FARM BARGAINING

by

Daniel I. Padberg

April 10, 1968 No.9

Farmer Bargaining*

D. I. Padberg

Cornell University

Contents

* Presented before the Agricultural and Forestry Committee, U. S. Senate, April 10, 1968. Also published in C. R. McConnell, <u>Economic Issues: Readings and Cases</u>, McGraw - Hill Book Co., Third edition, 1969.

FARMER BARGAINING

To advocate a system of farmer bargaining is to advocate replacing the market price system. Market price has been the basis of farmer incentives and coordination as well as the basis of income distribution in agriculture. Since replacing the market price system is a very basic and fundamental change, careful consideration should be given to alterntive methods of coordinating economic activity and regulating income distribution.

VEHICLES FOR ECONOMIC COORDINATION

There are three basic ways to coordinate economic activity.[1/] One important way is through the exchange method. In this approach to coordination, members of the economic community essentially are thinking positively. They say to each other, "you do something nice for me and in turn I'll do something nice for you". This type of system works best where it is clear to all parties that each benefits from the exchange. Prices are generated from these exchanges which are used as a system of signals that coordinate the economic activities of production, distribution and consumption.

Another way of coordinating economic activity may be called the integrative method. In this system, a firm or organization is created which takes responsibility for performing several economic functions. Within this integrated organization, the coordination of product flows from one function to another is affected by administrative decision. The main reason for the increasing importance of the integrative method of coordination comes from its greater efficiency. Often costs can be reduced by combining several functions in an administratively coordinated organization rather than through several separate organizations which buy and sell from each other.

A fruit or vegetable canning or freezing operation may illustrate the point. Within such an operation, several separate functions are performed in an assembly line type of setting. Product is received and inspected, washed, peeled or prepared, packed, and cooked or frozen. Product moves through this line rapidly and systematically. Instead of all of these functions being performed by one organization, each function could be performed by a separate firm. This would require, however, a buying and selling operation between each stage or function. Cost would be higher in the unintegrated system for two reasons: product could not be handled

---

1/ See K. E. Boulding, "Toward a Pure Theory of Threats Systems" AER, May, 1963.

as rapidly or systematically and buying and selling required special skills and additional time and effort. While this is an extreme example, the same general principles are causing increased integration between agricultural production and marketing. Integrative coordination is clearly increasing and largely for efficiency reasons.

A third method of coordinating economic activity may be referred to as the "threat system." The "threat system" is somewhat analogous to the exchange system, but it involves negative thinking. In this method of coordination one party says to another, "If you don't do something nice for me, I'll do something nasty to you." Threat is a bad word. Nobody likes to be threatened. Further, the threat has no meaning unless the threatener has power to fulfill the threat. The American tradition is a tradition of freedom. For that reason, we do not like threats or power. Both tend to erode freedom.

Although the threat method of coordination is not a comfortable part of our political and economic ideology, changes in the Twentieth Century American economy made it essential. As many economic functions which had earlier been performed in households were integrated into factories, individuals became workers rather than small businessmen. Their economic returns were not determined in an open exchange situation, it was arbitrarily determined by the factory or mill owner. The factory increased the productivity of the worker, but denied him an open marked for his services. The almost immediate result was severe abuses. These abuses were not corrected until the threat system was developed and made effective by labor unions.

Coordination in Agriculture

Integration of many types is increasing in agriculture. Backward integration by retailers is increasing significantly in several areas. Many products including livestock and fruits and vegetables are moving directly from producer to retailer--bypassing the conventional open market system. Feed companies are very big in the poultry industry. Meat companies are doing more feeding in both the poultry and livestock industries. Why is this happening, and what does it mean?

These developments represent a significant movement away from the exchange method of coordinating economic activity. They're occurring for efficiency reasons. There is certainly nothing wrong with efficiency. In fact, it's as much a cornerstone of the American economic ideology as any concept. While we may all agree that the integrative system is an efficient way to coordinate agricultural production and marketing activity, does it establish a fair value for the farmer's services and the productivity of resources owned by farmers?

