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Food, Agriculture, and Antitrust: Looking at the Recent Past

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USDA Economists Group Talk

October, 2009



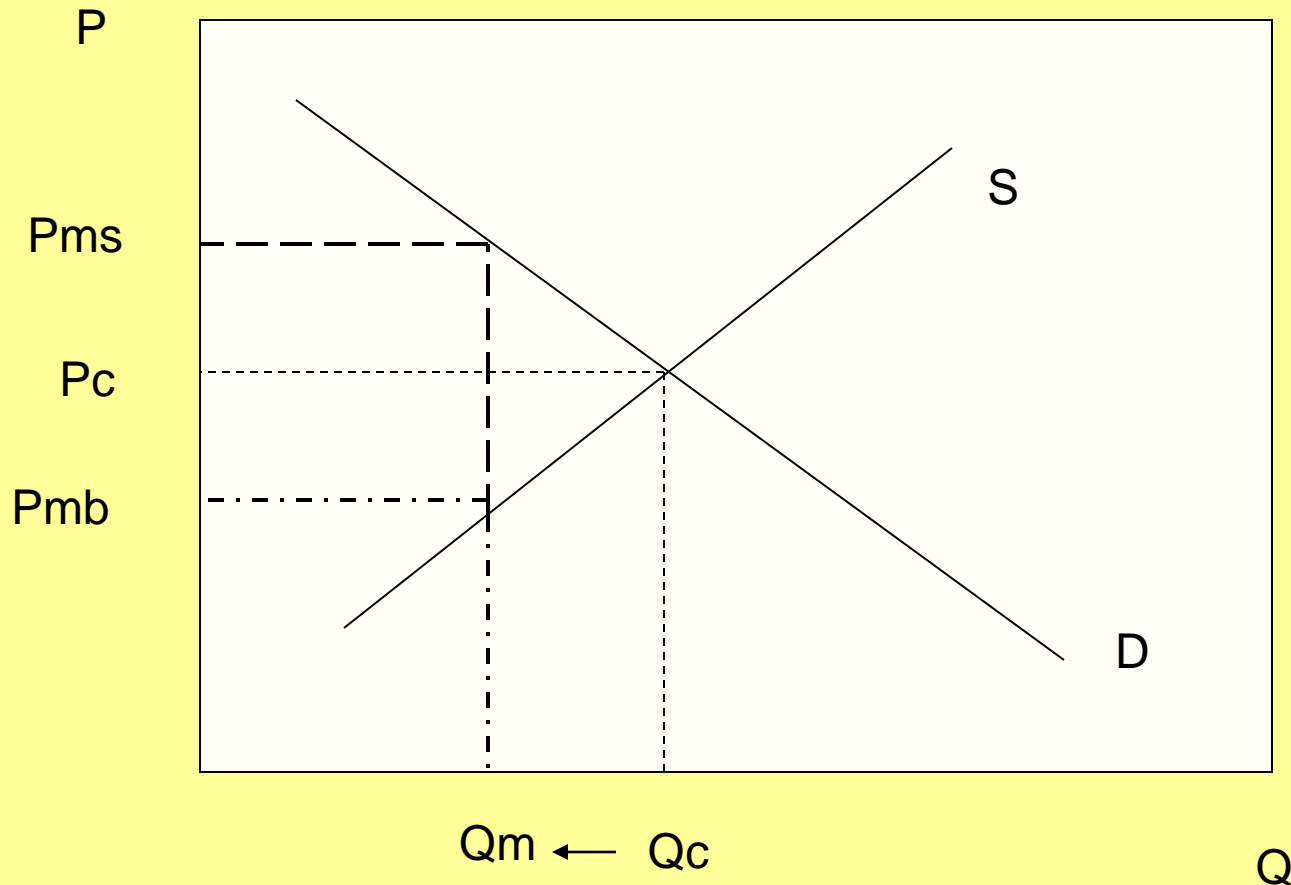
Why This Title?

