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SECOND EUROPEAN CONFERENCE OF AGRICULTURAL ECONOMISTS

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EUROPEAN AGRICULTURE IN AN INTEGRATING ECONOMY

VERTICAL INTEGRATION IN WESTERN EUROPE

INTRODUCTORY NOTES FOR A PANEL DISCUSSION

VERTICAL INTEGRATION IN WESTERN EUROPE - THE POINT OF VIEW OF
AGRICULTURAL PRODUCERS

Vertical integration involves bringing two or more stages of the food chain under substantially unified management. It has a number of advantages including economies of scale, reducing uncertainty, promoting specialization, introducing innovations, and transferring of capital into the farm sector. Major disadvantages for producers are loss of decision-making power to the integrator, and financial dependence on the integrating firm. Full vertical integration, where an integrator purchases farm units, is not common. However, contracts between farmers and processors, and between farmers and feed companies have become a way of life for some commodities. These contracts usually oblige the farmer to observe quality and quality standards, but do not necessarily affect the independence of the producers involved⁽¹⁾.

Contracting is typically found where there is a need for an organized market and no alternative arrangements exist. It is common in intensive livestock rearing where there are significant economies of scale of operation and a well defined standard production technology. It is common in fruit and vegetable production for processing where crops have to be processed on schedule or they rapidly lose their quality. It is also common for crops like sugar-beet and hops which have only one possible outlet and must all be processed.

Farmers view the process of vertical integration as inevitable, and indeed beneficial to the internal restructuring of agriculture. Their concern is that the control of farming remain with farmers. The 1959 General Conference of the International Federation of Agricultural Producers (IFAP) stated the position as follows:

"Integration - of which contract farming is only one of many manifestations - is an inevitable process. What matters to

1) Contracting is variously described as quasi-vertical integration (France) vertical co-ordination (U.K.) or vertical co-operation (Germany).

farmers is that they should control and utilize it through their own organizations, and not leave it to be exploited only by extraneous interests. To ensure this, the efforts of co-operatives in the technical and organizational field must be supplemented with the provision of full and objective information to farmers, to the members and non-members, and to the community as a whole. Farmers will in any case have to accept a certain limitation of their freedom in management and marketing, but it is essential that the discipline should be freely applied within the farmers' own democratically run organizations and not imposed by profit-making concerns in which the farmers have no voice".

This statement was confirmed by an IFAP Symposium on "Vertical Integration in European Agriculture" in 1963. The most recent statement by IFAP was in 1975 in Washington D.C. where the Standing Committee on Agricultural Co-operation repeated essentially the same view:

"Contract farming within the framework of co-operative organizations provides the greatest guarantee for farmers' interests".

What have farmers done to maintain control of agriculture while vertical integration progresses? The most significant development has been vertical integration through farm co-operatives. In the Scandinavian countries there is little scope for vertical integration by private firms because farmers have integrated upstream and downstream through their co-operatives. In Norway 87 per cent of farm products goes through co-operatives. In Sweden co-operatives handle over 80 per cent of farm produce. In Finland co-operatives handle 96 per cent of the milk and 70 per cent of slaughtered livestock. In Denmark co-operatives handle over 90 per cent of the pork, 87 per cent of the milk, 60 per cent of the beef and 58 per cent of the eggs. Co-operatives are also extremely strong in Iceland.

Vertical integration by private companies has also been avoided by the existence of statutory marketing agencies. For example, in Great Britain producer controlled marketing boards, as well as the Home-grown Cereals Authority and the British Sugar Corporation control the marketing of about one third of British farm products, by value.

Nevertheless, contracts with private companies are very common in Western Europe. One of the principal concerns of farm organizations with respect to contracts is the weak position of an individual farmer who is approached by a large company. There have been many cases of exploitation of individual producers. For example, in France the Confédération Nationale de l'Élevage (the National Stockgrowers Association) published a booklet on integration in 1973 giving several examples where the cost of supplies provided to the farmer by the integrator exceeded the value of the finished livestock. Farm organizations have attacked this problem on two fronts. First, they have urged their members to only sign group contracts, and then only those that have been approved by their union; or else to sign contracts with their co-operatives. In Great Britain, the National Farmers' Union has developed a seal-of-approval service for contracts to protect their members. In the Netherlands, the three farm organizations (Landbouwschap) have set up regional advisory commissions where farmers can check their contracts. They also negotiate national "general delivery conditions" to be specified in contracts. In some cases farm organizations have defended their members in the courts against exploitation by unscrupulous integrators. The second approach of farm organizations has been to urge governments to adopt legislation to protect farmers who sign contracts. In Belgium, for example, the law of April 1st, 1976 requires all contracts in the animal production sector to be in writing and to contain certain minimum clauses. In France the law of 6th July 1964 provides the same protection for French farmers. The French law covers all integration contracts, not just those for animal production. In addition, it shifts the burden of proof in case of dispute to the integrator. There is also legislation encouraging the formation of local producer groups whose purpose is to negotiate contracts with processing companies and so balance supply and demand. In France local producer groups and regional economic committees are encouraged under the law of 8th August 1962. There is also a law in France that gives legal authority to interprofessional organizations (law of 10th July 1975). In the Federal Republic of Germany, the 1969 law for the adoption of agricultural production to the requirements of the market ("Marktstrukturgesetz") promotes the formation

of producer groups and their associations, as well as the co-operation of producer groups and food processing industries. It should be noted that not all producer groups are in favour of the legislative approach to vertical intergration, e.g. The Landbouwschap in the Netherlands which prefers to improve the market information and advisory service to farmers.