While these tendencies toward integration may increase efficiency and reduce costs, therefore benefiting society, benefits to farmers are usually minimal. Efficiency has increased vastly in broiler production probably as a direct effect of integration. As a result, our consumers eat much more poultry meat at much lower prices. Feed companies have sold a lot of feed with minimum selling cost and effort. But the economic returns to the land, labor, and equipment which farmers contributed to this enterprise shows little improvement. Farmers' economic returns more nearly resemble the farmers' alternatives in less organized industries than the productivity of the industry to which he contributes. So the productivity benefits which result from integration are typically retained by the integrator or passed on to society.2/

Several types of integrating devices are emerging in beef. In western states where cattle are fed in large feed lots, more than two-thirds of these animals move directly from feed lots to slaughterer bypassing any central market. In 1964, 18 percent of the output from large feed lots had been custom fed for packers. A large part of the feedlot output was owned by packers for several days before shipment. These integrative developments enable a much more efficient and systematic flow of livestock to slaughtering operations. On the other hand, each of these developments marks a step away from the exchange method of coordination.

In each of these examples, and more could be cited, agricultural production and marketing operations are being more closely integrated. In each case, the efficiency of the physical functions of marketing is improved. Also in each case, the operation of the exchange system in determining prices and values, is either displaced or significantly eroded. The system that is evolving is very clearly an efficient one, but more and more the question arises: Is it a fair one? Do we have any assurance that arbitrary values of products and services assigned by integrating firms reflect fair economic returns for the contribution made by farmers?

Competitive Pressures in the Food Industry

Farmers often find themselves negotiating price directly with packers or other integrators. This negotiated price is very different from a market price. A market price is determined by the impersonal forces of supply and demand. Negotiated prices arise in a person to person confrontation and therefore reflect relative strengths of negotiators. For this reason, the element of threat is always present in price negotiations. In order to understand the formation of negotiated prices, we must take into consideration the competitive pressures generated throughout the whole system.

It has often been observed that the traditional seat of power in the food distribution system was the processor. He bought unstandardized products from unorganized farmers. He created standardized, branded and differentiated products. Then he sold them to consumers through unorganized retailers. He was the only organized part of the system. The coordinating functions he performed were so essential to marketing that he was in a position to reap most of the benefits--he was uncontested.

2/ A more complete discussion of this point is given in D. I. Padberg, "Efficiency and Welfare Considerations in an Integrated Agriculture", Journal of Farm Economics, December, 1966

It has been frequently pointed out that more recent changes have moved the seat of power to the food retailer. The retailer has become consolidated and organized. He occupies a strategic position--near the consumer. The most significant capability resulting from the power of large retailers has been their ability to integrate and organize the supply operations serving stores. Lower costs thus achieved have been translated into lower prices generally and particularly on "retailer branded" items. In this way large retailers have gained consumer acceptance and have grown rapidly.

Recent work of the Food Commission, in my opinion, has done much to varify these observations. This work also suggest the need for some caution in assessing the significance of this power. I found almost no examples where this retailer power had an adverse effect on consumers. Examples where retailer power benefited consumers were numerous. Ever since the earliest emergence of food chains, the largest and most powerful retailers have offered lower prices to consumers. The early integration of wholesaling with retailing had this effect as have retailer processing and private label programs.

The primary impact of retailer power is focused on the supply industries. These organizations force price down--not up. The large chains are not superior merchandisers and they have no significant barriers against competition from smaller retailers. Their power and acceptance rests on undercutting prices of retail competitors. This force partially explains why food prices and farm prices have advanced less rapidly than other prices during the post-war years. This competitive power balance retarded the passing on of cost increases to consumers. This pressure of increasing costs at retail and at the processor level presses very hard on farm prices.

The impersonal operation of open markets have traditionally protected farmers from the market power balance of the distribution system. As we see integrative devices eliminating markets, farmers are negotiating directly and personally with buyers. In this situation the force and power generated in other parts of the distribution system has direct bearing. Farmers have no protection from it. Farmers do not have a choice between market prices or the "threat system." Integration denies the market price alternative. Negotiated prices are threat prices.

