

**Report to the National Farmers Union**

**CONSOLIDATION IN  
FOOD RETAILING AND DAIRY:**

**Implications for Farmers and Consumers  
in a Global Food System**

**Report prepared by**

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## EXECUTIVE SUMMARY

The global/agro food system continues being restructured one commodity sector after another. Two years ago, we discussed this emerging food system which we suggested would be organized around five or six global food chain clusters. It has become increasingly clear that food chain clusters are being extended through the retail stage. The restructuring is the result of the three processes of horizontal integration, vertical integration and globalization.

### The Retail Sector

- *Horizontal integration through consolidation has occurred very rapidly in the last three years.* Today, Kroger, Albertson's, Wal-Mart, Safeway and Ahold USA account for 42% of retail food sales in the United States, whereas in 1997 the top five food retailers had only 24% of the market. In the last two years, Kroger bought Fred Meyer to match Albertson's acquisition of American Stores. Ahold USA and Safeway continued a string of smaller acquisitions, while increased grocery sales at Wal-Mart Supercenters makes it a challenger for the top position in US food retailing.
- *Vertical integration formally connects retailers back to the production and processing stages of the food system.* Kroger has case-ready beef supply agreements with Excel (Cargill), while Stop and Shop (Ahold USA) has a dairy supply agreement with Suiza Foods, and Wal-Mart obtains case-ready meats from IBP, Farmland, and Smithfield.
- *The impacts of global forces that will drive further restructuring in the agro/food system are just beginning to become evident.* Trends suggest six or fewer global food retailers will evolve over the next few years. Most of them will likely be European-based transnational firms, such as Tesco (UK), Ahold (Netherlands) and Carrefour (France). At this time, Wal-Mart, who triggered much of the consolidation in the European retail sector, will be the only major United States based global retail firm.
- *Retailers are now in a position to dictate terms to food manufacturers who then force changes back through the system to the farm level.* Perhaps 50-75 percent of the total net profit for large retailers comes from retailer fees from slotting allowances, display fees, presentation fees, "pay-to-stay" fees and failure fees.
- *As the balance of power shifts to the retailers, smaller entities in all parts of the food system are being left out.* The retailer fees in place at most of the larger retail stores present barriers to smaller processors and/or farmers wishing to place products on the retail shelf. Such restructuring presents critical problems for consumers and communities in inner urban and rural areas that are no longer profitable for global food clusters.

### Dairy

For decades dairy farmers seemed immune to the consequences of restructuring because, through their local or regional cooperatives, they were also a dominant processor of milk for their local or regional markets. National markets did not exist. Even most of the investor-owned firms operated at a community level. That structure began to change a couple decades ago, but like the retail stage, the most dramatic changes have occurred in the past three or four years as a result of horizontal integration, vertical integration and globalization.

- *Horizontal integration occurred as four firms consolidated a host of cooperatives and investor-owned firms and then formalized their own working relationships.* For years, Philip Morris (Kraft) has been the only dominant firm in the dairy sector, especially in cheese. This past year it was almost overtaken in total dairy sales by Suiza Foods. If one considers the close working relationship between Suiza Foods/Dairy Farmers of America and the less commingled Dean Foods/Land O' Lakes operations as two management units, Kraft ranks third in dairy sales.
- *Vertical integration, which formally connects the dairy processing stage to the retail stage, is probably the major driver of the restructuring at this time.* Through acquisitions, Kroger and Safeway own and operate their own dairy processing facilities to supply some of their needs. But Kroger and Safeway, as well as Wal-Mart and others are seeking long-term agreements which guarantees them consistent product to serve a coast-to-coast retail operation. Most processors now see the retail firms as their consumer.
- *The three largest global food processors (Nestle, Unilever and Philip Morris) are directly involved in dairy processing in the United States.* These firms will "source" their raw milk from wherever they can obtain it at least cost. Already there are calculations estimating the world price of raw dairy products if the United States produced none. In the past couple of years, the importation of milk protein concentrates, which do not face any import restrictions, has greatly increased.
- *Cooperatives are struggling to adjust to the above changes.* Through joint ventures with investor-owned firms they become part of a food system cluster and survive. However, because a cooperative is not the dominant firm in the cluster, it may not be able to assist its farmer members to receive any more for their milk. The very rapid restructuring of the dairy sector raises many questions about the future role of cooperatives.

