WHAT IS UNDUE PRICE ENHANCEMENT?

Aaron C. Johnson, Jr. and Edward V. Jesse

Abstract

Intensifying criticism of farmer cooperative antitrust "exemptions" has prompted the Secretary of Agriculture to more actively enforce the Capper-Volstead Act Section 2 undue price enhancement proscription. A price standard is obviously required for enforcement. This paper seeks to define the price standard intended by the framers of the Act.

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On January 22, 1979, the National Commission for the Review of Antitrust Laws and Procedures submitted to President Carter recommendations concerning effective enforcement of antitrust laws. Three of these recommendations focused on special antitrust treatment presently afforded agriculture; one dealt specifically with clarification and enforcement of the undue price enhancement proscription in Section 2 of the Capper-Volstead Act:

> "Section 2 of the Capper-Volstead Act should be amended to define more precisely the term "undue price enhancement," and the responsibility for enforcement of this provision should be separated from the promotional responsibilities either within or outside the Department of Agriculture" (National Commission, p. 253).

This recommendation reflects several years of increasing concern by antitrust agencies over the role of agricultural marketing cooperatives in food price inflation, a concern succinctly articulated by a Justice Department spokesman in the House of Representatives 1973 Food Price Investigation:

> "The only restraint that exists on the price level such (Capper-Volstead) farmer cooperatives can achieve is the power given to the Secretary of Agriculture to take action where 'the price of any agricultural product is unduly enhanced.' The Secretary has never exercised this power. While it is impossible to state with any precision what effect this exemption has had on prices of food in general or of any particular food, we can assume that it has been substantial" (Kauper, p. 393).

During testimony before the National Commission for the Review of

Antitrust Laws and Procedures in 1978, the present Secretary of Agriculture stated that in the past farm prices have been too low and cooperatives too small to trigger Section 2 proceedings. He also stated in his 1978 testimony that he had already initiated action to more effectively enforce the statute (see Bergland, p. 4-6). Proposed rules of practice regarding the review of cooperative marketing activities and the conduct of cease and desist proceedings under Section 2 were published in the Federal Register in July of 1979. At the same time, the Department of Agriculture made available a committee report outlining a possible way of operating a "Capper-Volstead Monitoring Office" under the direction of the Director of Economics, Policy Analysis and Budget (USDA).

The proposed monitoring unit would examine individual cooperatives and the markets in which they operate to "...identify cases calling for further investigation and analysis to determine whether a possible case exists" (USDA, p. 111). According to this preliminary report, one element or norm for judging whether prices were unduly enhanced would be countervailing power:

> "The legislative intent was that farmers were to be permitted to receive prices resulting from market power equal to that of firms with whom they must deal. Thus, the standard for judging undue price enhancement turns on whether a farmer cooperative has managed to go beyond the level of equality in market power in negotiating price and trade terms. Prices to farmer cooperatives that significantly exceed the level associated with equality of market power would constitute undue price enhancement" (USDA, p. 8).

This standard is consistent with that proposed by the Justice Department in several recent publications.[1/] It reflects a position that a cooperative may legally exercise market power at least to the extent

that it countervails market power evident on the buyer side of the market in which the cooperative operates.

We seriously question the appropriateness of using a countervailing power standard for judging undue price enhancement. Part of our concern is rooted in the lesser question of how such a standard could be made operational: How is the market power of a cooperative to be measured vis-a-vis a private firm? Which buyer should be compared with the cooperative in those cases where a cooperative faces many buyers of varying size? And so on. Of far greater importance, we do not believe that countervailing power was the standard perceived by Congress when passing Capper-Volstead, and we do not believe it is consistent with antitrust objectives in general.

The purpose of this paper is twofold: to argue that countervailing power is not an appropriate standard for Capper-Volstead, Section 2, and to present what we believe to be the proper standard. To support our position, we draw from the Congressional debate that preceded passage of the Act and from the House Report on the bill.

Congress and Monopoly

The proponents of Capper-Volstead were fully aware of and determined to forestall the "evils of monopoly" and thereby preserve the perceived virtues of competition. Senator King, who argued against Capper-Volstead[2], not because he opposed the bill but because he felt the appropriate procedure was to strengthen the Sherman Act, stated the position of his colleagues: "...competition is fundamental in our industrial and economic life."[3] And this belief had a long heritage, rooted in the common law: "...the Sherman law was founded upon the conceptions of the common law.

