NATIONAL FOOD MARKETING COMMISSION—KEY ISSUES

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Speaking informally at the 1964 meetings of the American Farm Economic Association about the prospective National Commission on Food Marketing (NCFM), Dr. Willard F. Mueller admonished his listeners not to take on assignments with private industry in the context of the inquiry, but instead to hold themselves available for public service. How seriously Dr. Mueller intended this advice is not for me to say, but there is a strong tradition favoring a fairly sharp cleavage between private and public endeavor—a tradition which was hardly weakened by the much-quoted malaprop of a Secretary of Defense who had taken leave from General Motors. Yet undoubtedly business firms do have opportunities, not to say obligations, to serve the public interest; and undeniably politicians as well as appointive government officials (not to insist upon *this* cleavage) sometimes act inconsistently with the public interest. If only because the public interest is not easily defined, the traditional cleavage would bear frequent re-examination.

This cleavage bears scrutiny in relation to NCFM work for certain additional reasons. A temporary commission of inquiry is presumably freer of political influence than an established government agency, hence the opportunity for economists to contribute to its work should be greater. The task assigned to the NCFM, on the other hand, was a particularly difficult one in that a most heterogeneous, amorphous, enormous, and kaleidoscopic so-called "industry" was to be evaluated. Firm evidentiary conclusions are so difficult to draw in this circumstance that slight nuances of impression or interpretation assume exaggerated importance, oftentimes accommodating a prejudiced viewpoint. An additional reason lies in the fact that, whether or not in response to Mueller's admonition, many competent economists made their services available to the NCFM.

My own tentative impression of the work of NCFM is that it has not been in the public interest. Before undertaking to chronicle the basis for this statement I should qualify it in several ways. First, let me stress that it is a *tentative* impression, which not only can but should be altered. If economists, in particular, will assume a professional concern not only about the findings of the Commission staff, but also about the treatment accorded those findings, the longer run conclusion will be that the inquiry has been very much in the public interest. A second qualification already suggested in the first is that I think the economic staff of NCFM conducted some admirable studies. A third qualification is that my impression is necessarily partial, in that I have not read all of the staff technical papers. In addition to the formal report of the Commission, including statements filed by the six minority members, I have studied the retail technical report with some care and read other technical reports only hastily or partially. This no doubt will be taken by some to reflect my own prejudicial attitude stemming from my affiliation with the National Association of Food Chains, for which I have served in a consulting capacity. In fact, however, the Commission itself focused heavily upon retail food chains, and this emphasis is largely a reflection of the importance of retail food chains in the food distribution sector. So I turn without apology to a somewhat selective chronicle of events which I believe to be of serious concern.

THE STRUCTURAL HYPOTHESIS

One of the early pieces of testimony taken by the NCFM was that of the aforementioned Dr. Mueller, who presented some results of an analysis prepared in connection with a then pending Federal Trade Commission case against the National Tea Company. In this analysis the common structuralist hypothesis that concentration confers power, which manifests itself in monopoly profits, was ingeniously modified to suit the special circumstances in which chain stores operate; namely, many separate markets in which they obtain widely varying shares of business. Mueller hypothesized that, within the firm but among markets, shares would be associated with gross profit rates in reflection of market power, which he interprets as the power to pay less or charge more in high-share markets. The abstract plausibility of the hypothesis is undeniable, whereas its validity is a question of evidence which is not easy to marshal, given the range of factors other than buying and selling prices which influence gross profit rates, the difficulties in measuring these factors, and the myriad changing faces of rivalry. Undaunted by such considerations, Mueller urged upon the Commission a similar analysis of other chains, appearing in parts of his testimony to be almost prescient in anticipating the explanations of gross profit rates which chain store executives were about to proffer.

Again I cannot know whether it came in response to Mueller's advice, but the Commission staff did conduct, for the nine top chains, the sort of analysis which he proposed. This must surely have been the most costly and most important study undertaken by the staff.

Great effort by the staff and a high degree of chain cooperation were required merely to design a questionnaire, not to mention the completion, checking, submission, and ultimate analysis of some six thousand completed forms. The data from these questionnaires were analyzed by the accepted statistical procedures, and the results provide perhaps the single most important refutation of a structural hypothesis ever published, and undoubtedly the single most important finding of the NCFM. It is to be hoped that all who are interested in the *evidence* of competition in food retailing will study these findings. But even more important, it may be hoped that these results will strengthen our insistence upon evidence in the broader effort to maintain competition, while reducing the tendency to rely upon the insinuations of structure theory.

