February 1989 - Borden buys Gross, a West German baker
February 1989 - Cargill to build wet corn milling plant in Brazil
March 1989 - Borden buys, Catelli pasta company from Labatt of Canada
June 1989 - BSN of France buys RJR Nabisco European biscust operations
October 1989 - Mitsubishi of Japan and Ferruzzi subsidiary, Central Soya, in joint venture in pork processing in Indiana

In 1988 both Ferruzzi and Cargill began building plants in China to anchor future pork and poultry enterprises.

Cargill is building large slaughter plant in Southern Alberta.

Cargill expanding poultry and beef operations in Brazil.

In 1987, ConAgra reported their poultry and pork operations in Portugal were very profitable.

C. In competitive system survival depends on efficiency.

D. In oligipolistic or monopolistic system survival depends on power (economic and political).

E. Can the concept efficiency deal with issues focusing on a sustainable food system?

Chairperson Elizabeth Baker
House Economic Development Committee
Testimony concerning HB 2766, Packers and Stockyard Act.
By John M. Stitz, Director, Catholic Rural Life, Archdiocese KCK

Catholic Rural Life in the Archdiocese is affiliated with the National Catholic Rural Life Conference, which for sixty years has supported family farm agriculture. Concern for the social, economic and spiritual welfare of the rural community has always been a major principle in Catholic social teachings.

Because of these principles, we support this bill. We see the section on immediate payment as a matter of justice. We see the section which will enable a producer or third party to file suit in case of price fixing also to be a matter of justice.

And we see the restrictions on vertical integration as a necessary regulation to preserve the family farm system of agriculture, and a protection of family farmers to insure free and democratic competition in the market.

We fear vertical integration in agriculture not only as monopolizing the farm economy, but reducing the democratic freedom of rural people to make decisions which affect their lives.

To see how the political power of corporations can reduce the democratic processes of decision making we need only to examine the USDA's proposals for the current GATT, General Agreement on Trade and Tariff. One section if passed will restrict the power and the ability of state legislatures to regulate agricultural policies within the state if it is internationally unacceptable. We should be frightened by this proposal, by the USDA. At least this bill will send a strong message to the USDA about state's rights.

House Eco. Dev. Committee
Attachment 11 2/5/90

STATEMENT BY

IVAN W. WYATT, PRESIDENT
OF
THE KANSAS FARMERS UNION
ON
HOUSE BILL NO. 2766
BEFORE
THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT
ON
FEBRUARY 5, 1990

MADAM CHAIRPERSON, MEMBERS OF THE COMMITTEE:

I AM IVAN W. WYATT, PRESIDENT OF THE KANSAS FARMERS UNION.

IT IS IMPERATIVE WE PRESERVE AND ENHANCE OUR PRICE DISCOVERY SYSTEM FOR DETERMINING THE VALUE OF LIVESTOCK.

TO DETERMINE A COMPETITIVE VALUE OF LIVESTOCK, WE MUST PROTECT THE INDEPENDENT PRODUCER AND THE INDEPENDENT PROCESSORS AND THEIR MARKETS FROM MONOPOLISTIC CORPORATE ENCROACHMENT THROUGH THE PRACTICE OF VERTICAL INTEGRATION.

FOR SEVERAL YEARS, MANY HAVE RECOGNIZED THIS THREAT TO OUR COMPETITIVE MARKETING STRUCTURE BY A SYSTEM IN WHICH THE CONSUMER'S SUPPLY AND PRICE OF FOOD IS DOMINATED THROUGH CORPORATE VERTICAL INTEGRATION FROM THE FARM TO THE CONSUMER'S TABLE. THE KANSAS FARMERS UNION HAS FOR MANY YEARS VOICED ITS CONCERN ON THIS GROWING THREAT.

RECENTLY, CATTLEMEN WHO OWN, MANAGE AND OPERATE THIS NATION'S COW-CALF HERDS HAVE BEEN VOICING THEIR CONCERNS ABOUT THIS THREAT TO THE COMPETITIVE MARKET.

JUST A FEW DAYS AGO AT A NEWS CONFERENCE HELD BY COW-CALF RANCHERS THIS ISSUE WAS ADDRESSED. POULTRY PRODUCERS WARNED THE CATTLEMEN TO BEWARE OR THEY COULD ALSO BECOME SERFS ON THEIR LAND LIKE THE POULTRY PRODUCERS HAVE.

I CLOSE BY SAYING WE APPRECIATE THE EFFORT REPRESENTATIVE LARKIN HAS MADE TO BRING THESE GENTLEMEN HERE TODAY AND HIS SPONSORSHIP OF HB-2766.

THANK YOU.

House Eco. Devo. Committee
Attachment 12 2/5/90