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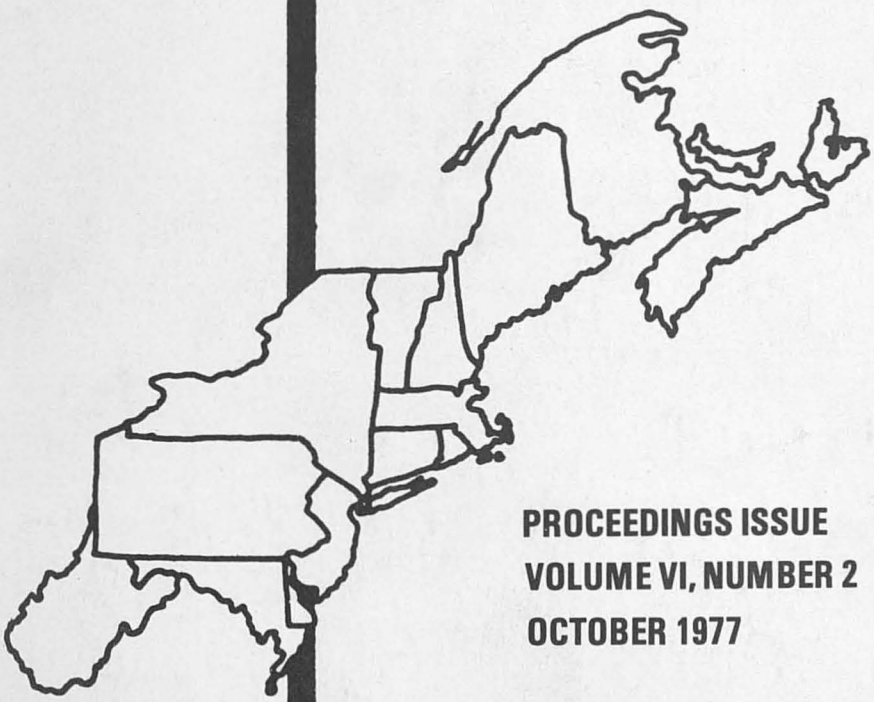

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THE POTENTIAL IMPACT OF INDUSTRIAL DECONCENTRATION AND SOME RELATED QUESTIONS ABOUT CURRENT ANTITRUST ACTIVITY IN THE MILK INDUSTRY

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Industrial deconcentration or restructuring refers to the break up or diffusion of large firms in markets with high concentration. The idea of carving up large companies into two or more separate entities is not new. A number of prominent economists, including Stigler, Kaysen and Turner, and Mueller, have argued persuasively for just such an action /16, 8, 11/. Since passage of the Sherman Act, the courts, while generally reluctant to perform surgery on large firms, have ordered corporate split-ups in at least 26 cases /15/. Some of the early orders were quite drastic, including the division of Standard Oil of New Jersey into 33 parts, the break up of American Tobacco into 16 pieces, the splitting of DuPont into three separate powder manufacturing firms. With the exception of the Pullman and Paramount cases in the 1940's, both of which are of interest because they involved vertical as well as horizontal dimensions of market power, more recent divestitures have been mild.

Still, pressure is even now being brought to bear for the break up of large companies: rumblings are heard about breaking up the giant United States oil companies. The Federal Trade Commission recently announced it was prepared to bring suit to split up General Motors. But the courts have been reluctant to perform surgery on huge firms; since the mid 1950's only a few divestitures — all of them small — have been ordered. Meanwhile, absolute size of firms, concentration, and market power within the economy have been steadily increasing.

There are a number of reasons for the lack of deconcentration activity under existing statutes /5/.

Current legislation is inadequate for restructuring concentrated industries. The Sherman Act is vague. Economists and lawyers have debated the meaning of the word "monopolize" for over 50 years. As a consequence, antitrust action is much more likely against anticompetitive conduct or corporate behavior than against the possession of monopoly power as such. Even if federal antitrust agencies were willing to vigorously enforce legislation to restore greater competition in concentrated industries, there are serious impediments. First, the cost of litigation in large "monopoly" cases is overwhelming. Present appropriations are inadequate to permit pursuing the Section II Sherman Act standard against the vastness of concentrated

industries, let alone against the very large firms within them. Second, manpower limits exist in federal agencies. Third, large firms may use political power to apply pressure on officials.