THE LABOR-MODEL ALTERNATIVE

As basic changes in the agricultural marketing complex gradually unravel the exchange system through which market price coordinated the activity of farmers and established their income, we must look for new methods of coordination and income distribution. Probably the most common method for replacing market price is by substituting collective bargaining concerning price and non-price terms of trade. The advantage of collective action has been to increase bargaining power of economic units which were small by virtue of the nature of the functions they perform (labor). By increasing the power of workers relative to units which were large, by virtue of the functions they perform (manufacturing, etc.), income has been redistributed in the favor of the workers.

The labor model has been attractive because most people think that bargaining strength should be more equal than the size of economic unit--which largely relates to the function performed. The large size of a manufacturing plant does not make its management better people or the management function more essential than the laborer and the function he performs. Technology is what makes the plant large. This is a part of the heritage of all of us. It should not be used by some to exploit others. Collective action on the part of workers leads to greater equality of opportunity among our people than the uninhibited combination of technology and economic incentives.

Collective representation of workers interest has been a more attractive solution to the problems created by the industrial revolution than direct government control of prices, wages and benefits. Most people consider collective bargaining by labor to be closer to a competitive system than to a socialistic system. In this regard it has been a compromise. It has mitigated the abuses caused by concentrations of economic power resulting from technology and industrialization leaving more competitive flexibility than probably any other system for protecting labor.

Collective Bargaining in Labor

Against this background of national experience many people are asking the question, "Can bargaining in agriculture do what bargaining in labor has done?" In order to approach an answer to this question, we must first carefully identify how bargaining has worked for labor. The first and foremost result of bargaining in labor has been to increase wages, improve benefits and modify working conditions. Collective action has superseded the market price mechanism. There is no question in my mind that the results which flow from collective bargaining have been a significant advantage to the laborer.

Collective bargaining by labor has stimulated automation and reduced employment in affected industries. By defining labor as scarce and expensive, employers have been motivated to use less of it and to find ways, where possible, to substitute machines for men. An important point to note here is that when labor increases its price--or wage rates, it is the employer who prohibits the flow of competing labor into this field. The employer simply does not hire the additional workers who are inclined to respond to the higher wage rates. In fact, the typical employer reaction is to find ways to use less labor rather than more as wages increase.

Labor bargaining has stimulated investment and economic growth. As firms invest in new equipment and new methods to mitigate higher wages, jobs are created to provide the new and better equipment. The new and better equipment increases productivity. Higher productivity, accompanied by higher wages, in turn stimulates demand. In this regard labor does not necessarily get a smaller slice of the same employment pie when it increases its wages. In fact, to the extent that investment results from higher wage contracts, the whole employment pie may be larger. In an economy dominated by technical development and the continuing availability of new processes and methods and equipment, labor bargaining may stimulate rapid adoption and therefore the economy's standard of living.

Bargaining in labor has also affected the efficiency of operations in the short run. While there may be some instances where negotiated settlements concerning working conditions have increased operating efficiency within firms and industries, the more common occurrence is that efficiency has been reduced. Featherbedding and clinging to obsolete commission rates, no longer appropriate in relation to current productivity rates, are examples where collective bargaining has made the economic system less flexible and denied progress and efficiency which was possible.

In summarizing these points, it is fair to point out the laborer's motivation and interest has been clearly in higher wages, more benefits and more convenient and comfortable conditions. They take little interest in efficiency, largely because efficiency has no direct payoff for them. The payoff for laborers is limited to wages, benefits and conditions. On the other hand, increased efficiency is the major motivation of the employer. His costs bear a direct relationship to his income. Actions taken by the employer to invest in new methods and reduce labor and other costs has in the long run, reduced or mitigated the effects of higher wages and less efficient work rules and in the end stimulated economic growth and development. In this situation, the labor union is dependent upon the employer for two things: 1) the establishment of entry barriers to protect the supercompetitive wage rates and 2) investment in equipment and new methods which bring the productivity of union members up to the new higher wage rate.