It is worthwhile to summarize the staff findings briefly. There were nine tests—one for each chain—to measure the net association of each of a number of factors with store gross profit margin. Of fifteen separate factors found to have a significant association in one test or more, twelve factors had more frequent and higher ranking associations than did market share, which had a significant association in only one of the nine tests—and a low ranking association in that one. Inventory shrinkage had a significant association in every test for which it was available, whereas both sales per square foot and store sales had high ranking associations in five of nine tests. A much longer list of factors was made available by one chain, for which nine additional factors proved significant.

In short, a very large number of factors were found to be associated with store gross margins, most of them much more highly than market share, yet all of them together explained a minor fraction of the variance in store gross margins. And as though to put one more nail into the lid of the coffin containing this structural hypothesis, when price comparisons were made between pairs of chains according to their shares in markets where they competed, the finding was that their prices bore no relationship to their shares. The staff suggested that perhaps the personal equation, which it was unable to measure, is of major significance. No doubt this is true, as it should be in an intensely competitive environment.

Casting one backward glance (which hopefully was not a longing glance) at the structural hypothesis, the staff related market shares directly to a number of operating data. It concluded that higher market shares are associated with lower expenses, higher average customer purchase, higher total sales and sales per square foot, lower inventory shrinkage, and greater profits. I find it only mildly disconcerting that these invigorating conclusions were drawn from a somewhat misleading statement of problem setting. The staff said "since local retail concentration and therefore local market shares of the largest firms is increasing"; but it neglected to point out that local shares of the largest *national* firms (the ones from which their data were obtained) have been *declining*. Knowing this, the staff might have wondered about the relevance of its additional test relating market shares to operating data. In any event, the staff reconfirmed the null hypothesis.

As it stands, the staff has given us two very important findings for the nine largest retail food chains: (1) the factual observation that their local market shares have been declining and (2) the analytical finding that their local market shares are not related to gross margins anyway and certainly not to prices and pricing margins. These two findings are, of course, consistent with one another and with the postulate that economic efficiency instead of economic power calls the tune in food retailing. They have also made a promising beginning toward a positive analysis of the constituent elements of this economic efficiency. While improved understanding of the economics of food retailing must await the extension of these promising beginnings, it is comforting to know from objective evidence that the public interest does not presently require limitations upon growth or change in this industry. It is at the same time distressing to find that the portion of the retailing study prepared by the Federal Trade Commission adheres to the Mueller hypothesis in the face of the evidence against it.

CONCENTRATION IN THE FOOD INDUSTRY

No other branch of the food industry was analyzed in the same fashion or degree as was food retailing. Hence, while some of the bare structural picture of other branches emerges, the relationship of structural characteristics to conduct and performance remains largely conjectural. It is nevertheless useful to summarize the bare facts.

1. Concentration in the food industries is neither high nor rising. Compared to nonfood industries, concentration in the food industries is conspicuously low. Compared to recent earlier periods, the trends are mixed, with increased concentration in some food industries and decreased concentration in others. With only two exceptions, the four-firm concentration ratios in twelve food industry categories are in the 20's or below—the two exceptions being cracker and cookie manufacture and breakfast cereal manufacture.

2. In food retailing, the four-firm concentration ratio is 18, where it was ten years ago. The twenty-firm concentration ratio has risen from 26 to 31. The local market concentration ratio has risen slightly since 1958, while the national ratio declined slightly and the top national chains' shares in local markets also declined. On the buying side, 50 percent of purchases sold through retail stores can be accounted for only by counting as many as seventy firms.

THE FOOD COMMISSION REPORT

While the staff study of food retailing breaks rich new ground in economic analysis, the final majority report of the Food Commission ignores the staff findings. The Commission had before it the realities of low concentration in food industries, especially in food retailing, evidence of a lack of relationship betwen shares and gross margins and pricing in retailing, no evidence of any general tendency toward increasing concentration, and evidence of relative gains by smaller retailers. Nonetheless, the majority concluded that "there is a tendency for business in the several fields of the food industry to become more concentrated" and "in the absence of restraint, concentration is expected to increase in most fields of the food industry" and "concentration of purchasing power by food retailers is especially significant."