- USDA-DOJ Task Force and Workshops
 - Has drawn a lot of interest
 - I can't speak for them, or report on them
- But I can provide a framework
 - What are antitrust issues?
 - What antitrust issues have arisen in the food system?
 - How might concentration fit?

Basic Antitrust Topics of Coverage

- Explicit collusion (conspiracy)
- Mergers
- Practices that facilitate tacit collusion
- Practices that create or extend unilateral monopoly

The Starting Point is Welfare: Consumer and Producer Surplus



Explicit Collusion

- Agreements to fix prices or limit output
 - Criminal violation: jail time, fines, treble damages
 - Focus is on detecting conspiracy (The Informant!)
- There was a major policy change in the 1990's
 - Increased use of jail time
 - Increased fines
 - Leniency programs

Explicit Collusion—Important Food System Cases

- Lysine (1990's)
 - 3 jail terms, \$100m in fines, plus treble damage suits
- Animal & human vitamins (1990's)
 - 1 jail term, \$875m in fines, plus treble damage suits
- Herbicides (2003)
 - 3 prison terms, \$30m in fines
- Smaller cases in school milk, NYC school lunch (16 jail terms), cattle buyers, mushrooms (civil)

Collusion Policy Isn't Overtly Ideological

- No significant shifts between Clinton & Bush
- Potential policy shifts are subtle
 - Resources
 - Carrots & sticks (ie, leniency programs)
- No change in U.S. legal standards in many years

Mergers: Background

- Charge to DOJ/FTC is to prevent those mergers *likely to reduce competition*
- Focus is on *likely price effects of merger*
- Merger guidelines focus on relevant market, level and change in concentration, ease of entry, and buyer behavior

Some More Merger Background

- Elite opinion matters for merger policy
 - Judges, academic lawyers, economists, & practitioners
- Elite opinion changed a lot over 40 years
 - Toward less of idea that \uparrow concentration necessarily means \downarrow competition
 - Based on plenty of evidence. But partly on ideology?
- Also, merger policy has become more regulatory
 - Negotiated settlements common

More Mergers Background

- Why should we care about mergers? Because collusion policy is about conspiracy, not prices or market power
- In principle, existing monopolies may be attacked (eg, AT&T)
 - But remedies are radical, & actions are costly & rare

Mergers: Food System Cases

- Seeds: Monsanto-DeKalb; Monsanto-Delta & Pineland; Syngenta-Advanta
- Equipment: Case-New Holland
- Grain: Cargill-Continental Grain
- Packing: JBS/Swift-Smithfield-National & Smithfield-Premium Standard
- Dairy: Dean Foods-Suiza

JBS Case Provides Useful Background

- 5/07: Brazilian-based JBS buys Swift (#3)
- 3/08: JBS/Swift buys National Beef (#4)
- 3/08: JBS/Swift buys Smithfield beef assets
 - Four slaughter plants (#5) & ten feedlots
- Steer and heifer CR4 would go to 85 from 81
- 10/08: DOJ files suit against acquisition of National; does not oppose Smithfield purchase.
- 2/09: JBS drops acquisition of National

The Smithfield Part of the Merger: Interesting but Irrelevant

- Irrelevant for antitrust purposes
 - Smithfield owned cow plants
 - Different input market (cows vs. s&h)
 - Different product market (ground beef)
 - Different locations (PA, WI, AZ, MI)
 - Implies no effect on prices
- Relevant market is steers&heifers/boxed beef
 - For s&h, a regional market?

National Beef was Relevant for Antitrust

- S&H procurement market is regional
 - Most cattle sellers (feedlots, usually) would see 3 potential buyers instead of 4, and DOJ argued that a CA/AZ market would go from 2 to 1.
- Boxed beef market is national and global
 - US boxed beef CR4 would rise a little
 - But really it would mean 3 sellers instead of 4

Would the Merger Lead to Efficiencies?