Application to Agricultural Marketing

Can we expect similar developments to result from agricultural bargaining? Can we "tear a page from the labor book" and apply it directly to agriculture? If we look at the bargaining environment in agriculture, several contrasts to the labor situation are apparent. The first contrast is essentially one of bargaining mechanics. Any effort to bargain for higher farm prices must be accompanied by some effective barrier to entry of competing and undercutting supplies--whether these supplies come from within the bargaining region, from other producing regions, or other producing nations. While excesses in the supply of labor are excluded by employers and cared for by the government, excesses in supply of farm products, place a powerful downward pressure on farm prices. Full supply contracts provide some opportunity to plan for a disciplined supply within the bargaining region. This method is very analogous to the entry barrier used in the labor situation. But it must be accompanied by protection from supplies from other regions and nations.

Another contrast results from the meaning of substitution among factors of production and the meaning of substitution of final products. You can make an automobile with less labor and more equipment. The addition of more and better equipment makes the labor more productive and therefore more valuable. Creating the extra equipment also creates more jobs for labor. While food products can be substituted in and out of the market, the effects are very different. If you make a chicken pie with less chicken, the addition of potatoes and carrots does not compensate for the reduction in chicken. No consequence of this substitution expands the market for chicken; rather it can only reduce it. Making chicken scarce and expensive does not stimulate the growth of the economy. It merely means that we are going to be eating less chicken.

Another important contrast between the bargaining situation in agriculture and labor is the position of "efficiency and cost savings" as a negotiating motive and incentive. While labor finds its payoff in wages, benefits, and working conditions only, farmers--who have production costs--increases their income as they are able to negotiate procedures or methods which reduce these costs. For this reason, methods and procedures which increase the efficiency of the entire system may be important among the bargainable issues in agriculture where labor bargaining has not included this dimension to any significant degree.

Market Price has Two Functions

As we look over just these three contrasts between the agricultural situation and the labor situation it becomes rather clear to me that farmer bargaining may go--in fact must go--quite a different direction than has evolved in labor bargaining. This is not really surprising. Market price has two major functions. One is the coordination of economic activity and the other is income distribution. It is quite natural to observe that when labor bargaining supercedes the price mechanism, its emphasis is primarily on income distribution. This is true for two reasons. First, the supply of labor is coordinated more by religious, sociological, cultural and family attitudes and traditions than economic stimuli and second, as we have seen earlier, there exists an effective supply control mechanism outside the bargaining unit which results from the actions of the employer. These two factors leave labor quite free from the normal role of price in coordinating economic activity (free from the "supply response" problem) and allow them to move directly into securing and increasing benefits.

In the case of agriculture, we do not find such a one-sided coin. If we are to replace the market price mechanism with a system of negotiated prices, we cannot move directly for increased benefits and disregard the coordinating role which price has performed. The price system has served to guide production and consumption although it may not be the best coordinator. In fact there are many demonstrations that it does a poor job in its role as a coordinator. When we take a continuously abundant supply of feed grains and convert it into too few hogs one year and too many hogs the next, we are doing a very inadequate job of coordinating this sector of the economy. Farmers can't meet the increasing cost of labor, land and equipment from the erratic returns which result from this lack of coordination, and consumers complain bitterly as well.

Bargaining as an Instrument of Coordination

These thoughts and observations lead me to the following hypothesis: Farmer bargaining may yield its greatest benefits by improving the coordinating functions of price while labor bargaining has emphasized primarily the income distribution aspects of price. If this hypothesis proves true, and I expect it will; we may need a massive job or redefining some terms. Bargaining has come to mean--in almost everyone's mind--negotiations for income shares. If farmers work together under new permissive legislation to improve coordination in the production and distribution of food products and stabilize and increase the economic returns to farming, this will be a process very different from anything we have seen in labor bargaining. Perhaps we should call it "collective action" rather than "bargaining". I would define collective action as a system of negotiations which replaces both the coordinative functions and the income distribution functions of the price system.

Let's lay some of the major characteristics and problems in agricultural marketing up against this hypothesis to see how they all fit in. A list of these characteristics and problems probably should include at least the following:

A. Factors affecting income distribution

1. While most of the small farmers earn lower rates of return on their land, labor and capital than firms in other parts of the economy, most of the larger farms which produce two-thirds of our agricultural output earns rates of return as high or higher than typical of other parts of the economy.