The Hart Bill: An Example of a Deconcentration Proposal

To implement industrial deconcentration on a national scale, it would be necessary to redefine market or monopoly power quite specifically.

One example of such a restructuring proposal is legislation introduced in 1973 by the late Senator Philip Hart — "The Industrial Reorganization Act" (S. 1167)—which would enable restructuring where industries are concentrated and where market power exists. This act was designed to:

1. Provide a strong congressional mandate for a vigorous policy to restore competition in concentrated industries through "judicious industrial restructuring in key industries."

2. Overcome the problem of definition of monopoly power in present legislation. Possession of monopoly would be specified by standards.

3. Establish an organizational and procedural framework that could expedite relief in the most important segments of the economy by:

   (a) establishing an Industrial Reorganization Commission for the purpose of enforcement;

   (b) establishing a special Industrial Reorganization Court that would provide a panel of judges to deal with cases originating under the act.

4. Authorize the commission and court to explore a variety of ways for reorganizing an industry to enhance competition. The Industrial Reorganization Commission could explore methods of increasing competition beyond those available to the Industrial Reorganization Court. For example, it might recommend that government actions be taken to encourage new entry into an industry; in others it might consider the desirability of establishing government owned enterprises in highly concentrated industries.

The industrial reorganization bill provided that "there shall be a rebuttable presumption that monopoly power is possessed" by any corporation that persistently earns after tax profits exceeding 15 percent, if there has been no substantial price competition among two or more corporations for a period of years, and if four or fewer corporations account for 50 percent or more of sales in a relevant economic market.

A corporation falling within these criteria would have the burden of rebutting the presumption that it had monopoly power. Three defenses against such a charge would be allowed:

1. The degree of concentration was due solely to the required economies of scale needed to run an operation of efficient size.

2. The market power stemmed from demonstrable superior efficiency and innovativeness.

3. The size of the firm resulted solely from the ownership of valid patents.

Applicability of Deconcentration Policy to the Dairy Industry

There is good rationale for looking at the dairy industry as an example of the potential impact of a deconcentration policy such as that embodied in the Hart Bill. The nation's seventh largest manufacturing industry, fluid milk, has been the focus of more antitrust action than any other agricultural product industry. In fact, one of the most significant restructuring decisions in recent times was in the dairy industry. In the early 1960's the FTC ordered the four largest dairy companies to divest themselves of 289 firms they had acquired over the years, and, in effect, banned them from further merger activity for a 10-year period. The commission also successfully challenged the acquisition of a leading Chicago dairy company by Dean Foods, a regional firm that ranked 12th among leading dairy companies in 1967.

More recently, antitrust activity has focused on the large regional dairy cooperatives. Far reaching consent decrees on the future conduct of the two largest, Associated Milk Producers, Inc. and Mid-America Dairymen, Inc., have been obtained, including the divestiture of three Mid-America plants. The Government's case against Dairymen, Inc. is still pending at this time.

The latest antitrust attack on the industry has been aimed at regulatory institutions affecting the industry, the Federal Milk Marketing Order Program and State Milk Control. Cooperatives are alleged to have utilized the former to seize market power. Processors should be viewed as the primary beneficiaries of the latter.

Not only has there been a long history of intense antitrust activity in the milk industry; the structure of the industry, which has been detailed in numerous studies /9, 14, 20/, strongly suggests that considerable fragmentation would be expected to occur under a deconcentration policy such as the Hart Bill.

On the producer side, over 86 percent of the dairy farmers in Federal order markets are members of cooperatives. Mergers among cooperatives, particularly in the central and southeastern regions, have resulted in a single large cooperative becoming the dominant supplier of raw milk for many markets. In about half of 61 Federal order markets, the dominant cooperative represented at least 75 percent of all producers in the market in 1973 /19/. To the extent that federations among cooperatives exist, this figure understates actual concentration at the first handler level. In recent years, cooperatives have successfully bargained for premiums, sometimes substantial, over the minimum order prices.