## **The Food System Remains Dynamic**

Although we can predict that the current direction of change will probably continue in the short-term, many questions arise to the sustainability of this system over the longer term given the many potential external factors that could have a serious impact on it. A variety of individuals and organizations are already raising serious questions. Even the neoclassical economic theory, which provides the academic legitimacy for the evolving economic order, is being challenged.

Some economists point to globalization and question whether we need US farmers. Although US farmers may be very efficient, they have integrated the cost of environmental, health and safety standards into their costs of production, and are therefore high cost producers, compared to countries that do not require such standards. Thus, we can (and do) import much of our food cheaper than we can produce it.

At some point, citizens must ask what kind of a food system they want and then design our food and farm policies to create and encourage that system. Even though the food system is becoming more like—and not different from—other economic sectors, such a question will probably force us to grapple with the question: Is it possible that food is so unique that it requires special public policies?

## Introduction

Over the last forty years, the agro/food system in the United States and in much of the rest of the world has been in the process of being restructured one commodity sector after another. Starting with the broiler sector in the 1950's and 1960's, the ownership and management of the production input stage (e.g. feed and young chicks) were extended to the production stage. These stages were then formally merged with the processing stage.

This vertical integration continued in combination with horizontal integration. A recent example of horizontal integration in the broiler industry is Pilgrim's Pride's purchase of WLR Foods – operating under the Wampler Foods label (*Feedstuffs*, 10/2/00). This acquisition combined with ConAgra's earlier purchase of Seaboard's poultry division (*Feedstuffs*, 12/13/99), means the four largest firms today share 50 percent of the production and processing of broilers. The turkey and egg sectors have followed a similar model.

For a variety of reasons unique to each, other commodity sectors have followed different paths to what appears to be a similar structural outcome, namely that market access for farmers is dominated by just a few transnational corporations. For instance, change came to the beef sector at the feedlot level. Today 20 feedlots feed 50 percent of the cattle and are directly connected to the four processing firms that control 81 percent of the beef processing either by direct ownership or through formal contracts. The only question that remains is how the cow/calf producers will be integrated into the predicted seamless system. Will many of the small and less price sensitive farmers be left without access to markets?

In many ways, the pork sector is being restructured through a process similar to that found in the poultry sector, but it shares some similarities with the beef sector. Regardless of the process followed, the results of restructuring are the same with both vertical and horizontal integration taking place. The final chapter of vertical integration is just beginning in the area of non-specialty crop production, but the horizontal integration is already in place in all but the production stage.

Almost two years ago, we discussed this emerging food system which we suggested would be organized around five or six global “food chain clusters”.<sup>1</sup> We omitted the dairy sector, however, because it did not fit into our clusters at the time, even though it was obviously being restructured. Furthermore, we ended our food chain clusters with the meat processing stage. Over the past couple of years, it has become increasingly clear that the food chain clusters are being extended through the retail stage with such new processing arrangements as “case-ready” products. This final step in the alliance is so powerful that it is further restructuring some of the commodity sectors that began horizontal and vertical integration long before the dairy sector. However, the dairy sector is interesting because it is experiencing the impact of several forces simultaneously.

The retail stage – the point where people buy the food they eat – also becomes more important as consumers find fewer and fewer shopping options. What follows is an attempt to delineate the actors at the retail stage from a national and international perspective, and show how they are

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<sup>1</sup> Heffernan, William D., Mary Hendrickson and Robert Gronski. 1999. *Consolidation in the Food and Agriculture System*. Report to the National Farmers Union. Washington, D.C., February.

involved in shaping the future structure of the dairy sector. The story that emerges can help us examine the implications of a globalizing food system for both farmers and consumers.

### What's Happening in the Retailing Sector?

The major players in food retailing in the United States are Kroger, Albertson's, Wal-Mart, Safeway<sup>2</sup> and Ahold USA, a subsidiary of the Dutch firm Royal Ahold. Together these five supermarket chains account for over 40% of food retail sales in the United States (*Supermarket News* 1/24/00). By comparison, the top five food retailers accounted for only 20% of food sales in 1993 (*Nutrition Today*, May 2000). Average market concentration of the four top retailers in individual metropolitan areas around the US stood at 73% just a few years ago and there is little indication that it has decreased.<sup>3</sup>

**Table 1: Top Five Grocery Retailers in the United States**

1997	2000
Kroger Co.	Kroger Co.
Safeway	Wal-Mart
American Stores	Albertson's
Albertson's	Safeway
Ahold USA	Ahold USA
<b>CR5 = 24%*</b>	<b>CR5 = 42%**</b>

CR 5 refers to percent of market share held by the top 5 retailers.

