T. Schmitz, Arizona State University

Discussant Comments

Selected Paper Session: Contract Bargaining and Selection Models

"Opposition to Contract Production: Self-selection, Status, and Stranded Assets"
David Skully, USDA/ERS

Summary:

There are many arguments made in this paper that are too numerous to summarize here. One of the main arguments is that the decision to contract is based on specific growing skills, general human capital, and credit worthiness. This paper argues that because broiler contracting originally occurred in areas of rural under-employment, low land prices, did not require much specialized skill, and required a small scale of operations, that it was relatively easy and socially desirable (in terms of household wealth and status) to contract for broiler production. Hence, there was little opposition to vertical integration in the broiler industry. On the other hand, because pork contracting is occurring in areas already populated by independent growers, and it requires a higher initial investment as well as a higher relative skill level, pork producers view contract expansion as a significant threat to incumbent's household wealth and status.

Comments:

1. I agree with the general arguments outlined in this paper. I would like to add that the environmental externalities of large-scale animal production near populated areas plays a major role in the hog industry.

2. It seems that broiler producers in the South are becoming more and more disenchanted with the current contractual arrangement and are seeking alternatives. As the older producers retire, the younger generation does not remember the price and market instability associated with broiler production prior to the 1970s. They are exploring alternatives to the structure of the production tournaments that are currently implemented by large integrated processors. Some are looking towards the horizontally integrated Canadian supply-managed broiler industry for alternatives. At the same time, many Canadian broiler producers are looking for alternatives based on the vertically integrated U.S. broiler industry. Each of these systems presents its own particular set of problems.

3. I would strongly agree with the statement that presently, moving to vertically integrated contracting systems in agriculture, in which one is forced to purchase the inputs and sell the outputs to the same company, represents a "step-down" in terms of household wealth and status. This is not only true in the broiler and hog industries, but also in many other agricultural endeavors. For example, 10 years ago, farmers that owned grain land in Saskatchewan almost always farmed their own land. Now, it

seems that they are moving towards the old landlord-tenant system in which the landowner rents the land out to field workers on a "cash-crop basis". Many of these workers also rent the machinery from the landowner.

T. Schmitz, Arizona State University

Discussant Comments

Selected Paper Session: Contract Bargaining and Selection Models

"Understanding Production Contracts: Testing an Agency Theory Model"

Rachael E. Goodhue, Gordon C. Rausser, and Leo K. Simon

Summary:

This paper tests the hypothesis that the relationship between growers and the processor will be designed to maximize the gains to the processor. It shows that higher-ability broiler producers receive preferential treatment from the integrator in terms of larger flock sizes and more consistent chick placements. Hence, they are shielded to a greater extent than other growers through benefits of reduced risk from the processors.

Comments:

1. The modeling efforts and techniques used for the empirical analysis presented in this paper are solid on both theoretical and econometric grounds.

2. The results of this paper seem to imply that broiler integrators have a fairly efficient contracting system that works to their advantage. This stems from the ability, unlike many other industries, to easily monitor the ability of each producer. They reward high-ability producers with larger flock placements and premiums, but they penalize low-ability producers. Once they have weeded out the consistently low-ability producers, they have the power to remove them from their production process by not offering these producers contracts in the future. This system works to the advantage of broiler integrators, but to the detriment of low-ability producers. While this may be efficient from a net welfare perspective, it may not be "fair" from a distributional perspective.

T. Schmitz, Arizona State University

Discussant Comments

Selected Paper Session: Contract Bargaining and Selection Models

"Quality Measurements and Risk Sharing in Contracts for California Fruits and Vegetables"

Ethan Ligon and Brent Hueth, University of California, Berkeley

Summary:

In this paper, the authors provide both a theoretical and empirical analysis of two different contracting schemes. The first model analyzes the Joint Venture Agreements by analyzing the contracts for "mature green" tomatoes. The second model analyzes the contractual arrangements associated with the processed tomato industry. The major contribution of this paper is that it offers a supply-side explanation for lower quality in canned processing because with canned products, grower's compensation can't depend on the downstream price of the initial product.

Comments:

1. The theoretical models that are developed in this paper do a good job of modeling actual "real-world" contracts for fresh and processed agricultural products.

2. The theoretical models presented in this paper can, and should, be applied to other contractual marketing arrangements. This paper offers a set of tools that can be used to further analyze agriculture beyond the farm-gate. In my opinion, agricultural economists should focus more attention on these types of issues.

T. Schmitz, Arizona State University

Discussant Comments

Selected Paper Session: Contract Bargaining and Selection Models

"A Dynamic Analysis of Price Determination Under Joint Profit Maximization in Bilateral Monopoly"

Stephen Devadoss, University of Idaho

Summary:

This paper examines bilateral monopolies involving a single seller of an intermediate product, and a single downstream buyer. The author explores possibilities for avoiding the well-known theoretical result that if both the buyer and the seller are not willing to behave as a price-taker, the market mechanism will break down. The author presents a two-stage bargaining model in which the quantity that maximizes joint profits is determined first and then the parties bargain for a satisfactory way to distribute the profits.

Comments:

1. The result that the equilibrium price is reached faster in a dynamic setting, when larger volumes of transactions are at stake, seems plausible.

2. The model assumes that each party has full information regarding the profits of the other in order to establish an equilibrium. Perhaps this model can be extended to include imperfect information of both a symmetric and asymmetric type. This may result in a different outcome in which the equilibrium price would not be equal to half of the per unit revenue of the buyer plus half of the per unit cost of the seller.

3. I'm not sure that in the real-world the buyer and seller determines quantity independently of price. The fact that this model is implemented in two stages seems to imply that this is the case. This needs to be clarified.

4. Finally, in order to test this model a researcher might have a hard time obtaining the necessary data. However, if this could be done it would be interesting to use this model to empirically test the interaction between cooperatives and (non-integrated) processors or to determine the pricing arrangement between, for example, provincial Canadian supply-managed marketing boards and processors.