Yet if these seem strange conclusions to draw from the staff studies, the truly fantastic awaits those who are willing to go down the rabbit hole with Senator McGee of Wyoming, who had introduced the bill to establish the Commission in the wake of his own allegations of chain store profiteering in the marketing of beef. Incidentally, the second most important finding of the Commission, in my view, was the disproof of this allegation, and proof of the inaccuracy of the BLS statistics upon which it has been partially founded.

The Senator is utterly unperturbed by the facts, as he writes in his individual statement that he is "profoundly troubled by the ominous portents" and elsewhere "worrisome portents" of the "supermarket phenomena." He says:

> As disclosed in the Commission report, we have barely begun to comprehend the implications arising out of the growth of the great food chains. I am not so much concerned with the relatively few cases in which market power of the chains is deliberately employed in predatory schemes. But size inevitably begets power, and inordinate power tends to subvert the free play of market forces of supply and demand upon which we have traditionally relied to insure producers and consumers equity in the marketplace.

> The central role in our food distribution system is occupied by food retailing. Over the past several decades the balance of power has increasingly shifted to retailers at the expense of farmers, processors, and consumers.
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> . . . It may be that we are on the threshold of a new era in food distribution, one in which raw market power rather than economic efficiency will determine the outcome of the competitive race.
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> . . . Our records show that some large chains operate numerous stores for sustained periods of time at a loss and at small gross profit margins, particularly in markets where they have small market shares. It further shows that when a retailer has a strong market position in a market he may enjoy sustained high net profits without having his market position eroded by competitors.

In perhaps his unkindest cut, he announces:

> One final warning would seem to be in order based upon the experiences in the Commission's study. That is the built-in tendency within the industry and those dependent upon the industry to resist all studies, investigations, or to withhold critical information necessary to the fullest grasp of the problems at hand.

These are the thanks earned by an industry which consistently received the plaudits of staff economists and the staff director for its spirit of cooperation during the course of the studies.

But the Senator uses a phase which I have used, and offers some advice with which I fully agree. Speaking of giving "first priority" to the "public interest," he says:

> If we are to achieve this approach realistically, we must divest ourselves of the old cliches, concepts, and fetishes that tend to inhibit our freedom of comprehension.

If the physician would truly heal himself, he might begin by divesting himself of the following old cliches, concepts, and fetishes selected from his statement:

> . . . the disturbing forces at work in the wake of the supermarket phenomena . . .
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> . . . The concentration of economic power among food retailers . . .
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> . . . the best available evidence indicates that the recent structural changes have already had an adverse impact on farmers and consumers.
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> . . . Farmers have an even greater stake in these developments because experience teaches that increased marketing costs bear most heavily on them.
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> . . . our antitrust agencies have been given a clear mandate for more vigorous antimerger enforcement in food retailing . . .
>
> . . . massive impact of huge concentrations of marketing power . . .

The Senator will of course continue to enjoy his Congressional immunity from the facts, but we who lack Congressional immunity must immunize ourselves against his fantasies, as well as some of our own. We need to be particularly wary of the "old cliches, concepts, and fetishes" of market structure theory, and the staff of the Food Commission has underlined that need with solid evidence.

ON PRICES AND MARKETS

I had not realized what a kindred spirit I had in the person of Representative Leonor K. Sullivan of St. Louis, Missouri, until I read her statement stressing the importance of futures markets. The subject was not studied by the Commission staff, but the majority report recommends that regulation by the Commodity Exchange Authority be extended to include meat and livestock futures, and possibly coffee and sugar futures. As one who has devoted considerable effort to studies of futures markets, I concur in these recommendations. I have recently recommended to the management committee of the Sydney Futures Market and to the Australian Wool Board that they give consideration to the possible advantages of statutory authorization of their futures market, based upon our American experience.

I wonder, however, in view of the fact that the staff made no study of futures markets, where Mrs. Sullivan obtained the impression that "the law which presently applies to futures trading in other (regulated) agricultural commodities is an obsolete and deficient statute which badly needs strengthening." If by any chance she is reflecting the view of the regulatory agency itself, which sponsored legislation earlier this year to amend the Commodity Exchange Act, she may be guilty of a too uncritical acceptance of that agency's point of view. That bill in fact contained provisions inimical to market performance and the public interest, as brought out in the hearings on H.R. 11788. It may be, however, that Mrs. Sullivan has other and better sources of information, which would warrant our giving her proposal serious consideration.

