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THE EXCLUSIVE AGENCY COOPERATIVE AS A VERTICAL COORDINATION MECHANISM

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In our roles as scholars, we have come to study the vertical coordination of the food system with an eye toward improving the performance of various food system sub-sectors. The study of vertical coordination processes is multi-faceted. One area of study in the examination of existent and potential vertical coordinating instruments. One such instrument particularly germane to producer-first handler transactions is the **exclusive agency cooperative**. We would like to share our thoughts about the possible improvements in coordination which could arise from proper design and implementation of exclusive agency cooperatives.

An exclusive agency cooperative is a cooperative with legal rights which enable it to act as an **exclusive** bargaining and sales agent for all farmers (members and nonmembers) in a defined bargaining unit. Enabling legislation is required. Public Act 344, the Michigan Agricultural Bargaining Act, signed into law in early 1973, incorporates the exclusive agency cooperative as one of its major components.¹ In its most basic form, any legislation establishing exclusive agency cooperatives must provide (1) for the legal right for a cooperative to be the **exclusive** representative of all growers in a bargaining unit, and (2) for rules and institutions to establish relevant bargaining units.

The definition of the bargaining unit is critical. The Michigan Law establishes a Board. An appropriate bargaining unit is determined by this Board in response to a proposed definition initiated by an association representing at least ten percent of the growers in the proposed unit. The law requires the Board to define the largest bargaining unit possible, consistent with a set of criteria which include (1) the ability to bargain effectively, (2) a lack of conflicts of interest among members, (3) the wishes of growers and (4) past marketing patterns. This allows bargaining units ranging from the growers selling to a particular processor to growers selling to all processor in the state. Obviously the consequences will be different depending on the extent of the bargaining unit.

Some argue that an exclusive agency cooperative established under state law can only be effective in those isolated commodities for which that state dominates production. If one defines effective only in terms of the ability to obtain prices significantly above those of competitive states this argument might be valid. However, as discussed below, there are other aspects to improved performance of commodity sub-sectors. Most of these aspects are not dependent on the bargaining unit being all encompassing.

Recognition of an association as the exclusive representative of all farmers in a bargaining unit, members of the association and non-members alike, is based upon the association meeting a set of criteria.

In the Michigan law this includes meeting the criteria for a co-op under Capper-Volstead, having acceptable bylaws which include the democratic election of a bargaining committee from producers within the bargaining unit, and having valid signed contracts representing more than half of the farmers and half of the production of the commodity defined within the bargaining unit. Thus, representation may be won without an election in the ordinary sense of the word. Farmers, however, may challenge the validity of the contracts and a procedure is established for requiring an election. Once accredited by the Board, the association becomes the exclusive bargaining and sales agent for all producers and production in the defined bargaining unit.

Provisions for compulsory collective bargaining, arbitration and mediation may also be necessary when the exclusive agency cooperative handles highly perishable commodities. Also, rules governing fair practices between handlers and growers, growers and other growers, and exclusive agency cooperatives and handlers must be considered. Properly instituted, an exclusive agent cooperative can bargain on all terms of trade and manage supplies within its respective bargaining unit.

In summary, the exclusive agent cooperative is fundamentally different from typical cooperatives, marketing orders and marketing boards. A typical cooperative can be the bargaining and sales agent for only its members. The exclusive agency cooperative acts for all producers in a given unit, not just its members. Marketing orders provide a mechanism for reducing market price uncertainty. But they cannot generate coordinating information or feedback like a system of exclusive agency bargaining cooperatives especially in combination with forward contracting. The exclusive agency cooperative should be more responsive to both farmers' and handlers' needs and is much more flexible than existing marketing orders. The advantage of the exclusive agent cooperative over government marketing boards is that the critical decisions are made by the producers and handlers of the commodities. Thus, those who are most affected by the decisions have power over those decisions.

DIMENSIONS OF PERFORMANCE

When discussing alternative organizations of our food system, we want to know how performance of the food system, including exclusive agent cooperatives, would compare with other realistic alternatives. What are some of the dimensions of performance that our society considers important? We want a system which will provide an abundant and reliable supply of food, one which will provide food which is consistent with consumer tastes within the constraints of our resources. Safe food and adequate nutrition for all is a national objective. We have concern for protecting the physical environment and in preserving the capacity

to produce food for future generations. We want a fair system. This includes some notion of fair returns to workers and resource owners in all activities in the food system as well as fair prices to consumers. A fair game also includes consideration of reasonable equity in working conditions. People also like to feel they have some control over their destiny. And finally most citizens would be concerned with unfettered concentration of either private or public power in control of the food system.

