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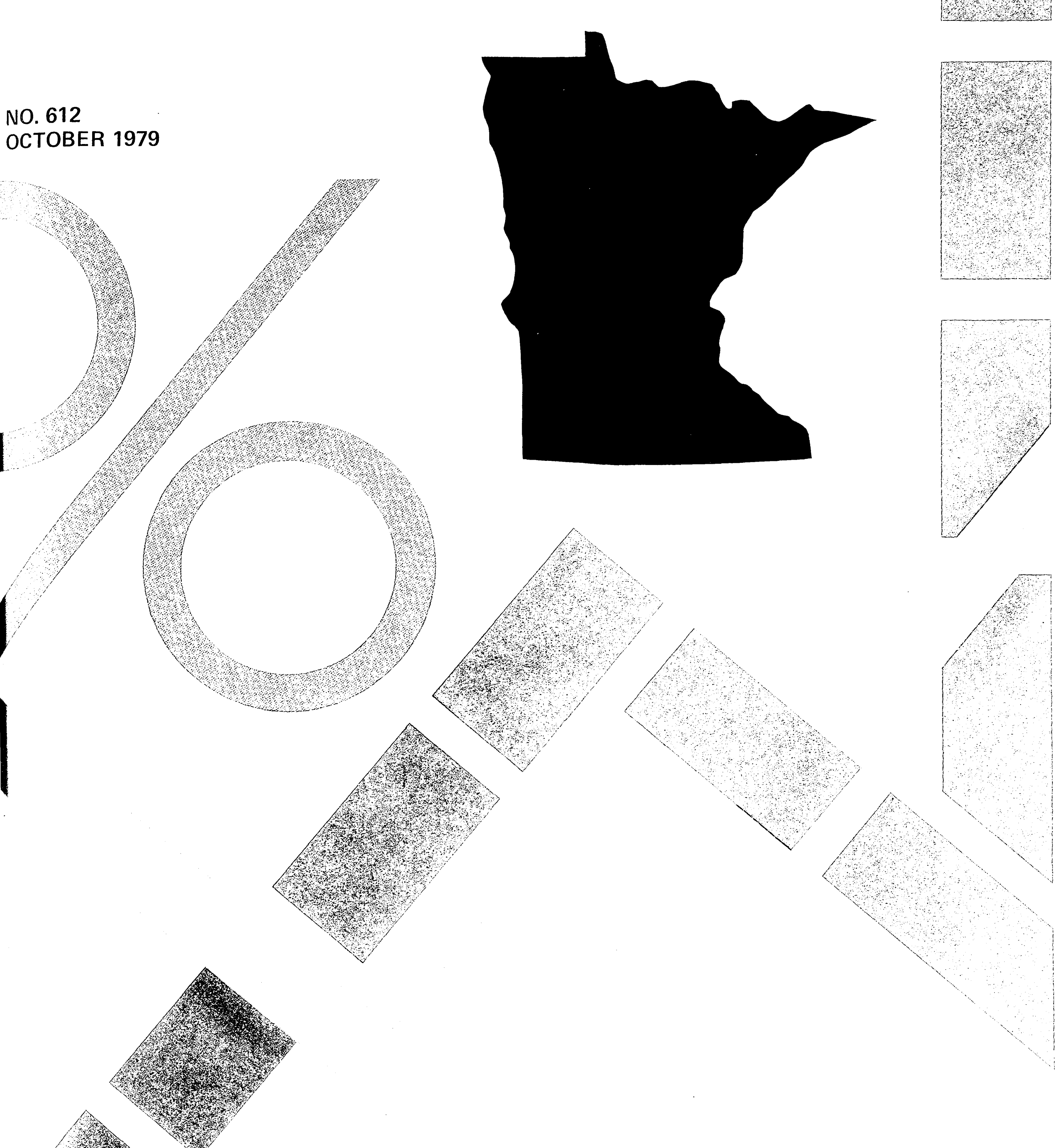

MINNESOTA AGRICULTURAL ECONOMIST

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Cooperatives, Antitrust, and the Public Interest

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Agricultural cooperatives have come under increased scrutiny recently by the U.S. Justice Department, the Federal Trade Commission, and various consumer groups. These cooperatives are sometimes called too big, too powerful, and contributors to food price inflation. These charges bring into question their special status under U.S. antitrust laws. In December 1977, President Carter appointed a National Commission for Review of Antitrust Laws and Procedures. This Commission recently issued its final report, which calls for some modifications in the Capper-Volstead Act of 1922, permitting farmers to jointly market their products through cooperatives. Its recommendations follow.