2. Farmers need <u>stability</u> of income to meet the interest and payments on the rapidly increasing debt burden which is associated with the modern capital-intensive agriculture.

3. Agricultural labor wage rates are increasing rapidly and are destined to continue significant increases in the future. Farmers need a way to systematically pass on these and other cost increases to the consumer.

B. Factors affecting coordination

1. Better coordination of food production, processing and distribution can significantly reduce costs and significantly increase the usefulness of food products to final consumers.

2. Consumers buy products on the basis of convenience, status, color, taste, texture and many other nonprice factors. Price is less

effective, therefore; in stimulating consumer to use up excessive surpluses or in rationing consumers in cases of scarcity.

3. Violent price fluctuations, as seen in pork products over the past few years, undermines consumer confidence in the food industries. The inability of farmers to control their industry appears to the consumer to be a case of price fixing and market manipulation.

4. Central public wholesale markets for farm products are rapidly disappearing from the scene. It is more efficient to move products from the large commercial producer to the processing plant or retailer. The function these markets performed in openly setling prices is largely lost and must be replaced with something.

5. Functions wholesale markets perform in sorting out product specifications among buyers have largely been transferred back to the farm. In many cases farmers now produce to specifications for their individual buyers. Low quality products which cannot be kept off the market often undermine prices received by farmers who make every effort to meet the needs and demands of their buyers.

6. The chaotic and undisiplined nature of many markets for farm products generates a sense of discouragement and futility in many of the most alert, sensitive and capable farm producers. Industries from which they purchase inputs have power, discipline and good performance as do the industries to which they sell. Farmers see the power and organization of these outside influences encroaching upon their traditional prerogatives and making them captives. Farmers need a system of coordination through which they can participate in the shaping of their own destiny.

Income Distribution Considerations

The situation regarding distribution of income indicates that the case for substantial price increases is virtually groundless. While there are many disadvantaged small farmers, two-thirds (68.3%) of farm output in 1966 came from farms with $20,000 gross income or greater.1/ These larger farms earn higher rates of return on their resources invested than is typical for the economy generally. The small farmers with only a trickle of output would not materially benefit from higher prices. This is particularly true for the smaller two-thirds of all farmers who produce only 14.6% of all output. Prices high enough to help these small farmers would be excessive for the larger commercial farming operations which produce the bulk of our food supply.

The case for more stable farm prices is impelling. This is particul-

1/ U. S. Department of Agriculture, Parity Returns Position of Farmers, Senate Document #44, U. S. Government Printing Office, August 10, 1967, p. 22.

arly true for the large, capital-intensive farming operation which is our primary provider. As farm labor is paid higher wages which stimulates the use of more large and expensive equipment, the debt burden of commercial agriculture will increase. While commercial farmers do not deserve substantial price increases, they do deserve dependable prices on which to plan investments in more efficient and productive operations.

Farmers also deserve a price system which they can adjust to accommodate changes in their costs. Our national policies of cheap farm labor--which included slavery, open immigration and braceros--have been terminated. Society is demanding better conditions and better wages for farm workers. If farm labor is a necessary part of our economy, people providing it should not be second class citizens compared to people providing other necessary functions. In responding to this demand, farmers incur increases in their costs. Farmers must be allowed to pass these (and other) costs on to society in the form of higher prices.

In the past farmers who depended on the market price system could increase their prices only to the extent that some of their numbers quit or were forced out. That transition may not be too difficult for the subsistance farmer who has little debt. Since the bulk of todays food comes from the large, commercial, debt burdened operation, price adjustment by economic suicide is generally unsatisfactory. Commercial agriculture deserves dependable prices and the opportunity to adjust them to accommodate cost increases.

Coordination Considerations

Consideration of coordinating the agricultural economy leads to some fundamental observations. The concept of "supply and demand" as the primary explainer of economic activity is probably becoming less relevant as our economy becomes technically complex and as consumers become affluent. Production requires planning which goes beyond the guidance given by price--the price which identifies the products usefulness to consumers. A great deal of planning and investment must be done before there is a product or a price. Among the items which must be planned is how to offer the product to an affluent consumer.