We believe in the principles of the Anglo-Saxon law, the principles which were announced by Adam Smith. We do not believe in monopolies, in trusts, in combinations in restraint of trade, in the destruction and strangling of competition."[4/] Senator Cummins, too, felt that the real issue at hand was the preservation of competition, something that was lost sight of during the process of enacting Sherman: "...when the bill was originally introduced it forbade the supression of competition; and that...was the thing that (Senator Sherman) sought to preserve -- fair, substantial competition in business."[5/] Unfortunately, in Cummins' view, extensive debate on the bill, followed by redrafting by the Committee on Judiciary, transformed the original "...purpose of preserving competition into the general language of the common law with respect to restraint of trade and monopoly."[6/] To resurrect and make explicit the preservation of competition, he proposed that"...instead of making the undue enhancing of price the test, I would like to put into the bill the elimination of fair and substantial competition as the fact to be found."[7/]

This concern with preserving competition was rooted in a fear of the price-enhancing effects of monopoly. Senator Sterling, cited Standard Oil: "'...the principle wrong which it was deemed would result from monopoly -- that is, an enhancement of price....'"[8/] Under common law, forestalling and engrossing -- making greater the prices of victuals and other necessities of life -- was viewed as evil. In modern times the word "monopoly" had come to denote the same evil. But (again he cited Standard Oil), "'...common sense caused attention to be concentrated not upon the theoretically correct name to be given to the

condition or acts which gave rise to the harmful result but to the result itself...'"[9] In his own words, "...the result, being the controlling thing, is an undue enhancement of price, and we may indifferently call it by the old common law name of engrossing or we may call it a monopoly."[10] This clearly associates monopoly with the undue enhancement of price, a condition long viewed as an "evil" condition. And one that all agreed was to be avoided.

Legal vs. Economic Monopoly

Although Congress was unanimous in the fundamental belief that monopoly should be avoided, divergent views existed on exactly what Capper-Volstead would create insofar as a monopoly was concerned. Many advocates of the bill felt that nothing pertaining to the creation of a monopoly could be inferred from the language of the bill, basing their argument on the proposition that"...the antitrust law itself does not prohibit any organization or association which the farmers desire to bring together..[11] Rather, "...Congress is merely asked to clarify the position of cooperative farm organizations...in relation to the Sherman antitrust law."[12] Those of this persuasion favored the bill on the ground that "...farmers have been deterred from forming these cooperative associations by the fear that they would be subjected to prosecution under the antitrust laws of the United States."[13] Farmers were "...in fear of that law...;"[14] consequently, the bill was needed simply to clarify what farmers could already do under antitrust.

But other proponents argued that Capper-Volstead would create a monopoly in the context of antitrust. Senator Lenroot: "We are compelled to choose as to permitting in the case of cooperative associations, such an association as may, on the face of the law, permit monopoly, but

but which every senator knows will not result in monopoly because there is no necessity of life today which is produced upon the farm which can be made the subject of a complete monopoly..."[15] And herein lies an important distinction, that between a "legal" monopoly and an "economic" monopoly. Insofar as antitrust, the Sherman Act in particular, was concerned Capper-Volstead permitted farmers through their cooperatives to engage in activities that were denied noncooperative organizations, activities that "on the face of the law" were in violation of the Sherman Act. In this sense Capper-Volstead would create a "legal" monopoly.

But there was, however, a near consensus that farmers could not create an "economic" monopoly, by which was meant the acquisition of such a control over supply that a cooperative would be able to extract from the marketplace a price higher than that which would have prevailed in the absence of such control over supply.[16] To many proponents of Capper-Volstead, the idea that a cooperative could create a monopoly in this sense was absurd, so much so that they argued vehemently that Section 2 of the proposed legislation was unnecessary. Although this argument failed to persuade and Section 2 was included, it remained that all spokesmen were of one voice in that farmers through a cooperative could not create an "economic" monopoly.

But a question: If all were agreed that farmers could not through their cooperatives exact an "undue price", why was Section 2 supported by the majority? There were, we believe, three basic reasons that led to accepting the final wording of Section 2. First, some felt the section was needed simply to improve the chances of passing the bill: "I favor (Section 2) because it is necessary to get (the bill) through..."[17]

Second, and related to the previous point, was the feeling that farmer cooperatives "...ought to be put under some supervision, because there has been complaint against some of the associations, and it was for that reason that Section 2 was drawn."[18/] In other words, "Section 2 of the bill is to protect the consumer and outlines the remedy in case these organizations should restrain trade and lessen competition. My personal opinion is that the farmers will never abuse the privileges extended to them under this bill; nevertheless I think the committee has acted wisely by staying on the safe side and providing a remedy in case the privileges should be abused."[19/] Third, to retain Section 2 "...would certainly cause the consumer to have confidence and trust in his (i.e., the farmer's) organization, and might in the future prevent some group from bringing into disrepute cooperative methods."[20/] To encourage passage of the bill, to make clear that the public was to be protected, and to create public confidence in farmer cooperatives were the persuasive arguments marshalled in defense of Section 2.

Countervailing Power Not Appropriate Standard for Section 2

The House Report states that the bill "...aims to equalize existing privileges..."[21/] It is possible to interpret "equalizing existing privileges" as "equalizing market power" and then slide into the concept of "countervailing power" as some seem to have done. We believe this is an incorrect interpretation of the legislative history.