\* *Pacific Crest Securities*, 1/8/99

\*\* *Supermarket News*, 1/24/00

### Kroger – The Number One Retailer in the United States

The number one supermarket in US, Kroger Co. based in Ohio, completed the acquisition of Fred Meyer in 1999 to become one of the first coast-to-coast chains in the United States. It is estimated to receive 10 cents of every dollar spent in supermarkets in this country (*Discount Store News*, 12/14/98). But to understand Kroger's rise to dominance, one must look at the pedigree of mergers and acquisitions that preceded the present organization. Kroger's most recent acquisition, Fred Meyer, was a large retailer in the western part of the United States. It grew by acquiring Smith's in 1997, in addition to Quality Food Centers (QFC) and Ralph's/Food 4 Less chains in 1998 (*Fred Meyer SEC Filing*, 1999). Moreover, one of the acquisitions of Fred Meyer, QFC, had already swallowed Hughes Markets in 1997, as well as Keith Uddenberg stores in Washington state. While Fred Meyer had been acquiring stores, it was Kroger's first major acquisition since 1988.

Kroger and Fred Meyer announced their merger in late 1998. Kroger's strength as a well-run grocer had been in the Southeast, although it also had such divisions as Dillons, Gerbes and King Soopers

<sup>2</sup> Not to be confused with Safeway PLC based in the United Kingdom.

<sup>3</sup> Cotterill, Ronald W. 1997. "The food distribution system of the future: Convergence towards the US or UK model?" *Agribusiness* Vol. 13(2):123-135.

in the mid-section of the country. Kroger also operates grocery stores under the banners of City Market, PriceRite, Kessel and Payless. In addition, it has convenience stores operating under the Loaf 'n Jug, Kwik Shop, Quick Stop and Turkey Hill names.

According to its 1999 *Annual Report*, Kroger's "primary financial goal is to increase annual earnings per share by 16-18% over the next three years." Kroger will do this by employing its fundamental strategy: ". . . to achieve the responsiveness of decentralized merchandising and operations, combined with the economies of scale available from coordinating volume-based activities and consolidating support systems." In other words, Kroger is hoping to stay flexible enough to respond to market conditions as its size increases, but also to cut costs by employing fewer people and obtaining volume discounts from suppliers.

As many retailers are now doing, Kroger has ties back to the production side of the food business. In March 1998, Kroger began to sell case-ready beef and pork products in many of its southeastern stores. The products sell under Kroger's own label, and are processed by Excel, a subsidiary of Cargill, which also provides a similar service to National Grocers, Canada's largest supermarket chain (*Omaha World Herald*, 4/22/00). This type of arrangement directly ties these retail stores to the Monsanto/Cargill food chain cluster identified by us in 1999.<sup>4</sup>

### **Wal-Mart – A Driver of Change?**

Wal-Mart, which had virtually non-existent food sales in 1993, is now the second largest food retailer in the US (*Supermarket News*, 1/24/00), and is on track to become the largest, with surprisingly strong food sales at its Supercenters. Wal-Mart is forcing many changes in retailing at the global level, some of which are discussed below.

When Wal-Mart entered the supermarket business in the mid-1990s, other stores were wary because of the incredible logistics system and supplier pricing that Wal-Mart brought to the business. Wal-Mart started selling groceries through its Supercenters. Now it also has almost 20 Neighborhood Markets, which at 30,000 square feet are significantly smaller than Supercenters. This means that Wal-Mart will have combined its considerable buying power with smaller, user-friendly stores (*Financial Times*, 6/29/99). One analyst, commending Safeway on buying chains in urban areas with less exposure to Wal-Mart Supercenters said, "I don't think it's a coincidence that Safeway is the most profitable food retailer and the one with the least amount of Wal-Mart exposure geographically" (*Los Angeles Times* 12/26/00).

More importantly, Wal-Mart's large size and market power causes concern as it integrates backward in the food system by creating relationships with dominant food chain clusters identified by us in 1999.<sup>5</sup> Wal-Mart is one of the first supermarkets to use case-ready meat in its stores. The first such prepackaged beef came from IBP. Farmland will supply pork in the Midwest stores (*Houston Chronicle*, 4/16/00), although Wal-Mart was also scheduled to buy pork from Smithfield's John Morrell for what appears to be the same stores. Smithfield was already supplying case-ready pork for Wal-Mart for some of its East Coast stores early this year (*Agriculture.online*, 4/12/00).

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<sup>4</sup> Heffernan, *et al.* 1999.

