



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*



Competition regulation against quality policy: the «Label Rouge» in the French Poultry Industry

Emmanuel Raynaud ¹, Egizio Valceschini ²

¹ INRA-SAD Paris Grignon and Centre ATOM (University Paris I)

² INRA-SAD Paris Grignon. Address: 16 rue Claude Bernard, 75231 Paris cedex 05 France.
e-mail: valcesch@inapg.inra.fr

Contribution appeared in Arfini, F. and Mora, C. (Eds.) (1997) “*Typical and Traditional Products: Rural Effect and Agro-Industrial Problems*”, proceedings of the 52nd EAAE Seminar, pp. 529 - 546

June 19-21, 1997

Parma, Italy



**UNIVERSITA' DEGLI
STUDI DI PARMA**

Copyright 1997 by Emmanuel Raynaud and Egizio Valceschini. All rights reserved. Readers may make verbatim copies of this document for non-commercial purposes by any means, provided that this copyright notice appears on all such copies.

EMMANUEL RAYNAUD¹, EGIZIO VALCESCHINI²

**Competition regulation against quality policy :
the « label rouge » in the french poultry industry**

ABSTRACT

The compatibility of the control of quality as associated with an official European label (PDO, PGI) and competition is a debatable issue. We examine this issue for the example of the «label rouge» in the French poultry sector. We will describe the controversy over co-operation associated with the «label rouge» which have been denounced as anti-competition practices and present an analysis aimed at improving economic reasoning which underlies the right to compete. We put forward the control of the players in positions of interdependence is closely linked to the collective use of the same economic asset, in this case a quality label. We will try to show that the creation of a pivotal structure allows the reduction of transaction costs associated with this control.

¹INRA-SAD Paris Grignon and Centre ATOM (University Paris I)

² (corresponding author) INRA-SAD Paris Grignon

Address: 16 rue Claude Bernard, 75231 Paris cedex 05 France. Email : valcesch@inapg.inra.fr

INTRODUCTION

The European Community Council passed legislation in 1992 which reserves the use of place names to products with «particular characteristics». These rules concern specificity claims associated with the protection of geographic indications and «appellations d'origine» for agricultural products and foodstuffs (AOP/IGP³). This decision was aimed at making official quality labels available to farmers and food manufacturers. These labels were to be used to valorise products of particular or superior quality. The use of these legal facilities has however encountered difficulties when confronted with the European Union competition laws which prohibit concerted actions between producers liable to limit competition⁴.

In the various countries of the European Union, businesses and groups of producers in the food industry who use official quality labels are currently the subject of legal proceedings, or have even been condemned for non respect of competition law. These problems highlight the problem of compatibility between quality certification by the use of official labels and competition law. The basic question is the following: should a policy of quality is restricted to the pure registration of signs of quality by an administration? Or should it be a vector to better coordination and more efficient arrangements among producers involved? Do such arrangements contradict the policy of competition?

We address this questions using a particular case, the collective brand name «label rouge» in the French poultry sector⁵. This case illustrates the application of free trade legislation in the field of collective strategies, and can be used for an analysis of the problems of collective management of quality control and guarantees.

In the first part, we will address the arguments presented in the judicial proceeding concerning various practices associated with the label system accused of being anti competitive. The theoretical question is: how to assess coordination modalities that are neither of the pure market type nor of the purely integrated firm type? In the second part, using behavioural assumptions of Transaction Cost Economics (bounded rationality, opportunism of the players), we develop a positive analysis of the label system, which could contribute to improving the economic reasoning underlying competition. We suggest that the issue of the control of behaviour in situations of close interdependence is crucial. The interdependence results from the collective use of an asset, in this case the official quality label «label rouge». This control generates particular contractual mechanisms.

³Protected «appellation d'origine» and protected indication of provenance, respectively.

⁴Articles 85 and 86 of the treaty instituting the European Community.

⁵In 1991, the French ministry of economics, finance and budget asked Conseil de la Concurrence (monopolies commission) to investigate an affair involving accords in the poultry label sector. The Conseil made a judgement in 1994 on the basis of a report by an investigator. This affair is the basis of our analysis. There are two principal groups of source documents: the legal proceeding; and studies conducted by the certifying organisations and slaughter companies. See Valceschini (1995a and 1995b).

1. THE LABEL SYSTEM VERSUS FREE MARKET LEGISLATION : THE HYPOTHETICAL SUPERIORITY OF THE MARKET.

The controversy is centred around the functions of the certifying organisation (see box 1). The practices criticised as anti-free market are mainly those of prohibited accords.

1.1.1 The concept of anti-free trade and the main complaints as concerns the poultry label

According to competition legislation, the free market is threatened by restrictive practices which, in addition to the involvement of national legislation, include cartels or monopolies. In Community law (art 85 § 1, in Gavalda, C., Parlicani, G., 1992, p 442) the principle is that « all accords between businesses, all association decisions by businesses and all concerted activities that are liable to affect commerce between member states and which are aimed at preventing, restricting, or manipulating competition within the Common Market, are incompatible with the Common Market and are forbidden ». In French law concerning free pricing and competition, the following practices are classified as prohibited: « express or tacit concerted actions, conventions, accords and coalitions aiming to prevent, restrict, or manipulate competition in the market, particularly if they restrict access to the market or free competition by other businesses; to impede the price being set by the action of the market, by favouring increases or decreases; limiting or controlling production, distribution, investments or technical progress; allocating markets or sources of supply ». Four arguments were used to condemn the label system as restricting free trade⁶.

