Testimony of

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Monopsony in Markets for Agricultural Products:

A Serious Problem in Need of a Remedy

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Buying Power of Processors in Our Nation's Agricultural Markets. "
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This statement draws heavily on a paper analyzing more generally the legal regulation of agricultural product markets that I presented at the meeting of the Law and Society Association in Pittsburgh, June 5-8, 2003, and at the annual meeting of the Organization for Competitive Markets in Kansas City on July 25, 2003. I am grateful for the suggestions and comments that I received at both meetings. I am honored to have been asked to offer my views on the problems

created by monoposonistic markets for agricultural products. In the last five years, I have been particularly interested in issues involving competition in the markets for such products. In 2000, I published an article in the Wisconsin Law Review: Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy, 2000 Wis L. Rev. 531. A central thesis of that article was that there are serious problems of market failure in agriculture directly related to the high and increasing levels of concentration in the industries buying from farmers and ranchers. I urged increased antitrust enforcement and also suggested legislative action in addition to antitrust enforcement was essential to restoring competition in agricultural markets. The goal of legislation should be to facilitate the operation of a dynamic market process that is efficient, transparent, open and fair.

Farmers are poorly served by existing market structures and practices. Farmers and ranchers today confront excessive concentration in most of the industries buying and processing agricultural products including those in meat, grain and dairy. The existence of concentrated markets creates the incentive and the capacity for such firms to engage in conduct aimed at exploiting those participants with limited options and to entrench existing market power against the threat of deconcentrating and effective competition.

Free and open markets are generally the best institutional structure for achieving all the important goals of economic policy: efficiency, dynamic growth, equitable allocation of resources, opportunity for all participants. Economists and policy makers have also long recognized that markets are not inherently fair, efficient or open. Where markets are unconcentrated, there are many buyers and sellers, and there is a strong tendency for efficient, workable and fair methods to develop as the inevitable outcome of the interaction of many participants all seeking a neutral and open market place.

But no such inherent tendency exists in markets where there is a substantial difference in size between buyers and sellers and the market is also highly concentrated, i.e., there are few firms altogether on one side. Also, if one side has significant and persistent advantages in information or some other important element related to the transactions between buyer and seller, then too such a market is unlikely to experience much pressure for desirable conditions. There is a grave danger that strategic conduct will shape such markets frustrating the goals of an efficient, open, fair and accessible marketplace. This in turn imposes immediate burdens on the disfavored class of participants and ultimately on consumers and the economy as a whole as less efficient production and market transactions take place.

When markets lack the inherent tendencies to create desirable conditions, the law can play a vital role in defining rules for the participants that reduce their capacity to engage in strategic conduct and restore greater balance between the parties. The statute books contain many such laws including ones regulating credit, insurance, product safety, job safety, franchising of various kinds (e.g., gas stations, fast food, automobile dealerships), energy markets and, of course, securities markets.
Because of problems of fraud and deceit in energy and public stock markets exemplified by Enron and Worldcom, we are witnessing today a renewed awareness that markets require well crafted and effectively enforced rules to ensure that they work in the best interest of the general public, producers, investors, and consumers. Such regulation does not replace the market. It

seeks to facilitate its operation by ensuring that all participants have reasonable information, equitable treatment, and access. It has been, I think, the genus of our economic system that we have over time preferred, whenever its is feasible, market facilitating regulation to governmental command and control of economic activity.

The focus of this hearing is on the problems created by the monopsonistic character of the markets into which farmers and ranchers sell their products and the potential role of law, both antitrust and market specific regulation, to restore open and competitive markets. My brief answers are that there is strong evidence of abuse including price manipulation by buyers, discrimination among producers, and conduct strategically aimed at exploiting and entrenching market power. The harder problem is how to restore a fair, open, equitable and accessible market.

Antitrust law can and should make an important contribution especially when other agencies of government having more relevant powers lack the political will and institutional capacity to act. However, the failure of antitrust law enforcers to understand the differences between monopsonistic power issues and the more familiar seller power analysis as well as to shape relevant enforcement policies, has greatly weakened the impact of antitrust law. The lack of transparency concerning decisions to enforce, or, more often, not to enforce antitrust law in monopsonistic contexts further diminishes the role of antitrust because the critics of enforcement policy are kept in unjustified ignorance of the bases for the decisions being made.

But in the contemporary enforcement world and given the inherent limits to antitrust law and its enforcement, market specific laws that limit or eliminate opportunities for specific kinds of strategic behavior are essential to achieving improved market behavior in a timely and effective way. Such rules can constrain strategic and opportunistic behavior as well as facilitate more open, accessible and efficient markets for agricultural products.

This statement, first, describes the structure of the key buying markets for agricultural products. Second, it outlines the kinds of monopsonistic problems that exist in the contemporary agricultural product markets. Third, it evaluates the potential for antitrust law to deal with those problems. Fourth, it describes and evaluates the existing market specific regulation that could eliminate some of the worst abuses and reduce the incentives for strategic use of buyer power. The final section suggests improvements in antitrust enforcement and options for better market specific regulation for agricultural product markets.

I. The Monopsonistic Market Structure in Agricultural Markets

It has become a common place that concentration has increased dramatically in most of the markets into which farmers and ranchers sell their products. In beef, four firms control more than 80% of the national slaughter of steers with, of course, even higher concentration in the regional markets in which livestock are actually sold. The pending acquisition of Farmland by Smithfield will increase national concentration in hog slaughter to nearly 65% in the top four firms. Similar concentration exists in poultry. Moreover, as with beef, the levels of regional concentration in poultry and hogs, the relevant markets for producers, are even more concentrated. In addition, increasingly the same enterprise owns dominant positions in more than one type of livestock slaughter. Tyson is the leader with the largest share of poultry, nearly one-third of all steers

slaughtered in its facilities and the second largest share of hog slaughter, approximately 20%. Smithfield dominates hogs and is an increasing presence in beef.