"1. Farmers should continue to enjoy the right to form agricultural cooperatives for the joint marketing of their produce. The antitrust treatment of cooperatives once formed, however, should be similar to that of ordinary business corporations. Specifically, mergers, marketing agencies in common, and similar agreements among cooperatives should be allowed only if no substantial lessening of competition results.

"2. 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.

"3. The Commission is not able to make a definitive recommendation concerning the current exemption for agricultural marketing orders. The Commission believes, however, that the Secretary of Agriculture should be required, as he is not by current law, to consider competitive factors and choose the least anticompetitive alternative consistent with statutory goals in his decisions under the Agricultural Adjustment Act."

–National Commission for the Review of Antitrust Laws and Procedures

This Minnesota Agricultural Economist examines the legal and economic characteristics of farmer cooperatives and the implications of the Commission's recommendations if adopted.

WHY THE CONCERN ABOUT COOPERATIVES?

The 1960's ushered in a new wave of corporate mergers in the noncooperative sector of the food industry. Mergers representing both horizontal and vertical integration occurred by the hundreds. These mergers resulted in many huge conglomerate business enterprises operating highly diversified business operations with huge financial resources.

The National Commission on Food Marketing, which had been appointed by Congress in 1964 to study and appraise changes in the food industry, reported finding a high degree of concentration in the food industry with a trend toward increasing conglomerate organization.[1]

Farmer cooperatives have felt a need to grow, so they could more effectively compete with the increased market power of larger noncooperative firms in the rest of the food industry. They also recognized the cost economies that could be achieved through mergers that would enable them to coordinate their marketing activities over a broader area and give them increased bargaining power.

Cooperative mergers in the dairy industry were far-reaching in the late 1960's. Associated Milk Producers, Inc. (AMPI), a cooperative that assembles and markets milk from Texas to Minnesota, was organized by a merger in 1969 which included a major Texas-based cooperative and the principal milk supply co-op for Chicago. After the initial organization of AMPI, several major Wisconsin and Minnesota dairy cooperatives joined it. By 1971, AMPI was marketing 15 percent of the total U.S. milk supply.

Mid-America Dairymen, Inc. was organized in 1968 through the merger of several cooperatives (of which the Twin City Milk Producers Association serving the Minneapolis-St. Paul market was one) in the west central region. By 1970, Mid-America Dairymen, Inc. was marketing 7 percent of the nation's milk supply. Similar regional dairy cooperatives were formed through merger in other areas of the U.S.

The formation of these larger cooperatives coincided with other economic events, such as the expanding consumer movement and world grain shortages in the early 1970's, with the associated increases in food prices. Cooperatives and the federal marketing orders, through which milk prices are established in many markets, became the focal points for public criticism. They have been charged with unduly enhancing food prices to consumers.

Integration and consolidation of cooperatives in some of the farm supply industries has been substantial. Cooperatives increased their share of the fertilizer market from 15 to 30 percent between 1950 and 1975.

Critics of cooperatives also argue that farmer cooperatives have become large enough to produce serious anticompetitive effects. Cooperatives in 1979 are larger than those in the past. True. But, size must be considered in perspective. Even today's larger cooperatives are not large relative to their competitors: noncooperative firms.

In the fiscal year ending June 30, 1976, the business volume of agricultural marketing cooperatives totaled $29.8 billion through 4,840 cooperatives in the U.S. Although this is nearly 30 percent of the value of America's farm output, a much smaller percentage of the value added to food in the marketing system is handled by cooperatives. Marketing cooperatives are most important at the levels of first sale and first processing of farm products.

Cooperatives have achieved their greatest market penetration in dairy products. They control about three fourths of all milk produced at the farm level. In 1975-76, cooperatives marketed $8.5 billion of dairy products. Cooperatives marketed $10.6 billion of grain and grain products in the same year. They handled about 35 percent of the grain sold by farmers. They also marketed $2.9 billion of fruits and vegetables in the same year, or nearly one fourth of all the fruits and vegetables sold by farmers.

