

Major Forces Shaping Competition in U.S. Food Markets

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[Overview]

- Discuss the major economic forces shaping food markets in the U.S.
- Argue that these forces in combination have created significant buyer and seller market power at various stages in the food market
- Examine implications of market power for farmers, consumers, efficiency of agricultural markets
- Emphasize the implications for competition policy and antitrust enforcement

[Major forces affecting world agricultural markets]

- Increasing market concentration in food manufacturing and retailing
- Increasing vertical coordination and control exercised by manufacturers and retailers over their upstream trading partners
- Increasing emphasis on product and firm differentiation and quality

[Increasing market concentration]

- Through mergers and acquisitions, both food manufacturing and food retailing sectors have become increasingly concentrated worldwide
- Large, international supermarket chains have replaced traditional specialized food retailers, almost worldwide

Market power implications

- Both buyer (oligopsony) and seller (oligopoly) power are important factors regarding food manufacturer and retailer behavior
- Farm product markets are natural oligopsonies
- Retail markets are natural oligopolies
- Market power exercised anywhere in the food chain is detrimental to the welfare of both farmers and consumers

Increasing vertical control exercised by manufacturers and retailers

- Market chains are becoming increasingly compact
 - “Middlemen” are being eliminated in a drive to reduce cost
- Decreasing reliance upon open markets
- Increasing use of contracts which differ widely in their provisions and the degree of control exercised
 - Contracts can improve market efficiency and product quality
 - But do they exacerbate competitive imbalances?
 - How are prices “discovered” in these settings?
 - How does the contract revolution affect small farmers’ access to markets?

Emphasis on product and firm differentiation and quality

- As food becomes a smaller share of consumers' budgets, willingness to pay for specific quality attributes of foods increases
 - Empirical studies document consumers' willingness to pay premiums for the quality attributes they desire
 - Range of valued quality attributes in food has expanded greatly

Emphasis on product differentiation and quality (cont.)

- Traditional attributes of a product, such as taste, appearance, and healthfulness, remain important
- But increasingly quality also refers to factors that characterize a good's production and marketing
 - Environmental sustainability of practices
 - Its location ("local" or country of origin)
 - Nature of inputs—organic, natural, GMO free, etc.
 - Treatment of animals
 - "Fairness" of trade
- This creation of specialized markets on the demand side is a counterbalance to the economies of mass production on the supply side

[Firm or seller “quality”]

- Buyers seek suppliers who can provide a variety of services in addition to providing a commodity:
 - category management
 - third-party product-safety certification
 - Electronic data interchange
 - Ability to supply products across a category
- Small firms have difficulties meeting this standard.

What are the implications of the structural revolution for. . .

- farmers?
- consumers?
- Market performance?
- policy makers and competition authorities?

[Implications for farmers]

- Market power exercised *anywhere* in the market chain reduces farmer welfare
- Improvements in food-market efficiency that would benefit farmers in a competitive market may not provide much benefit in an oligopoly-oligopsony setting
- Downstream buyers' demands for quality, food safety, consistency of supply, provision of ancillary services, etc. are difficult for small farmers and marketers to meet
- But increasing diversity in what consumers seek in food creates profitable market niches

Implications for consumers

- Higher prices due to market power exercised anywhere in the market chain
- Lower prices because consolidation, technological advances, and vertical coordination have produced cost-efficiencies
 - Walmart prices are 14% lower than competing supermarkets in U.S.
 - Competition with Walmart causes competing supermarkets to reduce prices by 3-7%
- Consumers also benefit from increased variety and product choice

[Implications for market performance]

- Small departures from competition in a single stage have little impact on the efficiency of a market
- Large departures from competition or market power exercised at multiple stages can have extreme market-efficiency implications

Implications for market performance (cont.)

- Small departures from competition have large consequences for distribution of benefits from a market or a policy
 - Market intermediaries may capture a large share of the economic surplus from a market or a policy at the expense of consumers and farmers
 - Taxpayers costs to provide a given amount of farm support may be much higher, and intermediaries capture much of the policy benefit

Implications for competition policy and antitrust

- Empirical research to date finds on balance significant but quantitatively small departures from competition in agricultural markets
 - Disconnect between empirical results and structural conditions
- How to appropriately measure grocery retailer market power?

Implications for competition policy and antitrust (cont.)

- Consolidation in food markets has probably increased pure efficiency
- The narrow efficiency calculus misses
 - Important redistributive effects
 - Distortions of incentives
 - Impacts on rural communities

Implications for competition policy and antitrust (cont.)

- Retailers and powerful food manufacturers are probably able to countervail each other's market power
- Farmers, consumers, and small food marketers likely would benefit from greater competition in the system
 - Competition policy needs to emphasize both buyer and seller power

[Conclusions]

- Agricultural markets have undergone a profound structural revolution worldwide
 - Fewer and more powerful market intermediaries
 - Streamlined market channels
 - Vertical control and contracts link production stages
 - Emphasis on product differentiation and quality
- Structural changes have made markets more efficient but also have had important effects on distribution of benefits from the market
- Most of the changes are harmful to farmers, especially small ones
- Both buyer and seller power need to be emphasized moving forward