Discrimination by quantity. Practices within the certifying bodies were incriminated. They include regulating production, limiting the entry of new farmers (in practice refusing acceptance of new farmers, and permission for new constructions, waiting lists etc.). The limits between coordination between adherents to a label aimed at planning production «allowing adjustment of the internal supply and demand» (Revue de la Concurrence et de la Consommation, p 61) (planning production and delivery by farmers for example) and regulation are not clearly established, although only the management of quantities which affects regulation is open to attack⁷.

Price discrimination. The accord within certifying bodies fixing prices, and in particular determining selling prices to slaughterhouses, and the attempt to impose a minimum resale price on slaughterhouses was denounced.

⁶This judgement allows analysis of several situations. Numerous practices (9 types) liable to be classified as accords were identified, and various players, both economic and trades unions (13 certifying bodies, 5 slaughterhouses, the National Syndicate of Poultry Labels, France, SYNLAFF) were incriminated.

⁷ In monitoring the establishment of rearing facilities, for example, an action aimed at managing flow is distinct from behaviour aimed at controlling supply. The first is an industrial production function to minimise very short-term variability, causing bottlenecks, or excess stocks. The second is centralised production planning in the medium term. Information about setting up corresponds to information about production levels, and thus controlling the supply when the price movements are unfavourable, in other words, manipulation of the volumes so as to prevent the free play of the market on prices.

Restrictive clauses in contracts. The elements attacked included procedures for admission of farmers, as they are discriminative (acceptance criteria for example), and the structural measures to reduce production (preventing construction of new rearing facilities), and the contractual clauses with the certifying body prohibiting competition between the member slaughterhouses. This corresponds to allocating market share to slaughterhouses under the same label.

Information asymmetry. The combination of three functions within one structure (the certifying organisation) has been condemned. From the beginning, the certifying body has fulfilled three different functions⁸: the co-ordination of activities according to norms, verifying conformity to specifications, and certifying products. This accumulation of functions gives the certifying organisation excessive powers over the characteristics of the products, and information concerning these characteristics.

1.2 Exemption clauses and economic arguments in favour of the label system.

1.2.1 Exemption clauses in competition legislation.

Article 10 of the French competition law of the 1st of December 1986 adapted from Community law allows two types of derogation. The first is stipulated in § 10.1 «accords and abuses of a dominant (monopoly) position are not liable to the various penal or civil legal sanctions if it is established that the anti-free trade practice results from a legislative text.» (Lamy, 1993, p 449). Thus it has to be determined whether those involved in restrictive practices can justify their actions by the existence of a law or decree. The practice must be shown to be an inevitable consequence of this text. The monopolies commission concluded that this was not possible in the case of the label system. This issue is a legal debate between lawyers, and not within the scope of this article.

A second exemption is laid down in §10.2 of the right to compete. Unlike the case above, it is based on a precise economic argument, involving proof of «economic progress». This exemption states that if «those involved in the practice (accords and abuses of a dominant position) can demonstrate «economic progress» and that the users receive equitable profit, without allowing elimination of the competition for a substantial part of the production, then the practice is exempt». These practices must not restrict competition unless indispensable for progress.

« Certain types of accord, particularly those aiming to improve the management of small business, are acceptable according to these conditions by decree following the favourable judgement of the monopolies commission » (Lamy, *Droit Economique*, 1993,

⁸ The only legal activities of the certifying body are control and certification. It is not legally empowered to coordinate the various operators. This function, called «economic organisation» is devolved by the rules to a «producers grouping» (farmers and industrialists). For the accreditation procedure for labels, the state recently specified the official separation of the certifying body and the economic organisation of farmers. The following distinction was made: the certifying body is charged with controlling and certifying, the group ensures the economic organisation and technical co-ordination.

Competition regulation against quality policy

p 449). The contribution of the accord or position of power to economic progress thus « eliminated » the anti-free market character.

The use of article 10.2 is however subject to certain conditions. The author of anti-free market practices has to show that only this practice can ensure economic progress, and also that this progress is sufficient to compensate for the restriction of competition. Two elements can be used to identify economic progress (Lamy, 1993): (i) improved productivity, associated with the efficiency of allocations (improvement in matching resources to needs) and production efficiency (better use of resources); (ii) improved market conditions: opening new opportunities, creation of new products, increasing the distribution of a patented product, improving consumer satisfaction (diversity of product ranges, and quality), contribution to the guarantee of quality or authenticity of a product, etc.

Economic progress can only be accepted if substantial benefits accrue to the client and economic system, as well as to the parties involved in the accord. The existence of economic progress in itself is insufficient to justify anti-free trade practices. Other conditions of causality, exclusivity, and proportionality are required. (1) The beneficial effects of the economic progress must be attributable to the shackles on competition: « a causal link between the economic progress invoked and the anti-free trade practice can only be used for justification if it is both exclusive and direct » (Lamy, 1993, p 464). (2) The anti-free trade practices must be strictly proportional to the beneficial results: « the greater the restriction of competition, the greater its contribution to economic progress must be » (Lamy, 1993, p 465).

During the judicial debate and judgement by the monopolies commission, two types of argument were used to defend the label system. The first was to show that the contentious practices appeared to be a restriction of competition, but that they were justified in that they ensured economic progress. The second was based on the idea that the practices were essential for the production of products under a label. Consequently, the label system is not collusion, but the normal workings of business.

1.2.2 Rejection of the economic progress argument.

To benefit from the economic progress clause, four lines of defence were developed for the label system (Revue de la Concurrence et de la Consommation, 1994).