Recent research strongly suggests that functions performed by coop-

eratives such as procurement, supply balancing, and surplus disposal and manufacture require a great deal of regional coordination and economies of scale for technical efficiency. For example, 10 million pounds of milk a month is required for a butter-powder or cheese plant to be reasonably efficient in terms of plant costs /1/. It is thus doubtful that the four firm concentration standard of 50 percent specified in the Hart Bill would be applicable.

However, under a deconcentration policy, it could be argued that there should be considerable fragmentation to place the cooperative sector on the same footing as a deconcentrated processor sector. There would be strong likelihood under such a policy of fragmentation of the interregional co-ops, cessation of marketing agency-in-common activity, and split-ups where feasible of local market cooperatives whose market share exceeds 50 percent.

On the national level, the milk processing industry is not highly concentrated. The largest four firms accounted about 19 percent of packaged fluid milk production in 1970. The perishability and bulk of milk, however, dictate that relevant markets, although they have widened considerably in recent years, are still quite localized. Sales accounted for by four firms in most markets are well in excess of the 50 percent criterion specified by the Hart Bill. Based on a minimally efficient sized plant of 40,000 quarts per day, the FTC has concluded that local market concentration in major markets is considerably higher than that justified by economies of scale /14/. Thus, the economies of scale defense would not likely be available to processors under a restructuring policy[1/].

Retail chains, a powerful force in the milk market, have continued to integrate backward into milk processing. Today, grocery chains process about 20 percent of the nation's output, up from less than 5 percent in 1964. More chain store integration has occurred in large markets, markets with high seller concentration, markets with high buyer concentration, and markets with state milk control.

There is no question that potential integration by chains has resulted in increased price competition among the remainder of the industry. There is little evidence that the chains, once integrated, have been price competitive. Nor does actual integration generally stimulate price cutting by other firms /14/. Restructuring would force many chain store plants to be spun off in markets with high concentration in dairy sales and/or food retailing[2/].

1/ The minimum viable sized plant is undoubtedly larger today. Mueller, et al, state that it may lie in the 40-80,000 quart range, but still conclude "that high seller concentration is not necessarily inevitable despite the substantial increase in economies of scale in production" /12 p. 30/.

2/ In 1972, average 4-firm concentration of food retailing in Metropolitan Markets was 52 percent.

Cooperatives are increasingly integrating forward into fluid milk processing, accounting for over 11 percent of national sales in 1970 /9/. The relatively small size of most cooperative plants would mean little impact of restructuring in this industry sector, except for plants owned by regional cooperatives.

In summary, under a national deconcentration policy, it appears that the milk industry might be forced to undergo some rather dramatic structural changes at the producer, processor, and retailer levels.

Potential Impact of Deconcentration

It borders on conjecture to speculate on the effects of restructuring the milk industry or any industry. Complicating the issue for milk is the morass of regulatory institutions under which the industry operates. It is reasonable to assume that even with restructuring the Federal order system, with modifications, would continue to exist. It is interesting to note that attacks on the Federal order system have targeted the interrelationship by order provisions with the activities of major cooperatives — not on the order framework itself.

Producers. Ippolito and Masson estimated annual monopoly losses from large cooperatives at $60 deadweight loss and $150-$200 for overorder premiums /7/. The latter figure is inflated because the overorder premium actually contains three components:

1. A charge for marketwide services such as procurement, quality control, testing, field services, payroll, advertising, and supply balancing;
2. A charge for individual handler services; and
3. Admittedly, a market power component.

Ippolito and Masson incorrectly charge that the entire premium is monopoly distortion. The Justice Department states that if the premium is a service, one would anticipate that it would vary among handlers depending on the level of services provided. The major producer cooperative in the Southeast, Dairymen, Inc., does in fact do this. Discounts from the announced price of 8 cents per cwt. are offered for accepting milk at producer weights and tests rather than tanker weights and tests. A discount of 20 cents is offered for receiving milk on Saturdays, Sundays and certain holidays. A surcharge of 20 cents is added for any change in plant orders with less than 48 hours notice. Justice also contends that if premiums reflected services, they would be assessed on all milk, not just Class I milk. Dairymen, Inc. currently is charging premiums of 46 cents on Class II sales and 36 cents on Class III sales. These practices serve as an example that some co-ops do attempt to base charges on level of services offered, but this is impossible for the marketwide services, as they accrue more or less equally to all handlers.