<sup>5</sup> Heffernan, *et al.* 1999.

## **Albertson's, Safeway and Ahold**

In 1998, Albertson's was the fourth largest US supermarket retailer when it announced it would acquire the second largest supermarket chain, American Stores. Two of American Stores' banners were significant players in major metropolitan markets. Jewel/Osco held top market share in Chicago, while Acme had the top position in Philadelphia (*BT Alexander Brown Research*, 1/28/99). Despite struggling to digest the American Stores' merger, Albertson's has had a good history of being a profitability leader among supermarket chains. In 1997, Albertson's had a 22.2% return on equity (*BT Alexander Brown Research*, 1/28/99).

Albertson's, based in Idaho, is creating linkages with other Northwestern all-star companies. The chain recently entered an agreement with Starbucks Coffee Co. to open 100 Starbucks coffee bars in Albertson's supermarkets across the country (*Puget Sound Business Journal* 11/19/99).

Safeway has consistently been a strong player in food retailing with a 36% return on equity in 1997 (*BT Alexander Brown Research*, 1/28/99). The chain is pursuing an aggressive acquisition strategy, most recently with its acquisition of Genuardi's Family Markets based in Pennsylvania. This is the fifth acquisition in less than four years (*Supermarket News*, 12/11/00). Safeway bought Vons Company (California) in 1997, then Dominicks Finer Foods, an Illinois retailer, in 1998 and acquired both Carr-Gottstein Foods (Alaska) and Randall's (Texas) in 1999. Safeway operates stores in Canada, and also has a 49% interest in Casa Ley de S.A. CV, a supermarket and general retailer operating in western Mexico.

Safeway continues to look for acquisitions. According Steve Burd, Safeway president, potential acquisitions should “. . . have strong market share, good physical facilities, [and] annual sales of about \$1 billion . . .” In other words, these are companies “who are feeling competitive pressures and worrying about the declining number of potential bidders . . .” which is the result of increased consolidation in the retail sector (*Supermarket News*, 11/13/00).

Ahold USA has a dominant presence on the East Coast with such names as Stop and Shop, Giant, Tops Markets and Bi-Lo. The chain is acquiring 56 Grand Union stores (New Jersey), and has expanded into the foodservice industry with the acquisition of US Foodservice and PYA/Monarch in 2000 (*Supermarket News*, 12/4/00 and 11/27/00). The real story is its parent company, Royal Ahold, one of the globe's largest supermarket chains. Royal Ahold is discussed later in this report.

## **The Rise of Global Supermarkets: Will Retail “Tribes” Seize Control?**

Wal-Mart is a key player on the global level. In 1997, Wal-Mart made a foray into Germany, buying Wertkauf and Spar Handels hypermarkets, and then headed west in 1999 to purchase Asda, Britain's third largest-supermarket (*New York Times*, 8/31/99). In fact, Wal-Mart estimates that Asda has 14.2% of the United Kingdom's food market, almost even with number two Sainsbury (*Supermarket News*, 11/20/00). Wal-Mart also operates in Argentina, Brazil, Canada, and Mexico, and is involved in joint ventures in China and Korea (*PR Newswire*, 3/3/00).

Not to be left out, European retailers are undergoing the same rapid consolidation as their US cousins. According to McKinsey, a European management consulting organization, “. . . only the Wal-Mart threat can explain a sharp rise in mergers involving European rivals” (*Financial Times*,

5/5/99). In 1998, \$12.4 billion worth of mergers in the European food-retailing sector happened. Moreover, “. . . almost half were acquisitions or alliances outside domestic markets, against 20 percent five years ago” (*Financial Times*, 5/5/99).

“This is a global phenomenon,” says Mark Husson, a supermarket analyst for Merrill Lynch in New York (*Baking Buyer*, 3/99). He traces much of the consolidation that is currently occurring to the realization among food retailers that they need to band together and seize greater control over pricing and promotions away from food manufacturers. Indeed, one vice-president was quoted as saying that Safeway “. . . intends to ‘optimize the supply chain’ by controlling the flow of products from the manufacturer to the store . . .” (*Supermarket News*, 11/13/00). In a statement that should cause farmers and processors a great deal of reflection, analyst Husson said that

. . . before, [food manufacturers] ruled over retailers the way the Romans did with their tribes. It was divide and conquer. But in the last two or three years, the tribes have gotten together. They’re now dictating price and promotions to the manufacturers. They realized they couldn’t be mal-coordinated. You can’t fight Wal-Mart with one hand tied behind your back. Once that [consolidation] process started, and it became obvious that it would be a winning strategy, *then the big players decided how big they wanted to be, who they wanted to acquire.* (*Baking Buyer*, 3/99. Emphasis added.)

