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MONOPSONISTIC FOOD PROCESSING AND FARM PRICES: REPLY

Henry Kinnucan and Gregory Sullivan

In their comment on our article on monopsony pricing, Kim and Schaible (KS) claim that an algebraic error was made in the twelfth equation of our model. We disagree. The error in the KS analysis inheres not in their algebra but in their failure to recognize the significance of the competitive industry assumption used in moving from equation (11) to equation (12) in our model. Since this point is a rather subtle one, a more careful development is in order. Consider again our equation (11):

$$P_a = \frac{VMP_a}{1 + \frac{1}{\epsilon}},$$

where P_a is the farm price of catfish under monopsony, ϵ is the farm level elasticity of catfish supply, and VMP_a is the marginal value product of catfish to the processor. This equation can be manipulated in a number of ways depending upon the purposes of the analysis. We chose to manipulate it in such a way as to yield an answer to the question of what role the elasticity of catfish supply plays in determining the relationship between the price that producers receive under competition (P_a^c) vis-à-vis the price they receive under monopsony (P_a). Because neoclassical theory indicates that $P_a^c = VMP_a$ in competitive equilibrium, a way to manipulate equation (11) to yield an answer to our question is to replace VMP_a with P_a^c, which is how we arrived at equation (12).

Rather than discovering an error in our analysis, in our view KS simply have shown an alternative way of manipulating our equation (11). Moreover, we find it peculiar to label P_a in their Figure 1 as a "price" because it does not exist (unless set by an outside authority) under either competitive or monopsony conditions and therefore has a vacuous economic interpretation.

Finally, even if one accepts KS's approach to analyzing the monopsony problem, the claim that the so-called error in our equation (12) "**invalidates**" our analysis appears too strong: by their own admission, it simply results in a larger estimate of welfare loss relative to their own. Given the research objective of our paper (to estimate the producer impacts of monopsony supplanting a competitive market structure), we believe our estimate is the more accurate one.

REFERENCES

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Henry Kinnucan is an Assistant Professor, Department of Agricultural Economics and Rural Sociology, Auburn University; and Gregory Sullivan is President, Advanced Marketing Systems, Dallas, Texas.

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