(i) The progress was collective economic progress and not simply an improvement of the position of the businesses concerned. Poultry labels were created during a period when poultry production had a poor image due to the use of intensive techniques, particularly the growth of factory farming. Labels allow the consumer the choice of a higher quality product. This would have a knock-on effect to the entire poultry industry, and allow improvements in the quality of all poultry.

(ii) The economic progress is the direct consequence of the contentious practices. To guarantee an identifiable and recognised high quality, it is absolutely necessary to have strict and rigorous production rules laid down by the public authorities and verification of the respect of specifications by a certifying organisation. Controlling production and refusing new members is an integral part of the technical constraints. Minimum and maximum ages at slaughter are essential indicators of superior quality.

Excess production over the demand would result in overage chickens, and thus their being down classed to standard chicken. Such down classing would result in a poor return on the human and material investments (sales price below cost price) and an increase in average production costs. Therefore, controlled coordination is required to reduce as far as possible the risks of imbalance, and consequent under-valorisation of production, to ensure the profitability of the activity. This is to the advantage of the consumer by preventing the product disappearing. The certifying body refusing to accept new members, and limiting production are thus indispensable management tools.

(iii) This economic progress would not be possible by other routes. The «label rouge» used by the certifying bodies belongs to the ministry of agriculture. This guarantee of superior quality assured by state authority could not exist without the regulatory label organisation. To avoid counterfeit, the public authorities which created the label (in the poultry sector only) only allow label products to use the positive-image term «fermier» and indicate the age at slaughter and type of feed. The controls over production and setting a minimum price assure a reasonable reward for producers efforts and are thus essential elements of the label contract. The price of label products must be maintained above that of standard products to allow the application of the specifications and conformity to the qualitative norm, without which there is the risk of a decline in quality to the disadvantage of the consumer.

(iv) The progress has been sufficiently large. Because of label products, the quality of the entire poultry sector has improved. Furthermore, the reduction in production costs has resulted in substantially better competitiveness with other meat products and consequently improved market share. The label has increased the choice available to consumers. Thus, quality, product range, image, competitiveness, and market share have all benefited substantially from the label system, as have rural communities and economic progress.

The basis of most of these arguments were not contested by the monopolies commission, which accepted that the poultry label system contributed to economic progress. However, several counter arguments were expounded to nullify the use of the economic progress clause. The central contention was that it could not be shown that the economic progress was greater than that which would result from the action of the free market. In particular, the regulation of production, and the concertation of prices were not considered to be necessary for economic progress. They were characterised as opportunist concertation, and not indispensable to the label system's management of quality. Similarly, the producers maintaining an elevated price was not considered necessary to the image of the label brand. If the label guarantees a superior quality defined by objective criteria to the consumer, the normal action of the market would result in such a product being higher priced as a sign of its quality. Thus, the image of quality associated with the label would be automatically valorised by the market, which would result in a higher price. There is also no justification for the label-system's intervention as concerns the distribution of added value (or quasi rent) within the sector: it is the function of the market to find equilibrium prices.

The contentious restrictions on competition do not therefore appear to be indispensable to the development of the production of label poultry. They were simply a response of the sector to temporary difficulties when the demand became saturated which deprived (intentionally or otherwise) the consumer of a fall in prices.

Competition regulation against quality policy

1.2.3 The single firm concept.

During this affair, the government representative, from the ministry of economy and finance proposed the single firm concept, so as to overcome the market-organisation dichotomy⁹.

Before arriving at the proposition of a single business, this analysis of the label structure aims to show that the upstream inhibition of free trade is necessary to the development of label poultry production. This line is based on a central observation. As the label rules require a minimum level of production, it is logical that the producers and certifying organisation organise the association of isolated producers and supply to slaughterhouses, so as to develop units able to deliver batches of homogeneous quality, with regularity, in proportion to the demand from distributors. The association of farmers into marketing structures is necessary to generate the competitive capacity based on quality, and competitiveness which it would be impossible to attain if they were completely independent and without the certainty of finding openings for their label production. Consequently, the formation of associations to select suppliers and optimise buying conditions, to regulate production and obtain a single selling price with a guarantee of selling the entire production all contribute to a positive economic outcome, albeit at the expense of a relative restriction of competition.

The *Revue de la Concurrence et de la Consommation* (1994) explains how this is an alternative line of argument to that taken by the monopolies commission. The commission followed the classic line in competition law, which is to examine whether an accord has an anti-competitive aim or effect, and if the economic outcome is positive. « The alternative is to consider that all the businesses working under the same label are in fact collective and thus constitute a single firm. Under a label, because of the specifications, the producers renounce their autonomy of production: there is production planning, the suppliers are common to all, the raw materials are the same, and prices identical. The choice of slaughterhouses to supply is collective, as are investments, the types of buildings and the size of farms. The producers thus do not exercise the complete functions of a production business, because the choice of investments, commercialisation, production volumes and outlets are made by a common structure. This structure is the true operator in the sector, because, despite not being a business in terms of company law, it has all its economic functions. Furthermore, it also has only one objective which is to improve quality and bring higher quality products to the market. Thus, this system should not be considered anti-competitive » (*Revue de la Concurrence et de la Consommation*, 1994, p 60).

⁹ This argument was not accepted by the monopolies commission because, in view of norm EN 45011, the certifying body cannot have the functions of both certification and co-ordination. Legally and legislatively, this argument is coherent, but does not detract from the theoretical value of the concept of a single business. The debate over this concept led to some of the concerted practices being considered anti-competitive (particularly transfer prices). The judgement excludes the possibility that the certifying body is a business, the concept remains valid.