### Can other firms compete with Wal-Mart?

The perception of the threat Wal-Mart poses on a global level is so dramatic that two French retailers, Carrefour and Promodes, announced their merger as a way to cope with Wal-Mart on a global scale (*New York Times*, 8/31/99). (Carrefour had and continues to have a significant presence in food retailing, although it does not operate currently in the United States.) An article in *Business Week* (9/13/99) indicates, “As Europe’s new top dog, Carrefour can use its buying clout to extract deeper discounts from suppliers, undercutting rivals and accelerating a push toward consolidation in the industry.” Carrefour’s merger with Promodes created the second largest retailer in the world. It is a strong presence in Latin America, where the merged entity is the number one supermarket retailer in Brazil – 20% market share – and Argentina – 30% market share. It is also the leading retailer in Taiwan, France, Spain, Portugal, Greece and Belgium (*Business Week*, 9/13/99; *New York Times*, 8/31/99). In an arena increasingly dominated by giants competing with each other, Carrefour has done well in head to head competition with Wal-Mart in Brazil and Argentina – countering Wal-Mart’s entrance into the markets by cutting prices, remodeling and relocating (*Business Week*, 9/13/99).

After Carrefour merged with Promodes, the Dutch firm Royal Ahold claimed to have a number of calls from European retailers approaching the company to be taken over by them. Ahold, which has about 28% of the Netherlands’ food retail market, operates across the world. Sales in Latin America – Brazil, Argentina, Chile, Peru, Paraguay and Ecuador – generate about \$4.5 billion, while Portugal, Spain, Poland and the Czech Republic provide another \$2 billion, with about \$.5 billion coming from the Far East (*Grocer*, 1/9/99). Ahold also has a 50% stake in the ICA group, the number one food retailer in Sweden, with 35% market share, and number two in Norway, with almost 28% of the market (*Nutrition Today*, May 2000). Ahold is also the largest foreign retailer in China, with a 50/50 joint venture with Yaohan Liancheng Co. (*Supermarket News*, 1/12/98).

Despite Ahold being considered a Dutch “national institution” where over 50% of Dutch private shareholders own stock, 60% of Ahold’s revenues come from its operations on the East Coast of the United States (*Business Week*, 1/24/00). In the US, it owns such stores as Stop and Shop – which has a major supply agreement with Suiza, the largest dairy processor in the US – Bi-Lo, Tops and Giant. Its planned acquisition of Pathmark in New Jersey/New York collapsed after the Federal Trade Commission required what Ahold considered to be too many divestitures.

Some analysts predict there will be only six or so global food retailers in the near future – Wal-Mart and the European firms of Carrefour, Ahold and Tesco (UK) are likely contenders (*Financial Times*, 12/22/99; *Grocer*, 1/9/99; *Supermarket News* 9/18/00).

### **Possible Concerns of Increasing Retail Dominance**

According to some commentators, food manufacturers have embraced consolidation in food retailing because it cuts down on the transaction costs of dealing with large numbers of customers. However, it also puts the food retailers “. . . in a position to demand so much more from food processors.”<sup>6</sup> Indeed the customer list of a large US dairy processor, Dean Foods, reads like the list of the top food retail chains, including such customers as Albertson’s, Wal-Mart, Meijer, Topco, Food Lion (Delhaize America), Marsh, Ahold, Publix, Fleming and Penn Traffic.<sup>7</sup> Still, Dean believes it holds a similar position of power vis-à-vis the retailer on the supply side.

While independent retailers and smaller chains are fast losing ground in the rapidly consolidating food retail market, in 1998 they still accounted for about \$70 billion in sales with 16 percent of the food retail market.<sup>8</sup> Moreover, industry analysts predict a good future for wholesalers (distributors) if they can forge close links with stores they supply (*Supermarket News*, 8/30/99). Perhaps, there are some options for farmers and smaller processors to work together. However, while Stanton and others might project some optimism, the case of dairy provides some insights into how farmers have tried and are now failing to bring the economic benefits of food processing and retailing back to the farm level.