This disagreement aside, let us assert that $210 million per year represents the reduction in receipts to members of co-ops extracting over order payments under deconcentration. It would be a certainty that increased

competition among cooperatives would make it impossible to maintain the "nonfunctional" portion of the premium under a dispersed industry. This would translate into about a $.40 per cwt. reduction in farm level Class I prices and a 1.8 percent decrease in total cash receipts from dairying in the United States.

This would not be spread equally among all Grade A producers, but would impact mainly upon current members of the large cooperatives. Independent producers and members of small local co-ops would stand to lose whatever "free rider" benefits they presently get, but would be assured of continued freedom of action and absence of predation.

Partially offsetting the above income loss, and accruing to all producers would be increased consumption of fluid milk because of lower retail prices. Assuming an elasticity of demand of .4 and current quantities and prices, this would amount to approximately $60 million. Also, offsetting the income loss would be lower prices for some operating inputs purchased from previously concentrated sectors.

Processors. Using multiple regression in a study of 144 markets, Manchester estimated that marketing margins increased by .0215 cents per half gallon for each percentage increase in the four-firm concentration ratio /9/. Suppose a deconcentration policy succeeded in reducing the average concentration ratio by 20 points. One can draw a crude conclusion that the result might mean a reduction in processor margins (and retail prices) of almost one cent per gallon[3/].

Increased price competition would be anticipated at all levels of the processing industry, reducing profits. The trend toward extinction of the small independent processor would likely accelerate, although medium sized independents (with plants in the 20,000-40,000 quart range) might have good opportunity to grow by merger and acquisition. To the extent that deconcentration affected input industries such as trucks, plant equipment, cartons, and the like, a partially offsetting cost savings would accrue to processors.

Retailers. Since food retailing is more concentrated at the relevant market level than milk processing, one might anticipate even greater savings from deconcentration there. It would be even more speculative than in the areas above to attempt to quantify such market power losses.

General Public. It is rather obvious that consumers would be the beneficiaries of a deconcentration policy. My belief is that the estimates of monopoly loss cited here overestimate losses from the producer sector and underestimate them at succeeding levels of the market channel. Nevertheless, one can still conclude that significant cost reductions in the consumer price of milk would be a result of an industrial restructuring policy. Revisions of the Federal Order Program and elimination of State

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3/ This would result in an additional offsetting gain to producers of about $10 million.

Milk Control, which would surely accompany restructuring, hold the promise for perhaps even greater benefits to consumers.

Deconcentration Unlikely

Based on the analysis of the possible impacts on the dairy industry above, it would seem that industrial deconcentration is a policy alternative that merits society's serious consideration. But this is just the tip of the iceberg. Scherer estimates total annual loss from market power at 6.2 percent of GNP /15/. Some economists believe that the social loss is less than this but Scherer believes his estimate to be moderate, even if not precise. At current GNP levels, Scherer's estimate would translate into a possible savings to society of over $100 billion per year from eliminating excessive market power from the economy by means of an industrial restructuring policy. Farmers in general, even though not typical Grade A milk producers, and the consuming public would benefit from such a policy.

Nevertheless, it is probably naive to anticipate that broad-based restructuring legislation such as the Hart Bill has any chance of being signed into law in the foreseeable future. The likely scenario is continued enforcement of existing antitrust laws, possibly with some less sweeping new legislation to encourage competition, and hopefully, with increased resources for enforcement agencies to do the job.

But this does not render a discussion of the potential impact of restructuring on the economy or on a particular industry, as was attempted here, a useless academic exercise. By examining a polar position, it often helps to put other more likely alternatives in their proper perspective, thus pointing out some of their shortcomings.

A powerful argument for deconcentration is that it would provide, through a new national policy toward competition, that all market participants would be treated on an equitable and consistent basis under the law. And this is something our current national economic policy toward competition has not done. If we do not mandate atomism across the board, we can at least seek consistent and equitable treatment under the law as a goal. Our present policy toward competition, the antitrust laws, is enforced in a manner which can be characterized as arbitrary, often politically motivated, sometimes out of step with existing economic conditions, and nearly always with an eye to which case the government thinks it can win. The dairy industry serves as an example of these inconsistencies, both in terms of applications of the law within the industry and in terms of applications in the industry versus those in other sectors of the economy.