Farmers also purchased $9.4 billion of farm supplies, such as feed, seed, fertilizer, and petroleum, through 5,538 farm supply cooperatives in 1975-76, almost one fifth of their total supplies. The dollar volume is the largest in feed, fertilizer, and petroleum products.

Another measure of the size of cooperatives relative to noncooperative firms is a comparison of the sales of the largest cooperatives with the largest noncooperatives by product lines. A USDA study showed that in 1975 the combined sales of the nation's four largest dairy marketing cooperatives was about $3.8 billion, only 25 percent of the combined sales of the four largest noncooperative firms in the dairy business. The combined sales of the four largest grain marketing cooperatives were 24 percent of the combined sales of the four largest noncooperatives in the same year. A similar comparison for fruits and vegetables showed the four largest cooperatives having total combined sales of 32 percent of the four largest noncooperatives.

These aggregate data show that although farmer cooperatives have achieved a significant volume of business, noncooperative firms dominate in the marketing of both food products and farm supplies.

ANTITRUST LAWS AND COOPERATIVES

Before considering the possible impact of its own recommendations, consider antitrust laws in relation to cooperatives and the Capper-Volstead Act. Antitrust laws in the U.S. began with the Sherman Antitrust Act of 1890. It prohibits contracts, combinations, and conspiracies in restraint of trade and also prohibits monopolization, attempts to monopolize, and combinations and conspiracies to monopolize. Farmers led the drive to obtain this legislation because they believed that control over the trusts would give them the benefits of increased competition. That is when agricultural marketing cooperatives were just beginning, so it was considered unnecessary to write a provision into the Sherman Act which excluded farmer cooperatives. Much to the surprise of farmers, however, some of their marketing cooperatives ran into trouble when dubbed "illegal combinations" under the Sherman Act.

The weaknesses of the Sherman Act relating to cooperatives were remedied in part by the Clayton Act of 1914. Its Section 6 provided:

"Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of . . . agricultural . . . organizations, instituted for the purpose of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations or the members thereof be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws."

Although Congress recognized the legitimacy of farmer cooperatives through the Clayton Act, this did not solve the problem. Section 6 was vague about the permissible actions of cooperatives and did not apply to cooperatives organized with capital stock.

The Capper-Volstead Act of 1922 further clarified the provision for agricultural cooperatives under the antitrust laws. Section 1 of that act authorizes producers of agricultural products —such as farmers, planters, ranchmen, dairymen, and nut and fruit growers— to act together to collectively process, prepare for market, handle, and market in interstate and foreign commerce their products; provides that such associations may have marketing agencies in common; and specifies certain requirements for the organization and operation of such associations.

To protect against cooperative abuses of market power, Section 2 of the Capper-Volstead Act grants to the Secretary of Agriculture the power to prohibit cooperatives from "monopolization or restraint of trade . . . to the extent that the price of any agricultural commodity is unduly enhanced."

A common myth is that the Capper-Volstead Act "exempts" farmer cooperatives from the antitrust laws. The exemption is very limited. The law gives farmers the right to market their products jointly through cooperatives and for cooperatives to form agencies in common without that procedure in itself violating the antitrust laws. But, the Capper-Volstead Act cannot be used as a device to engage in predatory or other unfair trade practices which violate antitrust laws. The U.S. Supreme Court has affirmed this in several decisions.

In 1939, the Supreme Court held in the *Borden* case (U.S. vs. Borden Co., 308 U.S. 188) that the Capper-Volstead Act did not permit cooperatives to join with noncooperative organizations in activities prohibited by the antitrust laws—in this example price fixing.

The Supreme Court decision in *U.S. vs. Maryland and Virginia Milk Producers Association* on May 2, 1960, (362 U.S. 458) held that a cooperative is subject to the antitrust laws if it attempts to "restrain trade or to achieve monopoly by preying on independent producers, processors, or dealers." But, the acquisition of market power by cooperatives solely through the voluntary organization of farmers does not constitute monopolization.

The Supreme Court placed a third limitation on the antitrust immunity of cooperatives, as provided by Section 6 of the Clayton Act and the Capper-Volstead Act in *Case-Swayne Co., Inc. v. Sunkist Growers, Inc.*, 389 U.S. 384 (1967). The Court held that the membership of persons and entities who were not themselves producers of agricultural products would destroy and remove the protection of those exemptions.