The same process of concentration is taking place in milk. Dean controls over about 30% of the nation's fluid milk. From the standpoint of dairy farmers through out the country, this means that there are going to be few buyers for their fluid milk. Further complicating this relationship, Dairy Farmers of America (DFA), a very large dairy cooperative, represents farmers and has a long term contract with Dean to supply milk to most of its processing plants and has a 50% stock interest in National Dairy, another large processor. Earlier this year, Hood, another major fluid milk processor, proposed merger with National. DFA would have retained a substantial ownership stake in the merged entity as well as a supply relationship with it. Because of objections by a New England based dairy cooperative that its members would loose Hood as their outlet (Dean and DFA are the only other major milk handlers in the region), the parties abandoned the merger and have proposed a new deal in which each with take a substantial stock ownership position in the other and they will share top management. Under this deal, DFA will get control of milk supplies to the Virginia plant of Hood, but will not have supply rights in New England.

Other elements of the dairy business are similarly concentrated and often becoming more concentrated. Milk not used for drinking is manufactured into cheese, butter, ice cream, or dried milk. Based on estimates for the year 2000, only 26% of all milk production is used as fluid milk, 37% is converted to cheese, about 13% becomes butter and another 8% is made into ice cream. Kraft dominates the cheese market with nearly a third of that business. Land O' Lakes, the second largest dairy cooperative in the country, is the leading butter producer in the United States controlling about 30% of the butter business. Thus, in each of the major uses of milk there is a dominant firm and each of those firm's has an interest as a buyer to keep prices down. Hence, there is little incentive to compete for supplies by raising price.

Finally in grain, we have seen a number of mergers and combinations resulting in increased concentration on the buying side for wheat, soybeans, and corn. For example, ADM acquired Farmland's soybean operations, both domestic and foreign, increasing its position of dominance in that field. Cargill, already the largest or second largest grain trader in the world, acquired Continental's grain trading facilities after some modest divestiture, thus further increasing concentration in all areas of grain.

Further downstream in food processing and food retailing, we have also seen a number of mergers and combination that effectively increase concentration on the buying side at both levels. For example, when Ralston Purina and Nestle combined, the resulting entity became the largest buyer, taking as much as 50% of all animal meal which is now largely used in pet food.

Grocery mergers and internal expansion by the largest firms have combined to increase concentration on the grocery buying side with the top five firms now sell more than 40% of groceries sold through supermarkets in the United States. As major buyers of food products, these chains have great power over their upstream suppliers even if their market shares, on a national basis, do not seem overwhelming when viewed in terms of seller market power.

II. Monopsonistic Conduct in the Markets for Agricultural Products

Concentration creates incentives to exercise the resulting market power. In surveying these issues, four categories are helpful: (1) the manipulation of public market prices to ensure lower costs to the buyer on the contractual side of the market; (2) direct manipulation and depression of producer prices often manifest in the increasing spread between the farm price and the wholesale or retail price of the product involved; (3) discriminatory contracting practices that avoid the open, public market; (4) imposing inequitable burdens on the producers. I will discuss each of these categories of problem briefly.

1. Manipulation of Market Prices

The basic idea is to manipulate the public price of a commodity where relatively low volumes are traded in order to affect the off-exchange prices where such prices are set in relation to the public market price. The impact on the integrity of the market process is the same whether the manipulation comes from the buyer or seller side. False signals are being sent. In the past, buyers of cheese, eggs and butter manipulated the pre-World War I exchanges to create artificially low prices that then governed many off-exchange supply contracts. The major gas refiners used the same strategy to manipulate the wholesale price of gasoline in the 1930s.

In the cheese business, Kraft and others manipulated their purchases of cheese on the old Green Bay cheese exchange to drive down the price of cheese. This in turn depressed the amount farmers got for their milk. The National Cheese Exchange in Green Bay, Wisconsin held a weekly public sale for a 30 minutes or so every Friday at which very little cheese was actually sold. But this public market provided the basis for a vast volume of cheese sales based on contracts. Hence, Kraft and other major buyers had a strong incentive to be sellers in that market to drive down the price of the products they were buying. According to Mueller and Marion, the effect of this manipulation was to dampen down price increases and drive prices lower in periods of price decline because of increased supply relative to demand. Federal antitrust law does not provide a remedy for farmers because they are only "indirect" victims of this conduct. However, they have sought relief under state antitrust laws with varying degrees of success.

In beef and hogs, similar problems of public price manipulation exist. For hogs, the majority of which are now sold under various production contracts, the price set in the upper Midwest still provides the basis for pricing many production contracts. By staying out of the public market at crucial times of the day or bidding low, the handful of packers that buy hogs can strongly influence the contract prices that they will pay for the bulk of their production. The incentive to engage in strategic conduct with respect to the public market prices is palpable. Moreover, Smithfield's acquisition of Farmland will reduce the number of potentially competing buyers in the price setting market from 6 to 5. Reduction in the number of bidders when the initial number is small can have very significant impact on the viability of the bidding process. Moreover, interdependent action with respect to bidding becomes increasingly attractive as the number of bidders decreases, and each bidder has an incentive to depress the auction price as a means of controlling its contract prices. Nevertheless, the Department of Justice has allowed the Farmland acquisition without any explanation of why it has concluded that this deal is not likely to have significant anticompetitive effects.

In beef, there is less dominance of production contracts, but they are increasingly important. Such contractual commitments are called "captive supplies." Here again, the tradeoff between

public market prices and the price to be paid for contract cattle invites manipulation. By lowering the market price, the packer can save substantially on its contract supplies.

2. Use of Buying Power Directly to Depress and Manipulate Prices

Basically, a volume buyer dealing with a number of small suppliers has substantial leverage to set a price within some range and stick with it. The sellers have to deal with the buyer eventually. Beef and hog feeding operations have faced highly concentrated packer buying power for a longer time. That experience shows that the slaughter houses pursue two compatible goals. First, they can use the power to drive down the cost of inputs as discussed earlier. If the farmer has any substantial sunk investment in the business, he or she will continue to produce for a considerable period of time even though the return is substantially below an acceptable level. Moreover, even in periods of short supply when prices rise, the use of buying power can limit the impact of that increase and deny to the producer the full benefit of the increased demand relative to supply. Second, to avoid the risk of disruption from other producers making inroads into their sources of supply and to deter new entrants, powerful buyers have an interest in creating barriers by tying up supplies through contractual arrangements. This makes it much more difficult to obtain the supplies necessary to enter or expand a processing business. Further upstream, monopsonistic buyer power in animal meal resulting from the acquisition of Purina will also affect the total price feeders get for livestock and poultry.