1.2.4 Problems associating with invoking the economic progress clause.

The exemption conditions are very strict and there are two difficulties associated with using the economic progress clause.

The first is « technical »: the criteria for justifying economic progress are varied and the justifications ad hoc. They are difficult to evaluate because the precise data required are not available. The main problem is to demonstrate that the conditions of causality, exclusivity and proportionality are satisfied. Gavalda and Parleani (1992, p 487) explain that to judge the legitimacy and pertinence of an anti-competitive practice, «generally requires each time a concrete study of the hypothetical action of the market in the absence of the contentious stipulations or practices ... The reconstruction of an unfettered market requires a sophisticated economic analysis, which does not exclude artificiality» The necessity to show the relevance of the criteria of economic progress adds the requirement for modelling a virtual situation (the unmodified market) which further increases the difficulty of the proof. As judgements are made case by case, the confrontation involves arguments the strength of which depends not only on their relevance, but also the weight of those using them. This is clearly shown by Dumez and Jeunemaître (1992) in the case of the confrontation between the State and companies over competition in the beer market in Great Britain.

The second category of difficulties is the divergence between the function and aims of competition policy on the one hand and the conflict between competition and economic efficiency on the other. Economic progress is clearly relevant if the right to compete is a method of improving economic efficiency. A recent communication from the commission is consistent with this: «reinforcing the policy of competition is not an end in itself. This is taken into account in other community policies» (the European Union Bulletin, 1994, p 34). This position is important because as indicated by F. Jenny (1993, p 193) «economic analysis teaches us that economic efficiency and competition are incompatible in various situations»¹⁰.

2. MONITORING AND DECISION MAKING IN THE LABEL SYSTEM : THE EFFICIENCY OF A PIVOTAL STRUCTURE.

The legal controversies in the label case raised difficult questions of economic theory. At both the level of community competition rules and the national monopolies commission, arguments were developed from representations of the workings of competitive markets for which both the boundaries (relevant market) have to be defined

¹⁰ Generally, the debate is not so clear. As observed by F. Jenny, for example, concerning abuse of monopoly positions, European law (article 86 of the EEC) states that «*the elimination of anti-competitive practices by business in a monopoly position is an end in itself, independent of the drive toward improved efficiency*» (Jenny, 1993, p 196). Competition policy relative to controlling concentration, judging between production efficiency and the power of the market (between reducing the intensity of competition and gains in economic efficiency) is very different in Europe and the USA. In Europe, competition is all important: «*effective competition and defending the interests of the consumer are emphasised, whereas in the USA, production efficiency is given more weight*» (Encaoua, 1993, p 4). This view is shared by M. Glais (1992a, p 97) who writes «*community rules abandon the theory of economic consequences in favour of the method of competition outcome*»).

Competition regulation against quality policy

and the businesses involved (decision-making unit) have to be identified. The debate in the label case, particularly as concerns the single firm concept show the difficulties of determining these references. In the theoretical domain, recent literature arising from Transaction Cost Economics shows that the two concepts, market and organisation, are insufficient to cover all the institutional arrangements used to govern transactions. There is at least one other family of arrangements, hybrid forms, which have their own characteristics.

The label structure has already been the subject of contractualist analysis, in terms of economic conventions (Sylvander, 1995) or hybrid forms of organisation (Ménard, Valceschini, Garnier, 1995; Ménard, 1996). The second of these approaches tried to show that the use of a hybrid form of organisation was partly due to the presence of specific assets in transactions. In the label system, temporal and brand name specificity explain the shift from market governance to hybrid mode of coordination. Complementary to this approach, and still in the domain of Transaction Cost Economics, we aim to analyse the label system but without particular reference to the specificity of the assets. We are especially interested in the label as a means of coordination of economic players who are highly interdependent. This interdependence results from the use of a common economic asset, the «label rouge» brand name. The analysis is focused on a central element of the label system: the certifying organisation, considered as a pivotal structure.

According to the hypotheses of opportunism and bounded rationality, the contract is not an «automatic pilot», and does not in itself suffice. There must be mechanisms to control the agents. The term control has a double meaning here, associated with behavioural hypotheses: (i) control as in surveillance (monitoring) of the behaviour of the agents during the transactions (linked to opportunism); (ii) control as the ability to make subsequent ex post decisions to respond to the incompleteness of the contract¹¹ (associated with bounded rationality). The complementary mechanisms form what Williamson calls the governance structure i.e. « the institutional framework within which the entire transaction is decided » (Williamson, 1996, p 11). The function of governance structures is « to identify, explain and attenuate the hazards associated with the contract » (Williamson, 1996, p 15) in the cheapest possible way (in terms of transactions costs). These contractual hazards¹² result from the two behavioral assumptions and the uncertainty of the environment which obliges the players to continuously adapt so as to fill holes in the initial contract.

The next sections address the issue of control from two approaches: (i) the identification of a specific contractual hazard generated by the label system, and the

¹¹ This meaning of control was popularised by Grossman and Hart (1986). They distinguished between contractual rights of control, that is the right to use assets as laid down in the contract, and the residual control rights, or the rights not explicitly included in the contract and which are associated with the possession of an asset.

¹² Williamson distinguishes several types of risk: (i) associated with the bilateral dependence of the players, (ii) associated with the weakness of the ownership rights, (iii) associated with measuring performance of attributes of goods, (iv) associated with the weakness of the institutional environment. Previous analysis of the label system (Ménard, 1996; Ménard, Valceschini and Garnier, 1995) addressed contractual hazards associated with bilateral dependence. Our analysis is principally a search for the contractual hazards resulting from the weakness of the protection of ownership rights.

monitoring mechanisms established and (ii) an analysis of the problems of subsequent decision-making in this particular form of governance structure.