Nor is the consumer guided by price alone. In time past, the housewife gladly shifted from scarce and dear commodities to abundant and cheaper food in order to provide necessities to her family. Now, her family has long since past the threshold of necessities and one of her concerns is to complete shopping quickly so it won't interfere with the leisure activities which are an important part of her life. Convenience features alone may be more important than prices in affecting her purchases. Variations in taste, texture, flavor and color must now be produced in the plant rather than the kitchen. This never ending variety of products, which adds up to several thousands of items in the typical supermarket, is a partner to affluence.

Price is not the dominant influence guiding consumption. Purchases based on living patterns, convenience, variety or other non-price factors continue when farmers underproduce and are very hard to stimulate when farmers overproduce. Since price was not much of a factor in their original purchase decision, consumers behavior does not change much when price changes. We cannot expect affluent consumers to diligently correct all of the farmers' mistakes by constantly changing their consumption habits. Probably the most prized dimension of affluence is being extricated from the discipline of responding to price.

As the production process grows more complex and consumers become more affluent, the need for planning and coordinating devices which go beyond price is increased. As this need increases, instability and uncertainty of production and prices will represent an increasing loss to society. Better coordination--pertaining to quantity, time and quality discipline--through production, assembly, processing, storage, distribution and merchandising can better serve the consumer, the food marketing industry and the farmer.

Farmer Bargaining Objectives

Realistic bargaining objectives of farmers would include massive programs to improve supply discipline and modest price increases. This combination of activities would substantially improve farm income by increasing prices and reducing costs. While this balance of emphasis between the coordination and income distribution functions matches the needs and problems of agriculture very well, it is not the emphasis most often considered. Farmers most often see bargaining only as a way to bypass the "market" and substantially raise prices. In the first place, this won't work because of the "supply response" problem and in the second place it isn't warranted in view of the nature of returns to commercial farms. It is only by putting the first emphasis on supply discipline that modest price increases can be attained. From society's point of view, a disciplined supply will be worth more than an uncontrollable one.

PUBLIC POLICY TOWARD FARMER BARGAINING

It seems clear that the future of agriculture will be characterized by increasingly effective supply discipline. The remaining question is what body will be given such authority. My choice is an elected group of farmers with legal powers to discipline the actions of their industry. This would require comprehensive permissive legislation guaranteeing fairness in election of representatives and regularizing procedures for financing and settling disputes. S.2973 is a prototype of such comprehensive permissive legislation.

My reasons for favoring farmers being disciplined by farmers are few and uncomplicated.

1. It will be more flexible and competitive than a government oriented system.
2. It gives farmers some control over their destiny.
3. While a government oriented system may be necessary, that extreme

degree of regulation should be sought only after actual experience shows the more flexible system inadequate.

How to Emphasize Coordination

My analysis of the problems of agriculture and the possibilities of farmer bargaining leads to the desirability for a heavy emphasis on coordination. It is now necessary to consider what type of policy could encourage bargaining emphasis in that direction.

Probably the most important prerequisite for coordination is information. Information concerning quantities to be marketed, location and delivery time is often inadequate. Improvements usually require better cooperation of farmers. Efforts to improve information by government, industry and other groups have often been rendered ineffective by farmer indifference.

Allowing farmers to conduct price bargaining without basic market information would be chaos. Obtaining and maintaining current market information should be made a necessary condition for bargaining of any kind.

Diversion programs, such as often used with market orders, should be available to bargaining groups. These programs allow the seller to discriminate between markets of different characteristics. The most important result is that quantities and timing of deliveries can be adjusted to the needs of the most important market with other markets or non-use taking up the slack.

Another possibility which should receive careful consideration is granting the elected representative enough authority to conduct compulsory bargaining in non-price terms of trade only. Any bargaining concerning price would have to be voluntary in nature. The power of the government would enforce all negotiated settlements concerning diversion decisions and non-price terms, but no coersion would be possible concerning price. This alternative would emphasize coordination and supply discipline and thereby enable voluntary price bargaining to be more effective then ever before. On the other hand it would make clear to all farm industries that farmer bargaining is very different from labor bargaining.