In milk markets, the history of cheese price manipulation is the best known example of how monopsonistic buying practices, distant from the farm (i.e., at the level of cheese buying) can directly influence the price of milk at the farm gate. Additional evidence of increasing spreads between farm gate and retail prices for milk has come from the work of Professor Cotteril looking at the highly concentrated New England milk markets. The spread between farm and consumer increased as the milk processing market became more concentrated.

3) Discriminatory Pricing Practices

The power of dominant buyers has another deleterious impact on the market-they have the power to engage in discriminatory buying practices. As a result, there are significant differences in the prices paid for like grade and quality livestock favoring the farmers, feedlot operators and ranchers who have received long run beef supply contracts (captive supply) in comparison to those operators who sell in the spot market.

There is no legitimate business justification for such differential prices. The primary effect is to disfavor the public market. Given the option, feeders will prefer contract sales. But contract livestock are withdrawn from the spot market, and this results in an increasingly thin public market. Yet this same spot market directly and indirectly influences livestock futures prices, the prices for calves and feeder stock, as well as the price for captive sales. As the public market signals become more unreliable, this makes it more and more difficult for farmers and ranchers to operate their businesses effectively. Thus, the impact of this price differential is to manipulate the entire price structure for beef and hogs.

As concentration increases on the buying side in milk, the same problems are likely to emerge. The pooling of basic compensation for all grade A milk in any milk marketing order area does

reduce the capacity of buyers to discriminate, but a central element of compensation is the extra payments for quality factors. As to these there is no way presently to ensure that all dairy farms willing and able to produce such factors get equal treatment when the number of buyers is limited. In the past the presence of multiple buyers provided a competitive market check on any unjustified refusal by a buyer to recognize valuable qualities.

We are seeing increasing use of contracting in grain production as well. Here too, the risk of discriminatory treatment of farmers is serious. No rules or regulations guarantee equal access to producers willing to provide the type of productive effort desired by buyers. My impression is that currently, the transactional market still dominates the area so that buyers are not yet as vulnerable to price manipulation through contracts, but as the use of contracting grows without regulation the potential will increase that the buyers will use contracts to manipulate the public market price and so depress prices to farmers while at the same time inducing them to enter into contractual relationships that reduce the public market and create even more misleading price signals.

4) The Imposition of Unjustified, Non-Price Burdens on Producers

The use of contracting and other practices by buyers of agricultural products operating in monopsonistic markets allows those buyers to impose additional burdens on producers. In the case of beef only chosen operators are given access to captive supply contracts. This imposes negative price differentials on many of the small and middle sized cattle producers in the country. Hence, even if the average prices for cattle combining captive and spot market sales were reasonable, this systematic differentiation among sellers creates serious equity problems and threatens the viability of our traditional farming system.

The same problems only worse exist in hogs. In some regions, if the single major buyer determines for any reason to refuse to deal, a farmer's entire investment is made worthless. Such farmers become serf-like in their dependence on the buyer and will accept any contract terms that are imposed. This includes grossly unfair, compulsory arbitration clauses that effectively eliminate the modest protections afforded by such laws as the Packers and Stockyards Act (PSA) intended to protected farmers from exactly this kind of exploitation.

In poultry there is no longer a spot or public market for general production. All supplies are captive under contracts that impose a wide variety of unfair conditions on the growers. The contract terms imposed on them reflect the power of the producer which can manipulate income by a variety of devices. Moreover, as in the hog contracts, the poultry buyers impose a variety of other constraints on their farmer suppliers that deny access to legal rights by compulsory arbitration terms including unconscionable notice requirements. In fact, the Attorney General of Oklahoma has offered the opinion that many contracts for production of crops and livestock are now contracts of adhesion which may in fact reduce independent farmers to the position of employees.

The implication of these kinds of contract terms for efficient market operation is threefold. First, the favored operator has an incentive to serve its economic master because its next best option involves a substantial loss of revenue. Such an operator is not well positioned to bargain effectively on the terms of the transaction. Second, buyers are under no obligation to deal with

all comers on equal terms, and so they can refuse to deal with any producer for any reason or no reason. The fact of high concentration on the buyers' side means that such refusals will often deny access to the market altogether as in poultry and hogs in some regions or to the more lucrative contract market as is the case in beef. Indeed, in those markets where open market sales are still possible, such buyers can refuse even to bid and so can eliminate a disfavored operator from the business entirely. Third, supply contracts are "secret" because the buyers claim the terms are confidential business information. Hence, farmers and ranchers usually lack the information necessary to evaluate the reasonableness of the terms that they are being offered. The capacity for this concentrated buying power to disrupt the market and contribute to inefficiency and market failure is a product not only of the concentration of these markets, but also the legal and institutional structure of the markets within which farm products are sold.

Down stream buyer power influences agricultural product markets as well. Brand name or differentiated retail grocery producers must get their products into a substantial number of stores to achieve the necessary volume for efficient operation. Hence, the producer needs to have many or even most large retail chains as customers. This confers on each chain substantial power to demand payments for access to its retail space, e.g., slotting allowances. Such buying power can foreclose access to the market to small firms that can not afford to make such payments. Moreover, the processors who make such payments are powerful enough buyers who will pass back to the farmer and rancher these costs. This will ultimately result in further reductions of farm income because the farmers and ranchers of America are so atomistic in structure that they can not resist effectively the reduction in prices inflicted on them. When processors urge that merger will give them greater "bargaining power," they are announcing that they plan to use their buying power to reduce the prices paid to farmers while trying to keep their prices to retailers up.

III. The Role of Antitrust Law in the Operation of Agricultural Markets

Antitrust law focuses on two elements of markets-their structure and conduct. Merger and monopoly law address structural issues. Conspiracy law and the aspect of monopoly law concerned with exclusionary and exploitative conduct provide the rules for the conduct element of antitrust.