In summary, these Supreme Court rulings confirm that Section 6 of the Clayton Act and the Capper-Volstead Act do not give cooperatives a license to engage in unfair trade practices that are prohibited under the antitrust laws. Further, cooperatives cannot include as members nonagricultural producers and claim immunity under these statutes.

WHY AGRICULTURAL COOPERATIVES?

In authorizing farmers to jointly market their products through cooperatives under the Capper-Volstead Act, Congress recognized that agricultural production differs from industrial production. These unique characteristics follow:

1. Each farmer must make production decisions, such as planting and fertilizer applications, long before demand for their product is known. These decisions are made individually by more than 2.5 million farmers, each of whom bears the risks. Farmers, in the sale of their products, approach the textbook example of a perfectly competitive industry.

2. Agricultural production is subject to high risk because it is greatly influenced by unpredictable weather and insects and plant disease. Consequently, both the quantity and quality of farm products vary substantially from year to year. This, together with an inelastic demand for food, results in wide fluctuations in farm prices and incomes.

3. Each farm is quite inflexible, which makes it difficult to adjust production quickly to changes in market demand. This inflexibility is due to several factors. First, there is an absence of alternative crops or enterprises on many farms because of soil and climatic limitations. Second, agriculture is a biological industry, so it takes time to build up livestock enterprises and change cropping patterns. Third, capital invested in farms cannot readily be transferred to alternative crops or livestock enterprises.

4. Finally, many farm products are highly perishable and must be sold immediately, regardless of the price.

As a consequence, a farmer acting alone lacks bargaining power as a seller. Historically, farmers have had to sell to a few buyers who do the processing and marketing of their commodities. Farmers have turned to cooperatives to strengthen their bargaining power in the face of the large organizations that buy their products and provide their supplies.

Though technological change has increased size and decreased numbers of farms, and corporations have expanded in areas such as poultry, the data indicate that the bulk of agricultural production still comes from individually operated family farms. Without cooperatives, farmer bargaining power would be substantially reduced for several farm commodities.

IMPLICATIONS OF THE COMMISSION'S RECOMMENDATIONS

If adopted, the Commission's recommendations would reduce the ability of cooperatives to merge, form agencies in common, and bargain for prices for some farm commodities. But some limits would be imposed.

Mergers

The first recommendation of the Commission, if enacted into law, would mean that the standards of the Clayton Act would be applied to mergers among cooperatives. Section 7 of this act provides that an acquisition by a corporation engaged in interstate commerce of all or part of the stock or assets of another corporation also engaged in interstate commerce is illegal where the effect "may be substantially to lessen competition, or to tend to create a monopoly." The Federal Trade Commission monitors corporate mergers and is one agency charged with the enforcement of Section 7 of the Clayton Act.

The Supreme Court's decision in the *Maryland-Virginia Milk Producers* case established that cooperatives were subject to the Clayton Act when they acquired a noncooperative firm, with the effect judged to be lessened competition. However, mergers among cooperatives and the formation of marketing agencies in common have not previously been subject to investigation and restriction.

Willard Mueller, a noted antitrust economist, predicts that cooperatives would encounter increased restrictions should their mergers come under the Clayton Act. He points out that courts, in applying Section 7 to other regulated industries, have come down on the side of applying the substantial lessening of competition rather than other standards of the regulatory agencies. Hence, he feels that cooperative mergers would be investigated and probably challenged even though they do not have significant anticompetitive effects.[2]

Tighter merger restrictions on cooperatives would limit their ability to achieve greater market power to effectively compete with powerful integrated noncooperative firms in the food sector. Further, cooperative growth through mergers can often be justified by significant cost economies that can be achieved through large-scale operations. Mergers enable cooperatives to achieve cost economies associated with transportation, processing, and marketing members' products. Central decisionmaking enables a larger cooperative to reduce the number of plants in a system designed to minimize transport and processing costs. Many studies lead to the conclusion that farmers, as well as consumers, could be better served by a smaller number of more efficient cooperatives. This would be true in those situations where benefits derived from increased cost economies exceed any possible anticompetitive effects associated with most horizontal mergers of cooperatives.