- There is evidence of scale economies...
 - 1980's consolidation led to lower costs, prices
- But...
 - 1980's consolidation realized bigger plants
 - Limited evidence of further scale economies
 - And you don't need mergers for bigger plants
 - And authorities are sceptical of efficiency claims

Would One Less Competitor Affect Prices?

- Broad empirical evidence: Cournot matters
 - Numbers matter, but at diminishing rate
 - But judges often want to believe in pure Bertrand
- Lots of cattle and beef studies, but they weren't directly relevant
 - Limited evidence of market power at existing levels of concentration
 - But, there's a mystery to that (why do packers compete?)
 - And, this deal would remove a competitor

Aside: Stock Market Evidence

- If the merger were to make Swift/National a lower cost competitor...
 - What should happen to the profits and stock prices of Tyson and Cargill (#2 and #3 packers)?
- Alternatively, if the merger were to lead only to reduced competition...
 - What should happen to the profits and stock prices of Cargill and Tyson?

Aside: Stock Market Evidence

- Cargill is privately held (no stock quotes)
- But Tyson Foods stock...
 - Rose 8.5% on announcement of deal
 - Fell 4.0% on announcement of DOJ opposition
 - (each is relative to overall market)
- And Smithfield (competes as pork processor)
 - Rose 4.5% on announcement of deal

Compare to Smithfield-Premium Standard

- 9/06 Smithfield announces purchase of PSF
 - DOJ closes investigation in 4/07
- PSF raised about 4.5% of US hogs, and had slaughter plants in MO and NC (4% of US capacity).
- Smithfield raised 14% of U.S hogs, and processes about 27% in NC and Midwest
- Procurement CR4 would ↑ to 66 from 62

Issues in Smithfield-Premium Standard

- Pork market: national
 - Multiple competitors and recent entry (Triumph)
- Key issues fell to procurement markets
 - Independent, for hogs, and contract, for growers
 - Regional markets for market hogs, larger for pigs
- DOJ argued that merger would not affect prices in MO—other packers and growers
- NC: DOJ argued that producers could ship to Midwest

Merger Policy Summary

- Defining the market is crucial
 - Then, will removal of this competitor impact prices?
 - Small numbers (4, 3, 2) matter
 - Specific relevant price evidence usually lacking
 - Evidence on entry barriers matter
 - Evidence on buyer mobility matters
 - Can they find alternatives?

Comments on Merger Policy

- There's a broad elite consensus, and change happens at the margins
 - You can lessen enforcement by not bringing cases
 - To expand enforcement, need to convince judges
 - That is, you need to win the case
 - You also need merger attempts to develop an expanded policy

That Brings Us to Practices

- *Facilitating practices* that limit the intensity of price competition among competitors.
 - Example (Rich Sexton): whole-dollar bids and MFN clauses in markets for fed cattle
- Practices that create or extend monopoly
 - Tying, network refusals to deal, exclusionary pricing, exclusive dealing
 - Example: Dentsply (dominant seller of false teeth refused to provide top line to dealers who carried other brands).

Price-fixing is per se illegal, but mergers and practices are rule of reason

- That means weighing efficiency and market power elements—particularly for practices.
- Concentration & market power matter a lot: it's easier to facilitate among a small number of players, and easier to create/extend if there are few options for players on the other side.

Food and Agriculture are Interesting in this Regard

- Lots of concentrated markets
 - Input markets: seeds (& chemicals), some equipment, rail transport,
 - Product markets: livestock & dairy processing; some grain processing, retail?
- Lots of changing markets
 - Shifts to larger farms everywhere
- Lots of politics, especially this year

Food and Agriculture are Interesting...

- Lots of distinctive contractual relationships and business practices
 - Production contracts
 - Some marketing contracts
 - Markets for seed and for associated ag chemicals
 - Coop exemptions
 - Retailer procurement arrangements

What's Coming? (my opinion)

- Workshops can provide more information on practices, which are poorly understood
 - Will also generate complaints, some relevant
- Practices are where policy change can be made
- Mergers: need test cases for more aggressive policy