The Clayton Act's prohibition of mergers that "may substantially lessen competition or tend to create a monopoly" is the most actively enforced element of structural law. The objective in merger law is to prevent markets from becoming unduly concentrated. Monopoly law is the ultimate recourse: when market structure has reached monopoly, then dissolution of the monopoly becomes a remedy. The key in both merger and monopoly law is to understand the nature of the markets involved and so be able to determine when a level of concentration raises serious risks of anticompetitive results.

Conduct elements of antitrust focus on the identification and prohibition of conduct that has adverse economic effect and lacks a redeeming business justification. Because antitrust focuses on individual actions and actors it does not have the capacity to establish market specific regulations for the general conduct of actors. It can and does forbid naked restraints such as those created by price fixing cartels or group boycotts having as their goal the elimination of a competitor or class of competitors from the market. Under the rule of reason, antitrust law allows courts to make more focused judgments about the merits of particular actions, but recognizing

the generalized character of such results, the tendency is to allow a wide range of conduct. This is particularly true when the effect of the challenged conduct is only to impose harm on an individual enterprise.

The central question for agriculture is how to apply these antitrust concerns when farmers and ranchers sell goods into concentrated markets. The analysis is of buyer power. While not unique to agriculture, these issues are much more relevant here than in many other areas of the economy and much less well developed. There is long standing recognition in case law and economics that anticompetitive consequences can arise from increased buyer power as much as from increased seller power. In the last few years, this insight has received powerful support from several courts of appeal decisions and by the Antitrust Division's challenge to the Cargill acquisition of Continental Grain.

The three leading court of appeals decisions involved a variety of businesses. In 2000, the Seventh Circuit Court of Appeals upheld the Federal Trade Commission's challenge to the efforts of Toys R Us (TRU), a major toy retailer, to block its suppliers selling toys to TRU's discount competitors. TRU is the largest retailer of toys in the country-selling about 20%. It induced its major suppliers to refuse to provide comparable toys to its lowest price competitors in order to protect its profit margins

In the same year and more directly related to agriculture, the Ninth Circuit has upheld the right of dairy farmers in California to sue the major cheese makers for the reduced milk prices that resulted from their manipulation of cheese prices. This decision most clearly recognized and articulated the stake of farmers and ranchers in having workably competitive markets into which they could sell their products.

In 2001, the Second Circuit upheld a class action by employees of oil and gas companies that challenged information exchanges among these employers that allegedly had the effect of stabilizing wage competition and depressing wages for the members of the class. Again, the decision canvassed the legal and economic bases for authorizing such cases and concluded that there was a strong public interest in preserving and promoting competition on the buying side of markets. The court also emphasized that in buyer power cases the incentives of the parties to collude are different from those in a seller side conspiracy. Specifically, the parties have a much greater incentive not to cheat by raising the prices they pay. In a selling conspiracy, there is an incentive to cheat because a slight price reduction can capture a large sales volume.

The challenge to Cargill's acquisition of Continental, two of the largest grain merchants in the United States, resulted in a consent decree so it has less precedential value, but stands as an indication of the willingness of the antitrust law enforcers to focus exclusively on adverse buyer power concerns resulting from a proposed merger. The position of the Department of Justice was that the merger would have no adverse effects in the downstream markets for grain, but it would have foreclosed competition in buying grain at various specific locations in the country as well as at some key export points. Ultimately, the government consented to the acquisition after the parties divested facilities that in the government's view, but not necessary that of a number of critics, eliminated the risk.

These decisions have re-emphasized the dangers of buying power to the overall competitive operation of the market. In addition, the three court of appeals decisions highlight the ways in which buyer power exploitation can rise from lower market shares as well as involving a different incentive structure with respect to adherence to or defection from the anticompetitive understanding. These analyses have great significance for the analysis of mergers because they demonstrate that actual harms, both unilateral and collusive, can occur as a result of buyer power emerging from much lower market shares than are currently deemed problematic on the selling side of markets. Despite this evidence of the significance for competition of buying power, its implications have not been a primary focus of antitrust analysis.
In developing appropriate buyer power standards, three contexts are important. First, a processor may need access to a large number of downstream buyers in order to be efficient. Slotting allowances in the grocery business and the power of Toys R Us illustrate cases where upstream producers need access to either a key retail outlet or to many retail outlets such that failure to get access to that segment of the marketplace results in significant loss of sales. In either situation a buyer with a significant share-10% or more of the national retail market-gets substantial power over the supplier. Each such buyer is an essential element of the producer's marketing process regardless of other outlets. This suggests that merger analysis ought to be attentive to the creation or expansion of such power even where neither the upstream nor the downstream selling market is concentrated in terms of conventional seller market analysis. Similarly, restrictive terms or special obligations on sellers in such contexts might be subject to stricter scrutiny even where the market shares seem low. Moreover, the Exxon case teaches that collusive risks arise even in contexts where there are more competitors than would trigger conventional concerns about collusion on the selling side.

The second context that must be understood is that if the seller has relatively few choices even though further downstream the ultimate consumer may have a number of choices, the buyer has power in the upstream market even if it may not have it in the down stream market. As discussed in Part I, an increasing number of agricultural product markets fit this model. The local grain elevator or slaughter house will have substantial power over its suppliers because they have few if any options. When reselling those products, there may not be much power because many other sellers will exist as well. The concerns are analogous to issues that arise when a firm can engage in price discrimination among its customers. Mergers or restraints that increase the capacity for a firm to engage in such conduct are anticompetitive. Similarly, mergers that increase the capacity of a firm to exploit selectively buying power or agreements which increase the ability of the firm to engage in selective buying practices raise important anticompetitive concerns.

Third, when a buyer imposes lower prices on its supplier, if that supplier can reduce its input costs, it is likely to seek to do so. Thus, when grocery stories reduce what they pay for goods via slotting allowances or requiring other discounts, the processors have every incentive to pass those lower prices on up the supply line. Thus, the ripple effect of a remote downstream price cut will flow up to the parties without the power to respond. The cheese exchange price manipulation is an example. The cheese buyers manipulated their purchases in order to reduce price of cheese, the cheese makers in turn reduced the price of milk to the farmer. The cheese makers may have absorbed some of the lower price but the farmers faced the bulk of that change. Here the implication for both merger and restraint analysis is that adverse effects may well occur in second or third tier supply markets. This means that investigation and evaluation of transactions

must be more comprehensively and emphasize the goal of antitrust to protect the competitive process. The fact that the first tear of suppliers may not be harmed does not mean that the overall market process is not put at risk by such mergers or conduct.