Marketing Agencies in Common

The first recommendation of the Commission also indicates that "marketing agencies in common, and similar agreements among cooperatives should be allowed only if no substantial lessening of competition results." The Capper-Volstead Act specifically authorizes cooperatives to organize "marketing agents in common." Under this provision, cooperatives have formed federations to perform many marketing services for members, such as pricing, bargaining, and processing. Many regional cooperatives are federations that perform such services for their member local cooperatives. Examples of federated regional cooperatives in the Upper Midwest are Land O' Lakes, Inc. and the Grain Terminal Association.

Sometimes federations of cooperatives or "marketing agents in common" may exist mainly for bargaining or pricing for their members. Such bargaining federations often do not own marketing facilities and may not handle farm products.

If "marketing agents in common" are to be allowed only if "no substantial lessening of competition results," many of these organizations may be challenged. Yet, these federations of cooperatives have important, legitimate functions. They perform a variety of services for their members more efficiently than the members can do individually.

Interregional cooperatives are developed and owned by regional cooperatives. They are essentially federations of regional cooperatives. Through them, cooperatives have integrated their operations closer to the consumer, such as marketing cooperatives, or to the source of raw materials, such as fertilizer and petroleum for supply cooperatives. For example, the Farmers' Export Company is an interregional cooperative, owned by several regional grain marketing cooperatives to export grain in competition with large, privately owned grain firms. Central Farmers' Industries, Inc. is also an interregional cooperative owned by several regional farm supply cooperatives.[3] It produces and distributes fertilizer to its members. Vertical growth through interregionals has enabled cooperatives to achieve significant cost economies and assured sources of raw materials for farm inputs and markets for members' products.

It seems that application of Section 7 of the Clayton Act to vertical growth of cooperatives through agencies in common would be a clear change in cooperative law. It could place Section 7 of the Clayton Act in conflict with a major provision of the Capper-Volstead Act.

Undue Price Enhancement

The second recommendation of the Commission is aimed at more effective enforcement of Section 2 of the Capper-Volstead Act, which enables the Secretary of Agriculture to guard against noncompetitive practices of cooperatives which may lead to "undue price enhancement." The record shows that no Secretary of Agriculture has invoked Section 2 of the Capper-Volstead Act. Secretary Bergland has pointed out, however, that the chief reason is that, for most of the period since 1922, farm prices and incomes have been seriously depressed relative to other sectors of the economy. Also, it has only been recently that cooperatives have reached the size where questions could be raised about the ability to "unduly enhance prices."

The Commission recommends that "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 within or outside the Department of Agriculture."

Secretary Bergland has recently announced the establishment of a separate monitoring system within USDA to carry out his authority under Section 2 of the Capper-Volstead Act. The separate system to monitor undue price enhancement will report directly to USDA's Director of Economics, Policy Analysis, and Budget.[4] He also needs the input of the General Counsel in the department.

Regarding the recommendation of a more precise definition of "undue price enhancement," Willard Mueller makes the relevant point that if undue price enhancement is to be better defined and enforced for cooperatives, similar provisions should be included in the Federal Trade Commision Act and the Sherman Act. He emphasizes that unless something is done to curb the pervasive problem of undue price enhancement in the noncooperative sector, the case for tougher enforcement of Section 2 of the Capper-Volstead Act is unjustified.[5]

Agricultural Marketing Agreements and Orders

The third recommendation of the Commission deals with agricultural marketing orders, but is less specific. It is difficult to disagree with its objective that the Secretary of Agriculture should "be required" to consider competitive factors and choose the least anticompetitive alternative consistent with statutory goals of that program. But what does this mean? Marketing orders and agreements are anticompetitive, albeit legal, devices. Marketing orders for milk fix minimum prices that must be paid by processors to producers for milk. For fruits and vegetables and other agricultural products, the orders permit the administrative agency to allocate supplies among different market segments. Sometimes, the actual quantity of marketings can be limited.

The order and agreement program, which is authorized by the Agricultural Marketing Agreement Act of 1937, provided for these devices to permit farmers, together with their cooperatives in most instances, to offset the market power of the buyers of their product and to attain parity prices for producers. The Act specifically excludes marketing orders and agreements from the antitrust laws.