2.1 The collective use of a brand name and the problem of externalities.

The label system allows a group of independent (in civil law) agents to participate in the development of products sold under the same quality label. The value of this label is its reputation with the downstream consumer. In a competitive final market, vertical differentiation by quality attracts the consumer, who value (and will pay more for) the quality of the product. We will not discuss the success of this policy of differentiation (confirmed by the continuously increasing sales of label chicken since the inception of the system). We address the possible problems of opportunism which can affect the label system. This involves one point in particular: the collective use by judicially independent players of a single economic asset, the «label rouge».

This brand name is a public good when there are several co-operating producers, « each coop members has incentives to encourage others to make the costly investments required to maintain quality, while shading one's own efforts to do so and free-riding on the group reputation » (Rosen, 1996, p 283-284). The system is thus confronted by a problem of negative externality (associated with the opportunism of the players). The individual actions of each member can diminish the collective reputation of the group to the detriment of all the others. There is a similar problem in franchise systems where the franchisor delegates the right to use a brand name to franchisees¹³. Each franchisee is encouraged to cheat in terms of the quality of the products if it is the most profitable strategy. This problem of externality becomes more acute with increasing market size: «the profits associated with the reputation are strictly proportional to the size of the market» (Rosen, 1996, p 283).

Some analyses of franchise contracts (Rubin, 1978; Dnes, 1993) distinguish between two kind of externalities: vertical externality arises from the relationship between the franchisor and franchisee (vertical relationship) as the franchisee can by his actions affect the value of the brand name; horizontal externality arises from the relationships between franchisees (thus horizontal relationships). The distinction is useful because it reveals how all the members of the system (franchisor and franchisees), and not just the owner of the brand or sign of quality, benefit from a reduction of opportunist behaviour¹⁴. Thus, farsighted players¹⁵ anticipate in part the mutual dependence (due to externalities) which results from the common use of the brand name. They will only accept this system if there are clauses allowing the players to be monitored, and mechanisms for resolving any conflicts.

This raises the issue of controlling (monitoring) all the independent players at low cost, when individual actions are potential sources of negative externalities. Alchian

¹³ Here also the problem of externality is present in the «common pool problem» (Hardin, 1968; Wiggins and Libecap, 1984).

¹⁴ Williamson used a similar reasoning to criticise certain legal judgements which aimed to protect franchise holders from the power of the franchise seller as expressed in clauses of the contracts described as unjust (Williamson, 1983).

¹⁵ «*Although Transaction Cost Economics continuously subscribes to bounded rationality...it also adopt a farsighted approach to contracting*» (Williamson, 1993, p 49).

Competition regulation against quality policy

and Demsetz analysed a similar problem where the externalities were generated by the technology of team production (Alchian and Demsetz, 1972). They conclude that for team production, the market governance (all the bilateral contracts between the different members) is not the least costly solution, in terms of monitoring costs. A different governance structure, the «classic firm» is a better framework for team production. We suggest that some attributes of this form (a central party common to all contracts with the right to monitor the others, to alter the membership) can also be found in inter-firm relationships with the same goal: to economise on the costs of monitoring the members. To avoid the multiplication of bilateral contracts between members of the team, and of monitoring mechanisms that have to be established by each player, the members create a pivot, the only party common to all contracts. One function of this pivot is to monitor all the other players.

In the label system, the certifying organisation is this pivot. It monitors the contractual relationships between the members. It monitors the conformity of the actions of the various participants to the specifications of the product and define its quality in the eyes of the consumer (see boxes page 3 and 5). It defines and applies sanctions in cases of non-respect of specification clauses. Note that this control is exercised over all adherents to the label. Some of the contentious practices can thus be interpreted as mechanisms to minimise negative externalities. As pointed out by analysis of franchise contracts, setting a bottom price to distributors is a method of limiting intra-brand price competition between slaughterhouse suppliers¹⁶. Similarly, the clause preventing competition between slaughterhouses with the same certifying organisation reduces intra-brand competition and thus negative externalities between players using the same label¹⁷. The costs of this control are financed by fixed contributions from the members and commissions on transactions between different producers. To ensure the independence of the control in the eyes of the consumer (and the credibility of monitoring), more than half the members of the board are external to the label system (representatives of consumers' association, distributors, farmers' associations etc.). In this situation where the relationships between the players involve potential negative externalities, the unhampered workings of the free market cannot necessarily ensure efficient coordination between the agents. This justifies the use of an alternative governance structure. It is even possible that the market would have itself led to the development of this sort of alternative organisation¹⁸.

2.2 The incomplete nature of contracts and subsequent decision-making.

The previous paragraph developed one interpretation of control, based on the analysis of the opportunist issue. The second is control as a mechanism of decision-

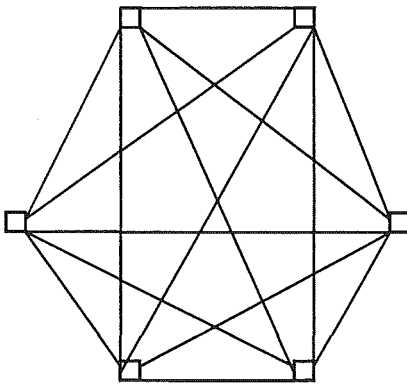
¹⁶ One can think of the label organisation as a particular franchise system. As pointed out by Ménard, « *growers act as franchisees but with no franchisor, the would-be franchisor, the « certifying organisation » is the emanation of a coalition among the franchisee !* » (Ménard (1996, p ?).