Antitrust law lacks a clear empirical or theoretical map of the contexts in which the dangers of buyer power are enhanced or conversely where countervailing market characteristics would make such harms unlikely. While the merger guidelines, for example, provide detailed analysis on the selling side of the circumstances under which an inference of likely adverse effect is or is not plausible, no comparable guidance exists on the buying side. The lack of guidance means that the issues are framed in a very ad hoc way that is very merger specific. Similarly, in cases involving complaints about buyer conduct, the lack of a clearly defined analytic framework recognizing potential harms makes litigation of such cases much more complex and problematic despite the recent court of appeals decisions.

The policy of the Justice Department of not explaining the basis for actions and its refusal to act further undermine the process of developing coherent public policy. The recent decision not to challenge the acquisition of Farmland by Smithfield is a prime example. For the reasons given earlier, this combination created a clear, prima facie, risk to the competitive process in hog buying. We do not know whether the government even considered that risk, and if it did, what standards, criteria and facts it deemed relevant to its decision. This greatly limits the capacity for critics of the decision to engage in a meaningful discussion of the merits of specific policy options.

Effective antitrust requires greater appreciation of and deeper analysis of buyer power. This would better inform all antitrust enforcement, but it would be particularly important for cases involving the sale of agricultural products. This, then, is an argument for expanding the scope of carefully developed, general antitrust doctrine to take better and more consistent account of the issues involved in examining the buying side of cases.

Another obstacle exists to private antitrust enforcement. As discussed earlier, the primary anticompetitive effects of monopsony power are often felt at upstream levels two or three stages removed from the point at which the buyer power is applied. Unfortunately, federal antitrust law allows only the first level of victims to recover. This is the teaching of Illinois Brick. A number of states have authorized state antitrust actions on behalf of indirect purchasers, but so far federal law has not. Since the direct supplier of a monopsonist is unlikely to want to challenge its powerful buyer, the limit on indirect purchaser claims has a very strong limiting effect on private enforcement of the antitrust laws in buyer power situations.

While such attention to buyer power would have a positive impact on the analysis of future mergers and could provide a basis to challenge some collective conduct among existing buyers in agricultural markets, the fact remains that these markets have already become concentrated or highly concentrated and many aspects of buying power, as illustrated in both the cheese and Toys R Us situations, may not require collusion to bring about harm to the overall working of the market. Antitrust is particularly limited in its doctrinal capacity to respond to unilateral abuse of market power by firms with less than a "monopoly" position. Thus, it is unlikely that antitrust law can either police very completely the conduct of buyers in these concentrated markets or

bring about the kind of restructuring of those markets that would significantly reduce the incentives to exploit buyer power.

IV. Agricultural Market Specific Regulation and Its (Non-)Enforcement

There is a long history of government regulation of markets for agricultural products. The stated goals of this regulation include facilitating efficient, fair, informed and equitable markets to which all producers have reasonable access. Significant gaps in the coverage of these statutes, lack of essential implementing regulations, and a serious failure in enforcement have combined to create a context in which the problems discussed in Part II of this paper have festered and grown.

A. Legal Framework of Agricultural Market Specific Regulation

Starting at the beginning of the last century, Congress has adopted a series of statutes intended to provide a legal framework for agricultural product markets. An important element was provision of government grading and inspection to ensure both the safety of the products and guarantee that the producers got appropriate grades and weights for their produce. But grading standards did not and do not resolve other problems inherent in the markets for agricultural products-in particular the risks of opportunistic behavior by buyers. In 1920 Congress adopted the PSA that provided for direct regulatory oversight of business practices including payment obligations of buyers of livestock and prohibited unfair and discriminatory practices by slaughter houses, buyers and stockyards. It was the precursor of a number of statutes at both the national and state levels that seek to redress the balance between small business operators and their large customers or suppliers. Thus, the PSA is a blend of provisions controlling conduct based on considerations of fairness and equity and ones focused on avoiding broader anticompetitive effects. The PSA has a clear point of view-it instructs the Secretary to regulate the conduct of packers and stockyards to protect producers and consumers from unfair and discriminatory conduct. It confers on the Secretary of Agriculture expansive rule making authority to implement this mandate. Moreover, the PSA recognizes that harmful results can be either intended or the consequences of the decisions made by packers.

Overtime, the PSA was expanded to respond to the changed context of livestock production. First, the coverage of poultry processors was expanded to include within the PSA's coverage the current organization of the business. Second, livestock producers were given the right to sue for both damages and injunctive relief directly for violations of the PSA. Prior to that change the PSA was strictly a basis for federal regulation of the conduct of meat packers. The most recent farm bill revised the statute to ensure that current hog production contracts were included with its coverage.

Two points about the PSA deserve special emphasis. First, despite the broad authority given the Secretary to adopt regulations implementing the general terms of this statute, the USDA has never used this power. It has sought to develop some law on a case by case basis. The results in recent litigation have been negative. Second, the PSA only covers transactions involving livestock. Hence, despite its clearly articulated goals, the PSA has not provided a basis for controlling discriminatory, exclusionary, or other undesirable conduct in agricultural product markets generally.

The Agricultural Fair Practices Act (AFPA) prohibits specific kinds of unfair trade practices involving coercion of producers into joining or not joining associations. This is a recognition that buyers may be hostile to producer associations and can retaliate by discriminatory refusals to deal with those join such organizations. The case law enforcing this statute is sparse. In part this is a consequence of the fact that buyers can find many apparently legitimate bases to refuse to deal with any specific producer. The burden on the producer to disprove these claims is substantial. Because the statute does not provide for a reasonable attorney's fee if the producer prevails, the daunting nature of the litigation can further discourage its use. In addition, most production contracts contain arbitration clauses that preclude recourse to courts and often entail very restrictive conditions that give substantial advantage to the buyer if arbitration is sought.

The policy of the AFPA remains clear and consistent with the overall structure of the law in this area: it seeks to ensure producers are free from arbitrary and unjustified refusals to deal. Implicitly it acknowledges that in many parts of agriculture, the producer has very few alternatives. Hence, a refusal to deal by one of the few or only potential buyers takes on a much greater economic significance than would be the case if there were more buyers in the market.

