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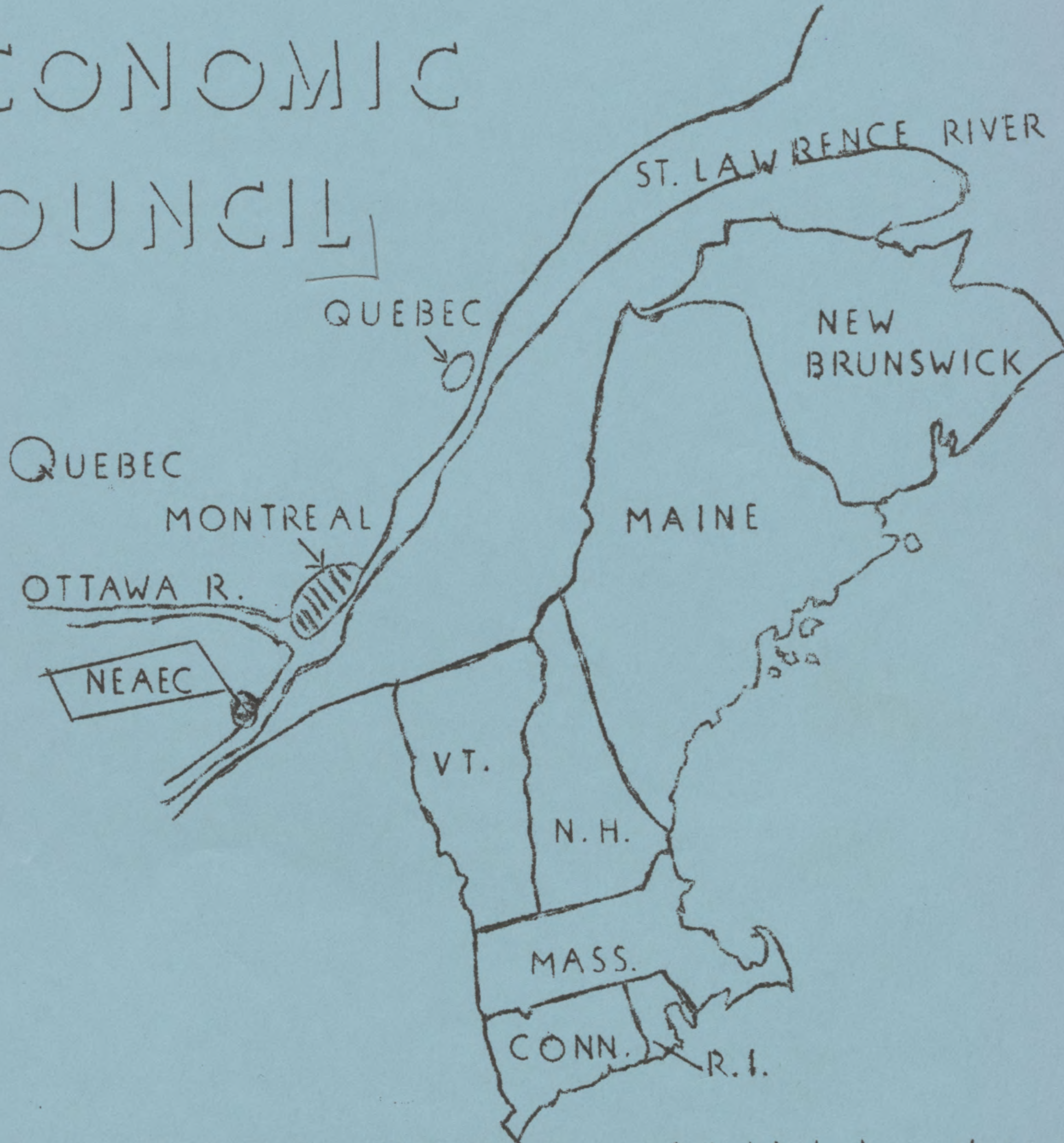

PROCEEDINGS, JUNE 1960

AT

MACDONALD COLLEGE - McGILL UNIVERSITY

STE. ANNE DE BELLEVUE, MONTREAL, QUEBEC, CANADA

MONOPOLISTIC COMPETITION IN AGRICULTURE

James R. Bowring
University of New Hampshire

It is generally agreed that the model of perfect competition has its greatest value as a teaching device and not as a description of reality. This acknowledges that in discussing or analyzing existing market situations, we are in the world of imperfect competition where the activities of sellers has some influence on price or where knowledge of demand and supply is less than complete.