¹⁷ This is the situation where intra-brand competition can be detrimental to economic efficiency (see F. Jenny's commentary).

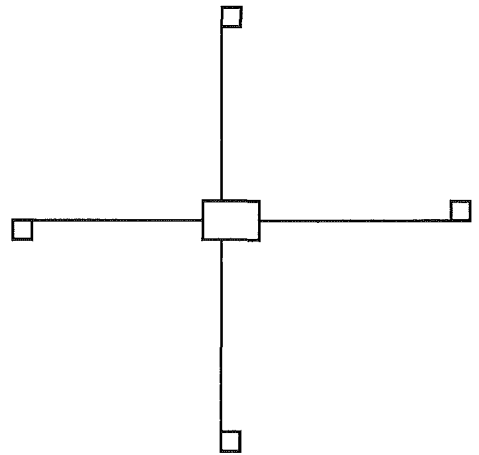
¹⁸ In an ongoing research, E. Raynaud study a particular franchise system whose main characteristic is that the franchisor is the emanation of the franchisee. The brand name involved in the system is owned by all the franchisees through shares of the franchisor equity.

making. Contractual relationships within the label system differ from those in the marketplace where the players make their decisions in the light of market signals (prices), completely independently and in a decentralised way (spot market contracting). The collective character of the quality approach requires more coordination between the players than simple adjustment of prices between the members (which is not to say that price is not important in the relationships between adherents to a label system). The collective approach to quality pioneered by the label system requires close coordination concerning other types of decision (for example agreement over the definition of the product, temporal coordination to ensure the stated quality of the product, etc.). Where the contracts between the players are incomplete (because of limited rationality) certain adjustments, and thus decisions, must be made subsequently in the light of new information. Is there a procedure which allows decision-making so as to adapt to changing circumstances in a coordinated way while economising on the bounded rationality of the members of the system? Williamson's analysis of «peer groups» (Williamson, 1975, chap. 3) gives an element of the answer. He distinguished between two types of decision structures for the organisation of peer groups: the complete network, where decisions are collective by all participants; and the wheel, or spoke, network (as illustrated in the figure for a small number of players).

Two type of structure (from Williamson, 1975, p 46).



Complete network



Wheel network

Competition regulation against quality policy

According to Williamson, two problems restrict the use of the complete network in collective structure, and argue for the use of the spoke network.

Communication requirements: In the first form, where decisions are made collectively, every member must be linked to every other. Evidently, the number of links increases with the number of members. For n members, the number of links is $n(n-1)/2$ in the complete network and n in the wheel networks. For large groups, Williamson diagnosed a change in the organisation economising on the communication costs (more than proportional to the number of members : for instance in a network with 10 members, the complete network need 45 connections, the wheel network only 9) between the members, and also a reduction in the volume of information that each member has to handle.

The decision-making process: analysis of decision-making also involves numbers but with reference to the number of connections required. The important number is that of decision-makers. The idea is simple: the greater the number of decision-makers, the longer the decision-making process will be for any collective decision that involves the views and preferences of each (the issue of aggregation of preferences). These delays in decision-making are a source of opportunity costs and possibly maladaptation costs if there is events requiring rapid decision. It is therefore preferable to modify the process by creating a pivotal player for all contractual decisions. This pivot is the only element common to all the parties (like the monitor described by Achian and Demsetz, 1972) and holds the right to make subsequent *ex post* decisions. This rights, results from voluntary delegation of decision-making by the other members of the group¹⁹ and the parties accept the delegation after negotiation.

The pivot will also reduce the costs of implementing monitoring mechanisms. The wheel or spoke network with a pivot reduces the costs associated with decision-making when two or more parties are involved. Within each label structure, as pointed out in box 1 the adherents partially renounce their autonomy of production. The delegation of decision right is negotiated previously (*ex ante*).

Despite the diversity of organisational forms in the label sector²⁰, all include a pivot for all contractual relationships. This pivot is the certifying organisation. It makes all decisions concerning the use of the quality label, that is, those about investing in advertising, commercial strategy, and information appearing on the final product. It also assures technical coordination between the various producers. The certifying organisation manages the interdependence of the producers arising from (i) the collective use of the label and (ii) the constraints on production by the adherents imposed by the specific characteristics of the final product.

¹⁹ Ménard (1995) used the term «authority» for this voluntary delegation of decision-making from one party to another. It is contractually established. He distinguishes authority (voluntary and negotiated delegation) of the hierarchy which is the power to make decisions resulting from the delegation, the terms of which are not negotiated but due to a position in a hierarchy.

²⁰ In an analysis of the poultry sector, Ménard (1996, p 166) identifies three form of organisation for this system: none of these forms are completely integrated either vertically or horizontally.

CONCLUSION

We have tried to show that judgements concerning the illegal nature of various commercial practices and co-operative behaviour should take account of recent developments in economic analysis. Using the label system in the poultry sector as an example, we reveal the tensions between a collective strategy for quality and competition law. These tensions have led to certain co-operative practices being accused of non respect of the right to compete. Stepping back from the economic references underlying these accusations, it can be shown that these practices result from the search for efficiency by those in the poultry label system. Transaction cost analysis sheds a different light on the incriminated practices. This gives less weight to the monopoly effects and emphasises the search for reducing transaction costs inherent to economic coordination. This paper is an analysis of the workings of a hybrid mode of coordination in which the players remain independent (in terms of company law) but organise their transactions more centrally than in a market. The creation of a pivotal structure, in this case the certifying organisation, reduces the transaction costs associated with the workings of the label system (monitoring costs, costs associated with communicating and handling information). This is done by delegating both the right to monitor the members of the system and the authority to make certain decisions without the need to (re)negotiate individually with each of the agents.