Antitrust Thrusts Against the Milk Industry

National Firms. In the 1960's the focus of antitrust activity in the industry was against the national dairy companies. The goals of the stringently enforced merger prohibitions against the largest companies were to prevent further increases in market concentration, channel merger

activity toward smaller firms, and force larger firms to expand internally /3/. The policy, which continues under modified guidelines today, has been successful in channelling merger activity toward smaller firms /12/.

But it has not stopped the postwar trend toward increasing seller concentration in local markets, despite the significant broadening of these markets /14/. And it has certainly not forced the major dairies to expand internally in the industry. The policy came just at the time that the chain store integration movement was entering full force. In markets where integration occurred, the national firms, which had held the lion's share of chain store accounts, desperately needed to recoup lost sales to reduce growing excess capacity and reachieve technical efficiency. Keep in mind that at about this time economies of scale in processing were increasing rapidly.

The inflexibility of the merger guidelines did not permit the nationals to recoup this lost capacity in such markets. Parker gives a good account of why such firms were reluctant to resort to price-cutting in an attempt to regain sales /14/. The merger prohibitions may have actually tended to increase concentration in many local markets as the nationals withdrew from unprofitable locations and consolidated their geographic base of operations in the milk industry[4/]. Also important to note, the policy did not curtail merger activity of the major dairies, but simply helped force that activity into conglomerate rather than horizontal areas. Percentage of total company sales in fluid milk by the four largest "dairy" companies in the late 1960's compared to 1974 are given by Mueller, et al /12/. Borden's sales in dairy fell from 39 percent of total sales in 1967 to 24 percent in 1974. Kraftco fluid milk sales dropped from 20 percent in 1967 to 10 percent of the total in 1974. Dairy product sales of Beatrice dropped from 36 percent in 1968 to 27 percent in 1974. Foremost-McKesson data are unclear, but its foods division declined in importance from 25 percent of total sales in 1968 to 22 percent in 1974.

Protection of the Independent. Regulatory activity to maintain the status of the independent milk company as a viable competitive force in the milk industry has been a central focus of antitrust policy since the 1930's. Some authorities question the degree of emphasis on preservation under the law, but most feel that there is an important element of protection embodied in regulatory activity affecting the industry.

Legal protection at the national level for the independent has been afforded by the above mentioned merger prohibitions and the Robinson-Patman Act. As a group, the national and regional dairy concerns have been involved in almost continuous treble damage litigation on charges of discriminatory pricing in recent years.

4/ The term national is more and more a misnomer. For example, Borden, the largest dairy company with 9 percent of national sales, operates 48 plants located in only 17 states in the East and Southwest.

The rationale of an enforcement policy protecting a particular industry sector should be based on three assumptions:

1. The sector is operationally efficient.
2. It provides an active source of competition for the remainder of the industry.
3. The policy does not adversely affect other industry sectors.

Harris, Knutson, and French raised serious questions about these assumptions based upon a 1970 study of independent dairies. This does not mean that all independents are not efficient or a viable competitive factor in the marketplace. It simply means the great majority are not and that independents will continue to exit the business at a rapid rate. Fear of Robinson-Patman litigation has likely been one of the reasons major dairies have not penetrated more new markets by internal growth. Meanwhile, the merger prohibitions insured that markets would not be penetrated by external means /6/.

Cooperatives. The focus of antitrust policy in recent years has been on the largest milk cooperatives. The major cooperatives have achieved a significant degree of market power. This is why co-ops were formed— to offset the power on the first buyer side of the market. Producer cooperatives are sanctioned by a significant but narrow exemption to antitrust laws under the Capper-Volstead Act.

There have been cases of abuses and misuse of cooperative market power. But the co-ops' power is limited to the extent that they cannot generally control production from their members nor prevent milk from alternative sources of supply from entering the market. Some additional facts are revealing.

In 1975, sales of the four largest dairy corporations were 79 percent greater than the combined sales of all 600 dairy cooperatives. Further, these four largest dairy corporations' sales were 4 times greater, assets 8 times greater, net worth 11 times greater, and net margins before taxes 20 times greater than for the four largest dairy cooperatives.