These laws have clear common themes: Congress identified specific failures of the agricultural product markets to operate in fair, accessible and efficient ways and adopted specific statutory rules in the belief that these interventions would remedy the problems and restore competition on the merits. However, from a more inclusive perspective, the result is a series of ad hoc responses to particular issues and problems that has not been revised and made systematic to define a workable legal context for agricultural markets.

B. Evaluation of the Legal Framework

The present legal framework regulating agricultural product markets has three major deficiencies: the statutory authority is a patchwork, the USDA has failed to use its powers within the areas over which it has authority to develop appropriate, market facilitating regulations, and its enforcement of even the existing rules has been ineffectual. These failings parallel and reinforce the structural and conduct problems that confront these markets. The result is that the skeletal structure of law and public policy lacks the muscle and coordination necessary to have a substantial influence on the conditions under which most product markets operate.

1. A Patchwork Statutory Framework

First, the authority of the Secretary to police the fairness and equity of treatment in agricultural markets is limited and different from product market to product market. For example, the most pervasive statute, the PSA, applies only to livestock and poultry. No comparable authority exists to police grain or dairy contracts. As market structure and conduct akin to that in livestock and poultry markets come to dominate other sectors, it will be increasingly apparent that there is a need to provide comparable rules and regulations to ensure fairness in pricing and equal access to market opportunities for all farmers and ranchers.

AFPA only provides a limited protection against refusals to deal based on membership or non-membership in marketing groups. This statute recognizes the potential for unjustified exclusion

from the market. But its coverage is limited to a single issue and does not more broadly address the problem of unfair treatment or create criteria that provide workable tools to evaluate and remedy such exclusions. Moreover, the increasingly pervasive use of arbitration can further blunt the impact of such rights. The fundamental policy behind the AFPA is an essential element to facilitating workable market conditions, but its details and lack of rule making authority to define and clarify its application mean that its effectiveness is limited.

2. The Failure to Use Existing Rule-Making Authority

Congress can not continually write and revise regulations that are fine tuned to the needs of specific markets. This why it often delegates to an agency or department the obligation to draft and revise regulations that implement the basic statutory scheme. The various agricultural market statutes have a range of such authorization from the very sweeping authorization of the PSA to no explicit authorization in AFPA. Nonetheless, it is clear that the USDA has substantial authority to draft rules in a number of important areas and could use its inherent authority to promulgate interpretive rules as well as the more general right of agencies to adopt guidelines that codify agency interpretation which in turn can influence judicial interpretation.

The USDA has failed to use any of the authority given to it to frame rules to facility open, fair and accessible markets in light of prevailing marketing practices. This is a very serious weakness. The most obvious example is the failure over 80 years to use the rule making power of the PSA.

Left to their own devices, large buyers will, as the Attorney General of Oklahoma has opined, force contracts of adhesion onto farmers and ranchers. If the USDA does not define the scope of what is permitted in contractual arrangements, the incentives in the market process with dominant buyers and many, powerless sellers, will drive contracts toward the lowest level of protection for the sellers' interests and accord the buyer the greatest discretion over all aspects of the deal. For example, arbitration clauses in such contracts often deny the producer access to the courts and at the same time impose unfair and inequitable arbitration terms that effectively deny the producer all recourse. Confidentiality clauses keep farmers and ranchers from sharing information that would make them more sophisticated decision makers. Even price reporting is unavailable where buyers are very highly concentrated. What is frustrating from the perspective of preserving and improving an open, fair, efficient and informed transactional market, is the failure of the USDA to use the powers it does have to develop such policies and regulations where it has authority. Such efforts would simultaneously highlight the gaps in its jurisdiction.

It is important to appreciate here that market facilitating regulation includes creating safe harbors and other rules that make clear that buyers do have legitimate discretion with respect to some aspects of their actions. Regulation could define "fair" arbitration clauses and as well as condemn unfair ones. It can specify the subjects that may be arbitrated and those that may not.

Political will is necessary for rule making. The great economic power of the large buyers translates into substantial political power as well. In addition, there are important groups of producers in the livestock area that gain or believe that they gain from the present system. Hence, the trade associations and farm organizations have not spoken with a single voice on these issues. Interestingly, it appears that many farmers and farm leaders recognize the need for specific

reforms but have not found a way to generalize that interest into effective political action. The dispersed farm community thus suffers many of the same problems in carrying forward a legislative or administrative agenda that it faces in the marketplace.

3. Enforcement of the Existing Laws

Third, regulations, however good, have little effect if there is no enforcement. While farmers and ranchers can bring individual cases or class actions, such efforts are very time consuming and may focus more on specific private concerns and less on the broad public interest in ensuring open and fair markets. Moreover, unless those suits directly develop or enforce relatively clear rules, their impact on future conduct can be quite limited.

Thus, effective public law enforcement is essential to the creation and maintenance of fair and open markets. This is the lesson of antitrust law and securities law to name but two examples. In both fields, the government agencies have set policy both directly and through amicus participation in key litigation. In contrast, there is widespread recognition that the USDA has failed badly in its responsibilities to police and enforce the rules that do exist. These persistent failures are the object of bipartisan concern in Congress and a source of great frustration to farmers and ranchers who look to the Department to protect their interests.

The current staffing and structure of enforcement almost ensures that little will be accomplished. There is a disjointed structure to the USDA's own enforcement efforts. GIPSA deals with meat and grain. Another part of the Department deals with cooperatives and still others focus on market information. The GIPSA division charged with enforcing the PSA is largely staffed with economists and not lawyers. It lacks the authority as well as the staff to initiate actions. Instead, proposed cases must be referred to the general counsel's office that itself is seriously understaffed and appears to require that any matter be re-investigated before any action is initiated. The end result is that there is very little enforcement.

In sum, despite a consistent basic legislative message concerning fundamental policy toward dysfunctional agricultural markets, the statutes lack necessary scope and coverage. Furthermore, the USDA has failed to use the powers it has to facilitate the more efficient, transparent, fair and accessible goals that underlie these statutes. Finally, its very modest efforts to enforce the existing law lack focus, appropriate organization and staffing. The result is that the law has had little positive impact in nudging markets for agricultural products toward more socially desirable conduct.