References

- Alchian.A, Demsetz.H [1972] : « production, information costs and economic organization ». *American Economic Review*, vol. 62 (December), 777-795.
- Arhel.P [1993] : « les pratiques restrictives verticales ». *Revue de la Concurrence et de la Consommation*, vol. 73 ; 26-33.
- Brousseau.E[1993] : *L'économie des contrats. Technologie de l'information et coordination interentreprises*. Presse Universitaire de France.
- Coase.R [1937] : « the nature of the firm ». *Economica*, vol. 4.
- Dnes.A [1992] : *Franchising : a case study approach*. Avebury, Aldershot, UK
- Dumez.H, Jeunemaître.A [1992] : « le bras de fer concurrentiel entre l'Etat et les firmes. Le cas du marché de la bière en Grande-Bretagne ». *Annales des mines-Gérer et Comprendre*, vol. 26, 38-49
- Encaoua.D [1986] : « réglementation et concurrence ; quelques éléments de théorie économique ». *Economie et Prévision*, vol. 76, 7-44.
- Encaoua.D [1993] : « contrôle des concentrations. Défense des intérêts des consommateurs ou arbitrage entre efficacité productive et pouvoir de marché ? ». Communication au séminaire d'Economie Industrielle de la Direction de la Prévision, Ministère de l'Economie et des Finances, juin.
- Glais.M [1993] : « analyse typologique des ententes illicites soumises à l'appréciation des autorités concurrentielles françaises et communautaires ». *Revue d'Economie Industrielle*, vol. 63, 45-83.

Competition regulation against quality policy

- Glais.M [1996] : « les entreprises de grande taille face au droit communautaire de la concurrence. Application au cas des multinationales de l'agro-alimentaire ». *Economie Rurale*, vol. 231, 47-55.
- Grossman.S, Hart.O [1986] : « the costs and benefits of ownership : a theory of vertical and lateral integration ». *Journal of Political Economy*, vol. 94, n 4, 691-719.
- Harding.G [1968] : « the tragedy of the commons ». *Science*, vol. 162.
- Jenny.F [1993] : « Droit européen de la concurrence et efficience économique ». *Revue d'Economie Industrielle*, vol. 63, 193-206.
- Lamy [1993] : *Droits économiques*.
- Libecap.G, Wiggins.S [1984] : « contractual responses to the common pool : prorationing of crude oil production ». *American Economic Review*, vol. 74, 87-98.
- Mattera.A [1990] : *Le Marché unique européen. Ses règles, son fonctionnement*. Jupiter Paris, 775 pages.
- Ménard.C, Valceschini.E, Garnier.G [1995] : « relationship between asset specificity and organization innovation : the case of the label in the french poultry industry ». 22nd annual conference of European Association for Research in Industrial Economics (EARIE), Juan les Pins/Sophia Antipolis, 3-6 Septembre, 18 pages.
- Ménard.C [1995] : « Inside the black box : the variety of hierarchical forms », in J.Groenewegen (ed), *Transaction Costs Economics and Beyond*, Kluwer Academic Press, Amsterdam, 149-170.
- Ménard.C [1996] : « of cluster, hybrids and other strange forms ; the case in the french poultry industry ». *Journal of Institutional and Theoretical Economics*, vol. 152, 154-183.
- OCDE [1993] : *Politique de la concurrence dans les pays de l'OCDE (1990-1991)*. Les éditions de l'OCDE, Paris.
- *Revue de la Concurrence et de la Consommation* [1994] : *Pratiques concertées dans le secteur des volailles sous label* », vol. 81, 59-62.
- *Revue d'Economie Industrielle* [1993] : *Politiques de la concurrence*, vol. 63.
- Rosen.S [1996] : « institutional transformation : supply or demand ? ». *Journal of Institutional and Theoretical Economics*, vol. 152, 275-286.
- Rubin.P [1978] : « the theory of the firm and the structure of franchise contracts ». *Journal of Law and Economics*, vol. 21, 223-233.
- Valceschini .E [1995a] : « la gestion des signes de qualité agro-alimentaire au regard du droit de la concurrence Le cas du label avicole ». Ministère de l'Agriculture et de la Forêt (DGAL).
- Valceschini.E [1995b] : « signes de qualité, coordination économique et formation des prix. Le cas du label avicole ». Ministère de l'Agriculture et de la Forêt (DGAL).
- Williamson.O.E [1975] : *Markets and Hierarchies : analysis and antitrust implications*. New York, the Free Press.

- Williamson.O.E [1985] : The economic institutions of capitalism : markets, hierarchies and relational contracting. New York, the Free Press.
- Williamson.O.E [1993] : « Transaction costs and organization theory ». Industrial and Corporate Change, vol. 2, 107-156.
- Williamson.O.E [1996] : The mechanisms of governance. Oxford University Press.

ANNEXE 1

Box 1

THE LABEL ROUGE SYSTEM IN THE POULTRY INDUSTRY Collective brand name and quality assurance.