Exclusive agency cooperatives are inconsistent with the theoretical ideal known as the perfectly competitive market, and thus some economists and others argue their use leads to inefficient use of resources. However, as long as all of the conditions of the perfectly competitive market are not met it is theoretically impossible to conclude that moving in the direction of meeting the conditions, such as making exclusive agency cooperatives illegal, would result in any improvement in resource use. More importantly, there is no basis to believe, given the realities of a modern food system, that an unregulated, purely competitive market would result in the kinds of performance desired by the society.

IMPROVING ECONOMIC COORDINATION THROUGH EXCLUSIVE AGENCY COOPERATIVES

All the dimensions of performance are dependent on how effectively the modern food system is vertically coordinated. At the most basic level, vertical coordination involves the coordination of supply with demand. Future demand and supply are uncertain. Coordination under uncertainty results in system performance less than what could realistically be obtained. Exclusive agent cooperatives can play an important role in improving vertical coordination and thus food system performance.²

The uncertainty about aggregate production decisions and demand can be reduced through organized contracting. Many farm commodities are currently produced under some type of contract thereby improving coordination. Where the contract provides for a firm price some of the uncertainty is shifted to the handler or processor. However, in many cases individual contracting does little to deal with the basic uncertainties associated with variations in aggregate supply due to individual production decisions of farmers. There is no well-developed mechanism for effectively equating the willingness of farmers to supply different quantities of a commodity in a future period at different prices with future demand.

The exclusive agency cooperative has the potential to organize farmers to contract for future delivery of commodities. By doing so it would contribute significantly to the coordination of the system.

One of the problems in contracting is that enforcement of contracts is difficult. And because large quantities of a product may be outside of the contract system, handlers are uncertain about future

quantities and prices. A food handler, as all of you know, is concerned not so much with the level of prices, but rather wants to assure that he pays no more for a product than his competitors. Under current contract arrangements they have no such assurance. These facts severely limit the effective use of contracts in our system.

The exclusive agent cooperative would have very special advantages in dealing with these problems. Such a cooperative could guarantee performance on the supply side of the contracts, within the contingencies imposed by the environment, and would be in a position to enforce and police the contract terms on the buying side. This would contribute substantially to an effective contracting system.

Even with modern technology, the weather and other natural events will continue to introduce uncertainty. However, this uncertainty can also in part be dealt with by the bargaining cooperative. It could negotiate contracts with a terms-of-trade schedule related to environmental contingencies, and thus total output. It could assist in planning production in terms of location and timing in order to reduce the aggregate effects of weather and provide risk pools among its farmer members to deal with the individual risks. Efficient calculation could be made on decisions to overplant and the excess supply could be diverted from the market, thus providing both a more certain supply and acceptable prices.

The exclusive agent cooperative can play an important role with regard to demand uncertainty. Under the current situation the individual farmer usually is the one who must anticipate demand and accept the risks of errors in demand projection. But of those in the food system, the individual farmer is probably in the least advantageous position to make such judgments. Collective action by farmers could shift the decisions about future demand forward in the system. Not only do those firms closer to the ultimate consumer have better access to information about future demand, they also have a very significant capacity to alter the demand for individual products through advertising and merchandising. Thus they are in a position to adjust demand, within limits, to available supplies and are therefore in a much better position to deal with the risks and uncertainties.

Coordination through competitive markets and the price system without contracts involves other information and uncertainty problems in addition to those of equating aggregate supply and demand. The price signal carries very little information. It does not tell why a price change took place. The needs of the modern industrial food system are for large quantities of commodities meeting high levels of product characteristic specifications, including conditioning, packaging, location and timing as well as nutrient or other physical characteristics. The price system never communicates demand for potential new products. Yet such demands can be identified and products designed to meet them. Not only may consumer demand be better served by improved communication concerning product characteristics desired, but the costs of

processing and distribution can be reduced. An exclusive agency bargaining cooperative can serve as an important link in communicating demand to farmers, in organizing supply and in communicating supply cost and response information to buyers as well as negotiating terms which provide adequate incentives to bring forth the desired products. In addition to initiating information flow within the vertical system, bargained contracts can provide for information for policy makers and interested observers.

Exclusive agency cooperatives can also help to coordinate society's efforts toward attaining a satisfactory environment and safe food. There is some evidence that competitive pressures on both farmers and processors lead to practices, especially the use of chemicals, which may result in both environmental deterioration and food adulteration. The appropriate approach to these problems is through government regulation. However where enforcement is difficult and/or ineffective, the individual farmer or processor may feel he has to use these chemicals to compete effectively in the market. The exclusive agency cooperative could operate to remove some of this pressure and help to police the regulations among both its members and processors. It is in the group's interest to protect the environment and to assure a reliable safe food supply. The publicity resulting from the marketing of an unsafe product can affect the sales of a commodity from all suppliers for years.