Today, the great majority of intensive animal production, vegetables for processing^{and}/sugar-beets in Western Europe is produced under contract. Agricultural producers have tried to capitalize on the benefits of contracting while looking to their farm organizations to avoid the dangers. They try to impress on governments the necessity of maintaining the family farm as the basis of Western European agriculture, and the right of the farm family to live as comfortably as other members of society. They point out that contracting cannot substitute for farm price and income supports, or appropriate market organization. As the process of vertical integration evolves it is vital that these fundamentals not be sacrificed. Thankfully most governments of Western Europe do have a commitment to agriculture in their country. However, their actions are not dictated by producers' interests alone. The profit-motivated companies involved in the food system generally play their part well, but all cannot be relied upon to do so. To farmers, therefore, the 1959 IFAP declaration on vertical integration is as relevant today as it was 20 years ago.

THE DEVELOPMENT OF INTEGRATION IN PIG PRODUCTION..INTRODUCTORY REMARKS

I - EVALUATION DIFFICULTIES

Several factors combine to shroud in obscurity the extent and forms of integration in the pig sector and, more generally, in raising of livestock which are not narrowly bound to fodder production.

i - The concept of integration itself and its socio-economic substance gives rise to diverging interpretations, thence it is given widely different status among the various schools of thought in contemporary agricultural economics.

ii - Terminology is vague and legal rather than economic. It is thus inadequate if interpretation is the objective.

iii - Statistical information is lacking. The Statistical Service of the ministry of Agriculture conducts annual surveys of pig production structures. These include a study of producer groups (groupements de producteurs) but no data on production. contracts are gathered.

iv - Integrators are very discrete about their activities - particularly after a number of judicial cases concerning contracts. They have the means of being so since they often conduct their business by simple oral agreements.

v - The attitude of the farmer's unions is not conducive to creation of information on the subject. They are opposed to integration since they claim that farmers are "entrepreneurs", "independant producers"... Thence, they have failed to organize and defend efficiently those farmers who are integrated - and when these have engaged in actions, it is through other means.

vi - Agricultural policy is also a source of confusion. The law on "contractual economy" should have provided a legal framework for different types of integration, but has been practically not applied. Producer groups which were intended to enable producers to set rules for their own joint organization have often been used by feed companies to hide their integration activities or to set up a kind of collective integration process of the producers.

vii - Lastly taxation confuses the issues as it induces pig raisers to change their strategies in front of integration. Farmers with sales above 500 000 F for two years in succession are subjected to harsher farm income tax since they must keep and present accounts instead of paying on some (favourable) flat basis. Thence, an increasing number of producers move in or out of contract production in order to avoid this threshold.

II - MAJOR FEATURES OF PIG INTEGRATION IN FRANCE

The general reasons which favour the development of integration contracts and their alledged advantages for the parties concerned are well known :

It appears that, in a number of countries, the rapid and sustained growth of pig productions is closely related to the fact that integrated forms of production were adopted.

This is the case in Belgium. In Italy and Spain there was rapid decline in traditional peasant production and development of modern intensive units which are strongly integrated. In Japan, there was a quick succession of various production forms starting with contract production and culminating with absolute vertical integration under the aegis of powerful japanese multinational firms. Last example : Canada where integration played an essential role in relocation of production which moved to Quebec in spite of the fact that this province produces a small share of the feed consumed.

The French situation appears significantly different. Compared to the above mentioned countries and in spite of vigorous efforts, production increases were rather modest. There was, however, a deep internal restructuration of the sector. The production increases and the restructuration essentially occurred in limited areas like Brittany and the North.

Two forms of contractual relationships appear.

a) The restructuration process of the pig sector took place almost exclusively under the aegis of producer groups which were the major tool used by private firms and cooperatives to intervene in the production processes. They thus, in fact directed the rationalization of a whole group of producers by technical advice as well as control of genetic improvement and of disease prevention. There is thus a real collective integration of pig raisers as the decision center progressively shifted to the feed supplier, the central feed firm (1) or the multipurposes cooperative.

b) Another and more traditional form of integration can be interpreted as an attempt to survive by various businesses in areas where independent (outside producer groups) production is decreasing without being replaced by forms of production directed by producer groups.

In that case, integration is run by agents whose business is directly endangered by the restructuration of the whole pork industry. This is the case of pig merchants in certain zones of the North and the South-East, or of feed manufacturers which operate on their own or under franchise from central feed firms (while retaining ownership of their factories), or of meat processors who have not gained access to import channels.

A clear explanation of the role of those agents in the integration process must take into account not the functions they perform but the type of capital they represent.

(1) These central firms supply concentrated components and advice to subsidiaries or franchised firms.

Feed multinationals prefer to withdraw their capital from this sector rather than engaging in operations of dubious profit earning potential (thus Provimi linked to Cargill and Lesieur-Sodeva have closed down and Duquesne-Purina, linked to Ralston-Purina, has hardly entered into individual integration operations).

On the other hand, individual integrations is the only solution when capital is of a family nature, unconcentrated, and located in regions where pig production is not dynamic.

There are, however, some cases of combination of modern and traditional forms of integration. In a given region, a given firm may operate both with integration through producer groups and with producers individually integrated.

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