The label system is the result of an initiative of a group of agricultural producers at the beginning of the 1960's who aimed to produce high quality chicken, which could be differentiated from industrial chicken²¹ raised above ground and which had a very poor reputation. The system had an initially French national then European legal basis. The «label rouge», as a generic name was a brand name owned by the state. The «label rouge» logo corresponded to a double differentiation: vertical in that it identified meat of a particular superior quality; and horizontal in that it differentiated between producers within the poultry sector. The image targeted was of high quality and traditional farming. The differentiation was based on (i) specification of quality indicators (weight, age etc.) and (ii) constraints on production techniques (rearing, production conditions and factors) which determine the defined quality.

The poultry label is a quality assurance system based on coordination between producers and on certification implemented by a third party (the «certifying organisation»). The National Commission for Labels and Certification of Conformity (CNLCC)²² examines applications for accreditation by the certifying organisation allowing the use of the label mark. The label is a collective brand name, because the certifying organisation²³ must necessarily associate all those involved in production, notably the farmers and slaughterhouses. The label structure thus regulates the central transaction of the system, that between farmers and slaughterhouses.

Accreditation of a certifying organisation and obtaining the «label rouge» involves developing: (i) a technical document, the cahier des charges (literally : « list of specifications ») which lay down the specifications defining a «superior quality» with reference to the so-called standard chicken; (ii) a control programme for all stage; (iii) specific information to be posted on the final product in conformity with the certification; and (iv) a system of penalties for non compliance.

²¹ The production of poultry under labels is essentially the production of whole ready-to-cook (RTC) chicken. Sales progressed slowly from 1965 to 1975, when it attained 2.5% of the market. From 1975, it was taken up by supermarkets, whereas it had previously been sold mainly in small shops, and this resulted in a large increase in production, of around 20% a year.

²²This commission is composed of representatives of the government, professionals, consumers and qualified specialists.

²³The certifying body has exclusive rights to use the accredited label. Accreditation also requires a minimum volume of sales.

Competition regulation against quality policy

The certifying body is an example of upstream accreditation of the producers and downstream control of the products. Its area of competence is controlling conformity to the norm, and commercial promotion of the products. It has three means of action: (i) defining and modifying the specifications (for example changing the strains reared); (ii) recruiting members (refusing or ejecting a producer); and (iii) withdrawing commercialisation rights from a slaughterhouse having broken the technical rules. The certifying body has authority over the management of production. This involves coordination according to a plan, the major phases of which are: communication from the slaughterhouses to the certifying body of the quantities to produce; selection of farmers and attribution of the production and delivery dates.

LABEL CHICKEN COMPARED TO STANDARD CHICKEN Specifications (from Valceschini (1995b))

| Year 1992/93 | LABEL CHICKEN | STANDARD CHICKEN |
|-------------------------------------|---------------|------------------|
| Age at slaughter | 86.8 | 44.2 |
| Mean weight | 2.15 | 1.85 |
| Feeding index | 3.05 | 1.93 |
| % loss | 2.4 | 5.1 |
| %seized | 0.28 | 0.9 |
| Hanging period | 21 | 17 |
| Batches/year | 3.38 | 5.96 |
| Starting density | 10.8 | 21.7 |
| Kg slaughtered/m ² /year | 76.6 | 226 |

Box 3

TECHNICAL RULES FOR POULTRY LABELS

Main clauses

- Selection of strains characterised by being traditional, and growing slowly and of high quality
- Large rearing area (with or without runs)
- Natural feed (at least 70% cereal, without added fats or animal meal).
- Growth period of at least 81 days.
- More severe quality control than standard.
- Informative labelling including descriptions of the specific characteristics associated with the label (age, feed, origin, the term «fermier» (traditional farm) the body responsible for the label and control)
- Guarantee of freshness with systematic hygiene controls and a strict shelf-life.

ANNEXE 2

Box 4

TRANSACTION COSTS ECONOMICS
Behavioral assumptions and form of organisations

Transaction cost economics (Coase, 1937; Williamson, 1985 and 1996) study the ways in which economic agents design coordination mechanisms to support their transactions. The central postulate is that the players look to establish efficient governance structures. In this model, this search for efficiency is the organisation of transactions so as to economise on transaction costs : « economising on transaction costs essentially reduces to economising on bounded rationality while simultaneously safeguarding the transaction against the hazards of opportunism (Williamson, 1985, p 51).

« Transaction cost economics poses the problem of industrial organisation as a problem of contracts » (Williamson, 1985, p 39). Study of the conception of these contracts will depend on the hypotheses used for individual behaviour. These hypotheses affect both the problems of economic coordination addressed as well as the contractual mechanisms applied²⁴ the answer to the «why?» and «how?» of contracts (Brousseau, 1993). Transaction analysis differs on this point from traditional analysis. It supposes that economic agents (i) have bounded rationality and (ii) may display opportunist behaviour.

The first hypothesis involves the cognitive limits of the agents to handle the information which is the basis for decision-making. The second behavioral assumption is « that human agents are given to opportunism which is a deep condition of self-interest seeking that contemplate guile » (Williamson, 1991, p 92). Our aim is not discuss the validity of these hypotheses, but to assess their consequences for the issue of industrial organisation. The main contractual and organisational implications of this combined behavioral orientation are summarised in the following table.

| Behavioral assumptions | Bounded rationality | Opportunism |
|---------------------------|---|---|
| Implications | | |
| For contractual theory | Comprehensive contracting is infeasible | contract as promise is naive |
| For economic organisation | Exchange will be facilitated by modes that support adaptive, sequential decision making | trading requires the support of spontaneous or created safeguards |

Williamson (1990, p 93).

²⁴ This comes back to the Williamson's distinction between different contract «worlds», those of (i) planning, (ii) promises, (iii) competition, and (iv) governance (Williamson, 1985, p 49).