The point I would stress in any case is that uncritical acceptance of the viewpoints or objectivity of regulatory agencies is not a suitable policy for a Presidential study commission. For this commission to have recommended that the Federal Trade Commission conduct continuing research into food marketing problems seems to me just as inappropriate as asking the Commodity Exchange Authority to write the laws regulating futures markets. If it is indeed true, as one Commission member believes, that size begets power, which in turn invites the abuse of power in quest of the easy life; then this principle must apply to the regulatory agencies, where the restraints are somewhat less automatic than those of the marketplace.

Elsewhere the majority recommends improved market information about prices and supplies, especially in view of decentralized purchasing and inadequate reflection of retail special prices. I am in full sympathy with this recommendation and hope that it will be urged just as strongly upon the data collecting agencies as upon the industry. Most responsible participants in the marketing process are likely to appreciate the benefits of prompt and accurate reports of transactions.

THE ISSUE WHICH ARISES

There are important issues, which do not arise out of the Food Commission report and which are not limited to food marketing, which the Commission might have helped resolve. Had the staff study of the nine top chains been accorded the importance it deserved in the majority report, this would have helped to resolve not only the issue of competition in food retailing but also the larger issue of the relationship between market structure and competition generally. Unfortunately, only a scant half page of the 113-page majority report is devoted to this important study, and this fact in itself emerges as an issue. How and why were important findings lost in a labyrinth of hostility toward large chains, and what can be done about it? It seems clear that some politicians saw in the Food Commission an opportunity to revive the middleman-scapegoat syndrome which is rooted in our populist agricultural heritage. Add to this the fact that many economists construe the competitive model as containing an implicit indictment of advertising, promotion, product differentiation, and all forms of nonprice competition, and it is fairly easy to see *why* the study got lost in the report.

How it got lost is not so easy to see, but the process can be at least outlined from the Commission report. Finding that concentration in food retailing at the national level is very low and static, the report focuses upon local market concentration, which is higher by definition and has been rising somewhat. Of the nine-chain analysis of local market concentration, the majority report says "higher market shares tend to be identified with higher gross margins." Yet the relevance of this statement had already been undermined by the acknowledgment that these largest chains have been losing shares in local markets. Also, the accuracy of the statement had been undermined by actual findings which showed a significant association between market shares and gross margins for only one of the nine chains and no relationship between shares and prices.

Ultimately then, it is to bargaining power in *buying* that the majority report turns for its indictment of chains. Finding here that buying *concentration* is not great, the report concludes that "the most important source of retailers' market power is their direct contact with consumers." This is not only a novel economic theory but it is a very curious theory to be advanced by a commission which elsewhere deplores the increasing complexity of shopping associated with the decline in consumer contact with sellers. The new theory is scarcely operational, in that every defunct corner grocer had the same or *closer* consumer contact, as of course did the unaffiliated independents who have been disappearing as chains and affiliated independents have expanded. Structure theory, for all of the jumping to conclusions which it has fostered, did at least lend itself to the framing of some testable hypotheses. It is dismaying that the Commission, having framed one such hypothesis and resoundingly rejected it, chose to neglect this result and to introduce a new theory of consumer contact which lends itself, not to economic analysis, but to the pillorying of retailers.

It may well be that in a buyer's market those closest to the buyers in the vertical chain are best situated and that in a seller's market those closest to sellers are best situated. I do not advance this as new economic theory, but I do suggest that the consumer proximity postulate is not likely to survive a seller's market.

In retrospect it is easy to agree with Dr. Brandow, the Executive Director, that the Food Commission model is not a correct one because Congressmen are too busy, and too committed ideologically and politically, to permit an independent approach. Brandow believes that a largely professional group of economists and lawyers would do much better.

Economists, lawyers, and others will have a continuing opportunity for objective evaluations in the public interest. Those who do not believe that change is bad per se, that growth is bad per se, that size is bad per se, that advertising is bad per se, that mergers are bad per se—but who are willing to analyze these and other phenomena (including Senator McGee's "supermarket phenomena") without prejudice—those students can help to convert the Food Commission publications to the public interest. They can do so by reading and evaluating the technical studies as economic analyses; and by reading and evaluating the Food Commission report as a political document.

PART III

The Crisis in Cotton