EXIT, VOICE AND LOYALTY

What will insure that an exclusive agency cooperative will act so as to achieve some of the benefits just enumerated? In economics and in general thought, a competitive market has been accepted as providing the most incentive for firm performance, except for the rare case of a natural monopoly, like telephone service. If sellers or buyers in a competitive market dislike the services or product of a firm, they are expected to discipline the firm by not selling to or buying from the firm. In a recent book, *Exit, Voice, and Loyalty*, A. O. Hirschman raises some serious questions about the general application of this conclusion.³ He argues that a slacker is born every minute, that there is a strong tendency for management to be relaxed if not under pressure, and that in our modern productive economy there is usually some substantial slack in performance. We have two basic mechanisms for disciplining the performance of an organization. One is what Hirschman calls "exit." This is the economic sanction imposed by a dissatisfied buyer, seller or other participant abandoning the organization. This economic approach is deficient in several respects. First, it does not effectively communicate the reasons for dissatisfaction thus does not provide clear evidence of the remedial action needed to retain the customer, worker or member. Second, if there is substantial slack in the system, it may put little pressure on the organization—this seems to be the case of many firms in oligopolistic industries. Third, the organization may fail when it could have suc-

ceeded with some modification. Failure may result in many of the resources of the firm being lost to the economy.

The alternative to the exit option is what Hirschman calls "voice." In this case the patron takes direct action to improve the organization. Rather than exit he speaks up. But the voice option also includes the possibility of imposing political pressure, in the broadest sense of the word. Hirschman argues that there is a set of circumstances under which the voice option will result in better performance than the exit option.

The voice option is most effective when exit is possible, but difficult. The difficulty or unwillingness to exit in response to a deterioration in performance is called loyalty. If a patron is loyal or if it is costly to change to an alternative, he is more likely to invest more in improving the organization.

We believe this new theory has special application to cooperatives. It suggests cooperative management is likely to perform better for its members than a private firm does for its customers if there is a high level of loyalty among members causing them to put effective and articulate pressure on the management.

However, in many cases cooperatives do not operate differently than an ordinary firm. They seek to show a sufficient profit to maintain the organization, the same as is true of the management of most proprietary firms. Members have little more loyalty to the cooperative than to a private firm and do not invest much in communicating their ideas about improving the cooperative or take action to influence management. This is true in part because exit from the cooperative is easy and next to costless.

The Hirschman thesis would suggest an exclusive agency cooperative would generate the most effective voice option. The costs of organizing such a cooperative are high enough that loyalty would be stimulated. The exclusive agency law makes exit from the organization difficult. Effective mechanisms exist within the organization, through elections and other democratic procedures, to communicate dissatisfactions and to articulate pressure for changes in management practices. Unusual pressure can be put on the management because of the option to vote the cooperative out of existence if it fails to perform at a level consistent with the wishes of a majority of its members.

Let us extend the analysis one step further. An exclusive agency cooperative would be in an unusually effective position to impose discipline on the firms with which it dealt. A slack management is little affected by the loss of a few patrons. But the threat of loss of most raw product suppliers would have to be reckoned with. The handlers and supply cooperative would be forced to communicate and accommodate each other. The cooperative would have an effective voice. If slack management is the mode, as argued by Hirschman, the cooperative would be in a position to both put pressure on such management and to benefit from the resulting improvement.

Voice options have always existed and been used. However, economists have always considered them but an adjunct to exit. Voice can be an alternative to exit. As Hirschman argues, in many cases it is a superior option for improving performance. Thus economists and social planners have a greater array of insitutional innovations at their disposal than if they were to limit themselves to only exit enforced systems.

FAIRNESS, EQUITY AND POWER

Thus far we have been examining how exclusive agent cooperatives can affect certain performance dimensions through better coordination and exit, voice and loyalty. The fairness of and the distribution of power within the system are important aspects of performance. Exclusive agency cooperatives necessarily involve restructured institutions and relationships between individuals and institutions. Thus issues of fairness, equity and power must be addressed.

Growers as individuals are often at an unfair advantage in negotiating with buyers. The contingencies of economies of scale in processing and/or distribution often result in growers dealing with monopsonistic or oligopsonistic buyers. Often the buyer has information not available to the farmer. Buyers often use standard form contracts which an individual farmer may find too difficult or too expensive to fully understand or enforce. Fairness includes equitable terms of trade other than price. Buyers often require growers to deliver to the processing plant and to wait in line for hours.

The exclusive agency cooperative can redress many of these sorts of problems. An exclusive agency cooperative could be an effective countervailing force to monopsonistic buyers, bargain for and obtain relevant information, help formulate standard form contracts, and negotiate delivery schedules.