At one extreme there may be many producers selling on markets where each individual seller has no influence on price. At the other extreme there may be a few buyers under written or unwritten agreement on price or on quantity or there may be examples of spatial monopoly on local markets with one seller or one buyer only to choose from.

In effect, there are all shades and degrees of imperfect or monopolistic competition to be found in the agricultural production, processing and distribution industries.

The general criticism of monopolistic competition is directed towards the effects of restrictions on supply and on control over prices. The greatest buyers of farm products are the food processing and distribution industries. They have long been the "whipping boy" for fluctuations in farm prices, particularly during periods when farm prices have fallen from the previous year. It is at these times that the unequal bargaining position of buyers and sellers becomes a major issue.

In discussing competition in the agricultural industries therefore, I wish to pose the hypothesis that despite their close relationship <u>the formation of prices for farm production and the price structure of processing and distribution services are two distinct problems</u>. If we can disentangle these two areas, it will, I believe, make for a more realistic discussion of their respective competitive conditions.

In the first place, we recognize the relatively inelastic demand for farm products on domestic markets. Therefore, the prices received by farmers become in large measure, a function of the supplies produced and marketed. Heavy production pushes prices down and light production results in higher prices. This phenomena is due in large part to the independent plans for production and sale of many small producers, as well as to natural causes of weather and disease.

On the other hand, the food industries are concerned less with the price they pay farmers for the raw material than with the spread or margin between purchase and sale of the finished product.

Therefore their demand is concerned more with the quantity necessary to fully utilize their labor and plant resources in order to reduce costs and with the quality necessary to meet consumer demand in relation to their competitors. The price which is of most concern to them is a selling price which will both meet their costs and provide profit.

Following this line of reasoning then, the major competitive problems are not between producers and prodessor-distributors as much as <u>among</u> producers themselves and <u>among</u> processor-distributors.

A large number of independent producers selling similar products on a market with inelastic demand will force prices down to levels close to cost of production. This is characteristic of conditions under perfect competition. It is apparent, therefore, that to improve the farm price and income problem under the given conditions of demand, will require less competition between farmers and more agreement on production and sales, and this would be true in the United States and Canada even if the number of producers were reduced drastically. An agreement among producers in order to influence price is a practice of monopolistic behavior. It is justified as an attempt to rectify a chronic condition of disequilibrium and to provide conditions for a more economic use of resources than would be true without such agreement.

In an economy where farm production presents no quantitative problem, the competition among firms of the food processing and distribution industries is reflected in the operating margins received. If there were few processor-distributors with little competition, then there would be a tendency for margins to be greater than if there were many firms competing for sales. Under active price competition there is a pressure to maintain profits by reducing costs and cutting corners, which at times can be quite painful. It is at this stage that we will find the greatest propensity to agree on trade practices. Therefore, associations are developed where members of the trade can exchange ideas and perhaps establish codes of market behavior including limits to price competition and where they can agree on methods to maintain "orderly marketing". By this approach price competition is reduced and without written agreement a degree of imperfect competition becomes accepted practice. Competition among firms then takes the form of product differentiation by non-price methods such as quality, package and service.

Given a restricted market and a high rate of competition among firms the goal of stability or of maintaining profit margins can also be achieved by consolidation or integration. A growth in this type of activity whether to gain economies of scale or to reduce uncertainties, is likely to be associated with an increase in monopolistic competition in food processing and distribution.

The question to be asked then is how serious are these deviations from perfect competition in relation to resource use and consumer welfare.

In the case of farmers a reduction in price fluctuations by agreements on supply control will reduce the income fluctuations with which they have been associated and lead to better planning and production resource use. If carried to extremes, however, so that supplies were controlled to raise prices above that level necessary to encourage production, then consumers would be the losers and could rightly call on the government to rectify the condition. There is something to be said for the argument that if prices are to be supported or controlled then the government should have this responsibility.

In the case of processors and distributors, controls on supply prices from concerted action by farmers would create conditions of bi-lateral monopoly in which agreement on supply prices would have more significance than it does now. However, the tendency to reduce price competition in order to maintain margins will grow as the number of firms declines and as the size of each firm increases. In this case the inelastic demand for food will not encourage price competition among firms and there will be a tendency for costs and prices to rise and consumer real income to decline.

It is obvious that there is no one gauge to indicate when monopolistic competition results in diminishing returns to consumers. However, the increased adoption of such practices as supply control and price agreement which appears inevitable, will pose greater problems of public regulation than we have had heretofore and perhaps eventuate into a call for "a positive program for laissez faire" or the need for consumers to develop a "countervailing power" to protect their welfare.