An important aspect of obtaining power in the market place relates the ability of sellers to obtain shelf space in retail stores and to achieve acceptance by consumers of brand names. Dairy cooperatives process only 28 percent of the Nation's milk supply and this is sold largely to other firms for further processing or packaged for private label distribution. Because dairy cooperatives primarily market raw milk, they have not been able to achieve the degree of market power to equal that of large dairy corporations and food chains /18/.

It appears that current antitrust activity is deliberately directed against farmer cooperatives rather than larger conglomerates because it is easier to file complaints and win cases against smaller firms. The selection process is seemingly simplified for antitrust agencies.

Attacks on the Fluid Sector. The antitrust attacks in the milk industry have focused almost exclusively on the fluid sector. If enforcement agencies want to tackle an industry sector where concentration is highest, and growing, why not take a look at the cheese industry? The Food Commission found national four-firm concentration to be 44 percent in 1963, up from 25 percent in 1954. Perhaps more significant, the 4 largest national concerns, Kraftco, Borden, Swift, and Armour, bought 54 percent of total sales of cheese from plants in May 1965 /13/. Unlike fluid milk, cheese is heavily advertised and easily differentiated—characteristics associated with market power.

Why the Dairy Industry?

Not only do there seem to be inconsistencies in enforcement within the industry, a bigger issue is why so much focus on milk? The dairy industry ranks sixth among all industries in terms of manhours expended in Section 7 investigations by the FTC /14/. As stated previously, the industry is large. But relatively speaking, the firms that make it up are not gigantic. The latest Forbes "500" lists only six dairy companies. The largest, Kraftco, ranks 48th /4/. In terms of both absolute size of firms and concentration, industries like steel, oil, automobiles, cans, glass bottles, cement and tires dwarf the dairy industry. The potential gains from deconcentrating the dairy industry identified here are but a fraction of one percent of total market power costs as estimated by Scherer. How many manhours, relatively speaking, have enforcement agencies devoted to other agricultural product industries such as cereal preparations, which had a national concentration ratio of 90 percent in 1970, cigarettes—84 percent, cane sugar refining—59 percent, soybean oil mills-56 percent?

In terms of profits, the milk processing industry ranked below both all food manufacturing and all manufacturing in 8 out of the 10 years between 1962 and 1971 /14/. Despite the existence of their cooperatives, dairy farmers are not getting rich. Studies of the cost of producing milk showed average costs higher than prices in 1974 and 1975, and only slightly lower than average price in 1976 /2/. The milk processing profit centers of most integrated chains are probably an exception to this profit picture, but the facts are buried in the aggregated income statements of the firms.

Aspects of market power stemming from vertical integration, conglomeration, and multinational expansion exist in the dairy industry. But again, the degree to which it exists in the industry is scarcely comparable to examples elsewhere in the economy.

Concluding Thoughts

While criticism has been levied at antitrust enforcement policy, university agricultural economists must share the blame. The state of the arts in industrial organization theory has advanced very little since Bain. Marion and Sporleder, in an excellent recent review, conclude by saying, "Although what we know about industrial performance may be an

'island protruding from a sea of ignorance,' at least we have that island /10/."

In summary, existing antitrust laws have been enforced in an ad hoc, arbitrary manner in the dairy industry. Perhaps industrial deconcentration would not be that bad an alternative for the industry—at least elements within the industry would be treated alike, and the entire industry would be treated like all others.

New York magazine recently contained a bit of fiction by Andrew Tobias. The setting is 1998 in the office of Carol Loomis, managing editor of Fortune. In compiling the list of the "Fortune 500," Ms. Loomis is shocked to find that there are only 479 companies on it. As she mentally recalls the sequence of events that led to such a state, it is interesting to note that most of the significant mergers and court decisions came prior to 1977. The story concludes:

"Lots of people had worried about this problem, but nobody had come up with much of an answer. The problem (corporate elephantiasis) was so abstract and corporate momentum so overwhelming that no one had done much of anything at all—and this was the result. And Carol Loomis was not even sure that it was bad. But it troubled her" /17/.

Problems of protecting the private enterprise system and enhancing competition in the years ahead should trouble all of us. Bold new policy initiatives, perhaps including deconcentration, need to be examined. But new policies, unlike the present one, must be enforced on a fair, consistent basis.

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