IV. Reform of the Law and Its Enforcement: An Idealized Vision of Legal Reform for Agricultural Marketing Regulation

When Congress embarked on a major review of agricultural policy in 2002, there was active advocacy for including a title on competition issues. This might have lead to an effort to revise and restate the law governing agricultural product markets in ways that are more applicable to modern conditions and provide for more general coverage of the basic policy principles found in those laws. The proposal also included efforts to identify the means for effective enforcement of these regulations through an appropriate combination of public and private mechanisms. Not surprisingly, it encountered major opposition from those on the buying side of these markets. It

was eliminated in the Senate committee in favor of seeking more immediate economic gains for specific agricultural interest groups.

In its place, the Senate adopted a proposal to prohibit packer ownership of livestock and a revision of the PSA to cover current hog raising contracts. The "packer ban" is the current flash point of popular farm concern. Such a focused constraint on the process of procuring livestock would probably have only limited significance, but it was fought bitterly by the major meat packers and their farm allies who currently benefit from the differential price advantage accorded captive suppliers. Although the packer ban was twice approved in the senate, it was deleted in conference.

Implicit in the analysis of antitrust law and market specific regulation of agricultural product markets is an agenda for reform. In the case of antitrust, most reforms can only be accomplished through internal changes in enforcement and policy interpretation. But Congress can play a role in spurring those changes. The one exception is changing the law about the right of indirect purchases to claim damages under the antitrust law for their injuries. In area of market specific regulation, both ideal reform and the politically more practical specific reforms require Congressional action if they are to happen.

A. Making Antitrust Law Relevant to Agricultural Product Markets

As the earlier analysis showed, a central problem in antitrust enforcement is the lack of clear standards specifically related to the risks posed by monopsony and buyer power. Current guidelines for enforcement of the antitrust law either do not discuss these issues at all or do so in the most abbreviated and cursory fashion. This is most troubling in the area of merger enforcement because this is the field where antitrust law has the greatest potential to limit the harms that concentrated buying power can create. It is evident that buyer power can create anticompetitive potential even if the share of buying market is modest. In addition, the effects of buying power can occur in markets remote from the selling market on which the government is likely to focus in doing its traditional analysis. Similarly, the incentives for and harmful consequences of collusive and interdependent conduct in concentrated buying markets are different from those in comparably structured selling markets.

If buyer power guidelines are created this will focus enforcement and ultimately lead the judicial system to take into account these concerns in both public and private litigation.

The second imperative is that the government antitrust law enforcers, both the Antitrust Division and the FTC, need to be more active in enforcing both merger and restraint of trade law. It is offensive to hear spokesmen from the Division say to farmers that they must come to Washington with a ready made case before the Division will do anything. The government has the resources, skills and legal power to conduct effective investigations. The problems with cheese, turkey, beef, hog, milk, and grain marketing practices are known and visible. Each involves real potential that the conduct involves collusive or monopolistic behavior having clear anticompetitive effects. But in none of these cases, so far as I know, has the Division or the FTC even conducted an investigation. Certainly, except for a few merger cases, neither agency has initiated any litigation. This is a woeful record of inaction.

Third, it may be time to repeal the Illinois Brick limitation on indirect purchaser claims under federal antitrust law. The growth of state law based cases has caused even defendants to look with greater favor on focusing all claims, direct and indirect, in a single court. Without the repeal of the indirect purchaser bar this can not happen. As discussed earlier, such a repeal would be particularly important to private actions challenging abuses of monopsony power.

Finally, there is a great need for much greater transparency concerning agency decisions. It is very troubling that the public can not learn why the Division choose not to challenge the Farmland's acquisition or what the bases were for its settlement in the Suiza-Dean merger that created a single firm controlling 30% of all fluid milk purchases in the country. Because we do not know why the agency made these decisions, we can not as effectively criticize the specific action. Representatives of the agency can piously claim that it considered any issue that is raised. As a critic of the observed end result, I do not in fact know whether the issue really was considered, what facts were found, what standards were used for determining the merits of the issue, or the standard of proof imposed on factual claims. Worse, if I do not know, neither do members of Congress who must oversee the actions and decisions of the Division to ensure that it is carrying out its mission appropriately.

This committee can insist on fuller disclosure of the reasons for actions and for inaction. It can command that representatives of the agency set forth their enforcement standards and policy for the analysis of buyer power. It can then invite scholars and practioners to review and comment on those decisions, standards and policies. In this way, it may be possible to make the Division more forthcoming as to its present activities and, perhaps, induce it to take steps toward improving its policies and stepping up its enforcement.

B. Reforming Agricultural Market Specific Regulation

1. The Ideal Response: A Comprehensive Statute with Effective Enforcement

The broad public policy of Congress, consistent across a wide range of specific pieces of legislation, is to facilitate a transparent, accessible, open, and fair, competitive market in agricultural products. Dominant firms gain strategic opportunities from ill-defined market situations. They have the resources and incentives to impose their own, self-serving order on such contexts. The public market will wither under such an onslaught. Moreover, strategic behavior will play a major role in defining contractual relations that will arise out of the ruins of the public market. Hence, legislation and regulation become essential antidotes. The underlying model of the workably competitive market that motivates and informs antitrust law provides useful guideposts, but, as discussed earlier, antitrust alone can not provide the necessary facilitating regulation essential to overcoming the dysfunctional aspects of contemporary agricultural product markets. Moreover, implementation of these policies requires a public agency is ready, willing and able to act.

The basic structure for public policy is clear:

1) regulation should facilitate efficient market transactions whether in transactional markets or through longer term contractual relationships;

2) it should limit the opportunity for strategic behavior to reduce the incentive to engage in unfair or discriminatory conduct;

3) it should require open access to all major methods of buying agricultural proudcts whether those are transaction or contractual in character;

4) it should mandate full and timely disclosure of relevant information to all market participants.