If countervailing power was what Congress meant to confer on cooperatives, equality of market power would be a logical performance standard to use in connection with Section 2. However, in the language of market

theory, such a standard would encompass market structures ranging from perfect competition at one extreme to bilateral monopoly at the other, a standard that could result in anomolous situations. In particular, there is no guarantee that a market price determined by a buyer and a seller possessing equal market power (which price presumably would not be an unduly enhanced price under the countervailing power standard) would be the competitive price, an important result to consider.[22/] Market competition has always been viewed as the basic organizing principle of the U.S. economy. And public policy has recognized the implications of such an organizing principle for economic and political power, and for the social justice and quality of opportunity associated therewith. Consequently, to employ a standard under Section 2 that would sanction, in the extreme, monopoly prices would be to adopt a standard that stands boldly in defiance of the long-held belief that the competitive market is the desirable norm. We do not believe that Congress meant for such a standard to be used.

A Proposed Standard for Section 2

Reading the debates on their face value leads easily to the conclusion that Congress intended the "competitive price" to be the standard for Section 2. And they did intend so. But in a particular sense. The real world offers an undifferentiated continuum where all differences are a matter of degree. So it is with the structure of markets: we find few, if any, with "large" numbers of sellers; we find few, if any, with a "single" seller--the economist's models of competition and monopoly are not observed in real-world markets. But to speak about real-world markets,

we must make distinctions, distinctions that are at once meaningful and imprecise, meaningful in that they permit intelligent discourse, imprecise because all know they defy exact empirical definition. Thus, "competition" may be used to characterize a market setting wherein the participants (usually "large" in number") are more or less governed by impersonal forces, they have no control over their destiny; and "monopoly" may be used to characterize a market setting wherein the participants (usually "small" in number) are able to more or less control events and, hence, their destiny. It was, we believe, in this sense that competition and monopoly were used in the Congressional debates. Hence, the extensive use of the word competition to characterize a market where "reasonable" prices would obtain. Keep in mind too that Congress was firmly convinced that farmers through a marketing cooperative could not acquire monopoly power, in which case the cooperative would necessarily price its products under "competitive" conditions. This belief would certainly influence the language of the debates and Section 2.

However, the framers of the Act did recognize the important distinction between the presence of a monopoly, on the one hand, and the possession and use of monopoly power to exploit the public in the former of higher prices, on the other. To paraphrase Senator Norris: there is no public concern with the presence of a monopoly if that monopoly is not using its power to the "public injury"; there is a public concern when the monopoly does, by reason of the power of monopoly, increase the price to the consumer.

On the basis of this important distinction, we conclude that Congress did not by the lagnuage of Section 2 intend to deny prices resulting from

superior products, brand (consumer) loyalty, innovative management, provision of better services, and the like (assuming that once attained such prices were not then maintained by otherwise illegal conduct -- market foreclosure, price discrimination, predation, collusion with noncooperatives). Rather, we believe that Congress meant to deny only prices that arise as a consequence of the use of monopoly power. Hence, the appropriate standard for Section 2 is not the competitive price *per se* but the price that would have existed absent the use of monopoly power.

FOOTNOTES

*Professor, Department of Agricultural Economics, University of Wisconsin-Madison, and Agricultural Economist, National Economics Division, ESCS, USDA.

1/ See, for example, Fones, Hall and Masson; Masson and Eisenstat; and Eisenstat and Masson. The authors of the Justice Department *Milk Marketing* report interpreted the legislative history of the Capper-Volstead Act as follows:

> "While Congress intended that farmers be allowed to associate for the purpose of exercising countervailing power in their dealing with corporate entities, Congress did not contemplate that the organizations, in turn, would hold such a degree of market power that competition and the consumer would be adversely affected" (p. 52).

2/ The Senator abstained from the final vote on the bill.

3/ 62 Cong. Rec. 2224.

4/ id., 2223.

5/ id., 2225.

6/ id., 2225.

7/ id., 2225.

8/ id., 2219.

9/ id., 2219.

10/ id., 2219.

11/ id., 2266.

12/ id., 2217.

13/ id., 2261, for similar view see 62 Cong. Rec. 2216. For a popular account of antitrust indictments of farmer cooperative members preceding passage of Capper-Volstead, see Saturday Evening Post.

14/ id., 2260.

15/ id., 2223 (emphasis added). Senator King also felt that Capper-Volstead created a monopoly and, hence, opposed the bill in debate, asserting that he was "unwilling to see the competitive system in our industrial life absolutely destroyed...," 62 Cong. Rec. 2277.

16/ Some proponents agreed that cooperatives could not control "the food supplies of the nation" and thereby extract a higher price. But they were concerned over the possibility of a "local" monopoly, citing a milk market as one instance where an element of monopoly could arise.

17/ 61 Cong. Rec. 1042.

18/ 59 Cong. Rec. 8017.

19/ id., 8023.

20/ id., 8025.

21/ H.R. Rep. No. 24, 67th Cong., 1st Sess.

22/ See Jesse and Johnson, especially Section IV.

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