Institutions of exclusive agency cooperatives raise several types of equity issues. In commodities involving substantial fixed assets specialized to the production of a specialized commodity, it may be possible for a buying firm to gain an advantage by offering terms which create incentives to invest in the farm enterprise and then lower its prices. The prices may be just high enough to cover variable costs, to maintain production, but not high enough to cover total costs plus a normal profit. In these cases an exclusive agency bargaining cooperative should contribute to greater equity between growers and processors.

There are significant equity issues involving the interrelationships of growers. The free rider issue is an equity issue. Is it fair for non-members to get the advantages of a market which is developed and maintained by a cooperative? In labor law it has long been held legal to charge non-union members for services provided by the union as well as to require nonmembers to work under the provisions of the union contract. The "exclusivity" of an exclusive agent cooperative is designed to deal with this equity issues.

Since an exclusive agency cooperative may involve some coercion of individual growers, rules and procedures must be established to provide fair and equitable treatment of individual growers. While open membership to the cooperative and voting rights are important, it seems necessary to provide a grievance procedure with a judicial board to ensure that all classes of growers within a unit are treated equitably.⁴

The issue of the concentration of power in the hands of bargaining cooperatives and especially in the hands of an exclusive agency cooperative must be addressed. Will the processors' and consumers' interests be protected?

It is assumed that the cooperative will behave in its own interest. However, the farmer members have a strong interest in promoting a healthy processing and distribution system for their products. They will not try to destroy it but rather will try to make it economically viable. Where there are too many firms or where a firm is inefficient or offering an unessential service the cooperative may very well put pressure on the system which results in fewer, more efficient firms. At the same time, by offering raw products to all buyers under more uniform terms, the bargaining cooperative may contribute to the survival of some of the smaller firms which are efficient processors, but lack the power in the market to acquire raw product on terms comparable to the larger buyers. Such results are not inconsistent with the public interest nor is it an abuse of power.

Nor is it likely that exclusive agency cooperatives can extract large monopoly gains from consumers if they are operated under a reasonable set of rules. While it is reasonable that the cooperatives should be able to bargain over quantities to be delivered and have power to manage the supply of those within the bargaining unit, they would not have the power to restrict entry to the bargaining unit. Thus, the cooperative would have an incentive to bargain for reasonable prices—not prices so high that many new entrants are attracted.

While the demand for all food is very inelastic the demand for individual commodities is much more elastic, especially in the long run. Any cooperative which attempted to extract a large monopoly gain through extraordinary high prices would lose its market to competing foods. Given modern technology, if no close substitute currently exists one could be developed. Thus the reality of the conditions of supply and demand and freedom of entry protect the consumer from abuse of power by the exclusive agency cooperative provided, of course, that proper rules are instituted.

Short-run abuses could occur—working to the short-run disadvantage of consumers and processors and long-run disadvantage of farmers. Because of this, continued stress must be put upon the importance of highly qualified leadership and well-informed memberships as inputs to an effective exclusive agency cooperative system.

Rather than contributing to the concentration and abuse of power

the exclusive agent cooperative may act as a check on the growing power of a relatively few firms in the U.S. food system. America has a problem of increasing concentration of economic power and the food system is not an exception. The exclusive agent cooperative, without restriction on entry, may be able to contribute to the economic viability of the independent farmer. The alternative may be more control by a few corporations. While a cooperative provides a means by which farmers can act collectively, the power remains dispersed among its members.

CONCLUSIONS

Institution of exclusive agency cooperatives does raise some fundamental issues about equity and power. These issues can be resolved. Even though empirical evidence is virtually nonexistent, we believe the exclusive agency concept, properly instituted and judiciously administered, is a viable alternative coordinating mechanism for improving performance of food system sub-sectors. Clearly much research is needed to identify the necessary conditions for successful institution of the exclusive agent cooperative and for identifying the relationship of specific rules of the game to various dimensions of performance.

¹ For a detailed explanation of the specifics of Public Act 344, see "The Michigan Agricultural Marketing and Bargaining Act of 1972," *Michigan Farm Economics*, No. 361, Department of Agricultural Economics, Michigan State University, February 1973.

² For a more complete discussion of the possible benefits of exclusive agent cooperatives, see James D. Shaffer, "Farm Bargaining Legislation and the Public Interest," paper presented at the National Conference of Bargaining Cooperatives, Washington, D.C., January 14, 1974.

³ Albert O. Hirschman, *Exit, Voice and Loyalty*, Harvard University Press, Cambridge, Massachusetts, 1974.

⁴ Public Act 344 has many rules and procedures to recognize and adjudicate conflicts among members.