The first element is the most important. The testimony of Professor Koontz to the Senate Agriculture Committee concerning livestock markets provides a useful illustration of the kinds of actions required. He suggested that the USDA needs to be much more pro-active in developing new grading standards and certification systems so that the transactional market can provide a place in which buyers can readily find the kind and quality of animal that they sought. It is not enough he points out to be concerned with bad practices, the government must be take the initiative to modernize the spot market and related market transactions to facilitate desired transactions.

This point applies generally. Government must take the initiative to facilitate workably competitive, efficient market contexts. Public markets in agricultural products have not and will not happen on their own in equitable and fair ways. The powerful economic interests of buyers at stake in these markets will shape them to serve those interests. The role of government is to restore the balance and facilitate the equitable development of the market.

Second, the law should minimize or eliminate the unfair, strategic, inefficient conduct of powerful buyers. In a lawless market, economic power is unchecked. That which is rational for individual, powerful economic actors is not necessarily fair to the parties on the other side of the transaction or, more importantly, in the best long run interest of economic efficiency. The best method for achieving this objective is to limit the ability of dominant buyers to select terms and impose conditions in their buying programs. The adoption of standard forms for transactions, public disclosure, and significant sanctions for violation of the standard procedures make it more costly for a dominant buyer to seek to engage in strategic behavior. This element also should include safe harbors that define acceptable terms that may in fact be rational elements to an efficient contract.

Third, open access to the market is another essential element. As buyers move away from reliance on spot markets in which sellers can easily participate by shipping livestock or other commodities to the market, they have the capacity to pick and choose among specific suppliers in ways that can be harmful to the supplier. If the buyer finds the open, public spot market unacceptable, then the contractual or other transactional market context needs to be defined in a way that gives all willing sellers equal opportunity to participate. The goal is to ensure that all producers have the ability to compete for forward contracts to supply livestock, milk or grain, and that the pricing is done in a way that limits the capacity of the buyer to manipulate price by its future transactions. Although the access rights would have to be product specific, the same fundamental goal should govern the regulatory process. Such reforms also reduce the scope for strategic conduct by buyers.

Fourth, information disclosure needs to be a central policy objective. As discussed earlier, dominant buyers have in many circumstances strong incentives to conceal or even misstate their buying activities. Recent legislation has sought to require more disclosure of buying information with respect to livestock. Not surprisingly, it was vigorously resisted by the packers and the resulting disclosures are of limited value because they exclude information from the most highly concentrated markets. Yet these are exactly the ones where full information is most needed and least likely to be provided absent government regulation. In an idealized world the law would command that all such information be provided to sellers.

This idealized reform could be accomplished through a foundational statute analogous to the PSA. It would establish broad goals for agricultural market processes: transparency, fairness, access and efficiency. This authorization would include rule making authority so that the activity and product specific regulations could be adopted along with an effective set of incentives, public and private, to adhere to the regulations.

New legislation with broad rule making authority is necessary for reforming agricultural product markets, but it is not sufficient. There must also be a willingness to use the authority to develop rules and enforce them. The current structure of the USDA disperses the market facilitation responsibilities among a variety of bureaus and administrative divisions. This makes it much harder to achieve a coordinated reform program that takes account of the interaction among the various elements of the legal system that can and should facilitate efficient and effective markets. The same problems exist on the enforcement side. An idealized reform would clearly have to create a new and more workable structure for developing regulations and enforcing them. Perhaps Congress should transfer these duties to an independent agency or assign them to the Federal Trade Commission.

This ideal would not resolve important problems in agriculture. There would still be the potential for excess production especially when subsidy is keyed on output. Effective market facilitation would not address directly the serious problems of pollution of water and air resulting from very large feedlots for hogs and cattle or from the vast herds of dairy cows established in the west. These issues involve other aspects of the economic process. The distribution of subsidies in the form of direct payments as well as in the allowance of externalizing costs illustrates a different level of the economic issues arising from agriculture. Who gets a subsidy on what basis will strongly effect the options for economic success in any branch of agriculture. Similarly, if operations with large numbers of animals are not required to compensate for the burdens they impose on adjacent property and the harms they impose on water and air quality, that will significantly change the economic calculus for investors deciding on the scale and type of animal operation in which to invest.

2. Incremental Improvements

Congress and the members of this committee should not wait, however, for the kind of ideal solution that I have just suggested. While I remain hopeful that the continued crises in agricultural product markets will induce a stronger legislative response, realistically that is going to take a long time and great deal of consensus building. By then, so much of our farm community may have been lost that the remedy will arrive too late to salvage a viable family

farm system. Hence, it is important to proceed with more focused legislation until such time as a more global reform becomes possible.

Two specific focused proposals deserve particular attention. First, S. 91 offered by Senators Grassley and Finegold would prohibit arbitration clauses in livestock supply contracts. The parties could of course agree to arbitration at the time a dispute arose, but recourse of the courts would be available as well. While this legislative patch is limited to livestock contracts, it is of great importance because it will give farmers and ranchers greater opportunity to protect their rights by access to fair and open legal process. It is more absolute than my idealized response, but the failure of the USDA to use its existing powers to impose a more nuanced solution makes such categoric legislation necessary. Congress is not in a position to write nor is the USDA prepared to interpret and enforce a more complex regulatory scheme.

Second, S 1044 proposed by Senator Enzi and others would regulate the use of supply contracts, limited once again to livestock markets. Hereto, the statute is a patch made necessary by the failure of the Secretaries of Agriculture of both parties for many years to use the power conferred by the PSA to develop fair contracting rules for livestock and poultry markets. I prefer this proposal to the so-called "packer ban" because that ban did not address the most important concerns which are with the contracting and captive supply activities of the slaughter houses.

Both of these proposed patches to the PSA are good ideas and should be adopted. They are both limited to livestock and so fail to provide protection or facilitation to the more general process of contracting that is expanding in all agricultural markets. These limitations highlight the need for a more comprehensive approach to facilitating fair, open, transparent and accessible markets in all agricultural products.

Conclusion

Monopsony power in agriculture is a growing threat to the operation of agricultural product markets. It is vital that the law be used to both limit the growth of this power and to regulate its use. Both consumers and producers will be better off if both antitrust law and market specific regulation are directed at the problems that have arisen in this area. It is my hope that the members of this committee will use their influence both to bring about legislative change and to insist on more active and effective enforcement of the existing laws that address these problems.