The reports of the Commission provide some indications of the changes that are implied by this recommendation. One suggested option would require public interest and competitive impact findings by the Secretary of Agriculture before enactment of any order provisions. The reports also listed some proposed order changes that would reduce their anticompetitive impacts and yet permit achievement of the legitimate program objectives.[6] These proposals are as follows:

1. The artificial pricing barriers to the use of reconstituted milk products in federal order milk markets should be eliminated. Currently, the required procedures for pricing milk on orders require a handler to pay a higher price (sometimes including payments to local fluid milk producers) for milk in the form of concentrated ingredients than if milk is purchased in fresh fluid form. This occurs even though the concentrates may originally be a cheaper raw product source.

2. The Class I price in federal milk orders should be reduced. The Class I prices are the prices charged handlers for milk used in fluid products. It is usually a fixed differential over the average price paid for manufacturing grade milk in the Upper Midwest. The rationale for the differential is to generate a price to producers that will provide adequate supplies of milk. The charge has been that, at least for fluid milk needs, the class prices have generated local supplies far in excess of needs in many federal order markets.

3. The decisionmaking process for order formulation should be made more open and the consumer interest standard should be clarified. Though legally possible now, public participation in hearings to promulgate orders or to change order provisions is limited because of the lack of expertise to represent the public at the hearings.

4. The allocation provisions in some fruit and vegetable orders that maintain production in existing areas should be eliminated. These provide for marketing allotments to producers and deliveries to processors which effectively prevent production from moving to potentially lower-cost production areas.

It is difficult to describe briefly how adoption of these proposed order changes would affect the respective industries. The conclusion is that shifts in regional patterns of production of some products would occur. Futhermore, prices for milk and certain fruits and vegetables would be altered. Prices of each product in some uses would decline; prices in other uses would increase. Regional price patterns would also change.

CONCLUSION

Antitrust law has attempted to reduce the organizational basis for market power and its anticompetitive effects. In its application, it became apparent that the prohibitions in this legislation should not extend equally to all types of businesses and groups. Partial exemptions have been granted to labor, to agriculture, and to various regulated industries. The National Commission for Review of the Antitrust Laws and Procedures was charged with examining the continued need for exemptions from these laws. It concluded that the agricultural "exemption" be limited in its scope.

The Commission concluded that agricultural cooperative mergers should be assessed, in terms of possible anticompetitive effect, in the same manner as nonexempt businesses. It further concluded that a standard of "undue price enhancement" be operationally applied to agricultural cooperatives. And, it suggested that marketing orders and agreements be carefully scrutinized for the economic impact as well.

These recommendations have raised concerns in the agricultural community because it is charged that the recommended changes will place farmers and their cooperatives in a weaker competitive situation initially, and because agriculture is being "singled out" in the application of an undue price enhancement standard that would not be used against other businesses involved in food and fiber production and distribution.

Restrictions on cooperative mergers and marketing agencies in common that may result are aimed at prohibiting cooperatives from achieving monopoly power. But, this fear may be more illusory than real. History shows that cooperatives have frequently sought more monopoly power than they have been able to achieve. They have been notoriously unsuccessful in several past attempts at controlling market supply. This is because membership is open and voluntary in most cooperatives and cooperatives do not control the production of their members.

If cooperatives are to be monitored for undue price enhancement, *while their competitors are not*, the effect will be to give unique advantage to noncooperative business for economic growth and market power.

The recommended changes in market orders and agreements could substantially reduce the market power that cooperatives currently possess under this program. Regional price and production patterns for milk and some fruits and vegetables could change.

It is clear that the public interest is best served by careful, complete, and unbiased analysis of the likely long-term effects of any changes in existing antitrust policy. The authors of this publication urge legislators to embark on such studies before any amendments are made.

FOOTNOTES

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[1] *Food from the Farmer to Consumer*, Report of the National Commission on Food Marketing, June 1966, pp. 93-97.

[2] Willard F. Mueller, "Cooperatives and the Antitrust Commission," *Farmer Cooperatives*, Economics, Statistics, and Cooperatives Service, U.S. Department of Agriculture, February 1979, p. 8.

[3] It should be noted that supply cooperatives are not under the exemptions of the Capper-Volstead Act.

[4] U.S. Department of Agriculture, Economics, Statistics, and Cooperatives Service, "Some Legislators May Attempt to Limit Scope of Farmer Cooperatives," *Farmer Cooperatives*, March 1979, p. 6.

[5] Mueller, op. cit., p. 9.

[6] National Commission for the Review of Antitrust Laws and Procedures, *Staff Paper on Agriculture*, October 2, 1978.

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