### **The Implications of Processing/Retailing Consolidation: A Case Study of the US Dairy Sector**

For decades, most dairy farmers seemed immune to the consequences of restructuring because, through their local and regional cooperatives, they were also a dominant processor of milk for many of their local and regional markets. The dairy sector was vertically integrated from production through the processing and distribution stages, and often through the retail stage as well, mainly because cooperatives had well-established brand names in their local areas. In the case of cooperatives, however, the control of the vertically integrated system remained with the dairy farmers. In fact, one could argue that the large portion of the dairy sector controlled by cooperatives was the first agricultural sector to be vertically integrated. This structure cushioned them from non-farm processors who came to dominate the other commodity sectors.

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<sup>6</sup> Stanton, John. 1999a. “Support the independent grocer – or else.” *Food Processing* 60(2):36.

<sup>7</sup> Informal discussion with Doug Parr, Vice President at Dean Foods. Social Sciences Unit, College of Agriculture, Food and Natural Resources. University of Missouri. September 24, 1999.

<sup>8</sup> Stanton, John. 1999a. “Support the independent grocer – or else.” *Food Processing* 60(2):36-38.

As recently as a decade ago, most investor-owned processors tended to also operate at the local level. They were usually known as family businesses and, like the cooperatives, they had operated over a couple of generations as well-known brand names in their communities. Although low milk prices resulted from overproduction, encouraged by new technologies and the emergence of very large or industrialized dairies, many of the medium-sized dairies were able to survive in the local market with some sense of being independent entrepreneurs. However, the emerging horizontal integration rapidly sweeping the dairy sector today suggests that this sector will soon be horizontally and vertically structured much like other commodity sectors, to the detriment of dairy producers.

### ***The Dairy Sector Historically***

A decade ago it was becoming apparent that new forces were challenging the dairy sector. Investor-owned firms like Borden began to move into more highly processed products such as yogurt and frozen novelties. As the growth in fluid milk sales remained flat, it appeared that these more highly processed products would be the growth area of the sector and would lead to a disproportionate amount of influence in the sector by the firms that controlled them. Cooperative leaders reacted to some of these forces by increasing their research budgets for product development, expanding their line of more highly processed products, and beginning to restructure the cooperative system.

In 1988, the largest four firms (Borden, Dean Foods, Labatt Foods and Kroger) had about 26 percent of the fluid milk sales in the United States. Borden was the largest with only a 9.2 percent share, and there were hundreds of other processors across the country. Although there remained over 200 operating dairy cooperatives, that number was down considerably from the 1,000 operating 50 years earlier.<sup>9</sup> In an interview with *Feedstuffs* (3/18/93), an executive of Land O'Lakes said, that "Land O'Lakes expects 500 locals to consider mergers over the next five years." Many of those would be dairy cooperatives.

Early in the 1990's, Philip Morris (Kraft) continued to dominate cheese processing in the U.S. It had 54 percent of the processed sliced cheese market, 88 percent of the cheese loaves market, and 56 percent of the grated cheese market. However the new growth area of the dairy sector, namely the more highly processed products section, was not dominated by one or even a few firms. In 1992, the largest four firms (Dreyer's, Philip Morris, Kemp's and Haagen-Dazs) had 41 percent of the frozen yogurt sales. Unilever had 14 percent of the frozen novelties and shared with the next three largest firms (Nestle, Snickers and Grand Metropolitan) 28 percent of that market. Unilever, Pillsbury, Dreyer's and Blue Bell sold 34 percent of the ice cream with half of that (16 percent) being sold by Unilever. (*Advertising Age*, 1993).

### ***Forces Impacting Change in the Dairy Sector***

With the exception of Philip Morris' (Kraft) dominance in the cheese segment, the concentration of the market share by the largest four firms in dairy product sales is relatively low, but is changing rapidly, particularly in certain regions of the country. One estimate shows approximately 35% of the \$23 billion fluid milk market dominated by four firms –Dean Foods, Suiza Foods, Kroger and

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<sup>9</sup> Kozak, Jerry. 1998. "The changing role of dairy trade groups and coops." *Rural Cooperatives*, September.

Prairie Farms (*Chicago Sun-Times*, 6/1/00), up from 26% in 1988. However, there are at least three major forces of change that are and will continue to restructure the dairy sector.

The first force for change is the concentration of control in the retail sector. When the Western US retailer QFC (now operating under Kroger) had obtained Hughes Markets on its acquisition path, it also acquired a 50% interest in Santee Dairy, one of the largest dairy plants in California (*Kroger Annual Report*, 1999). Through acquisitions, Kroger now has a 10-year product supply agreement with Santee that requires purchasing 9 million gallons of fluid milk and other products annually. Safeway's Dominicks operates Ludwig Dairy, which produces cottage cheese, sour cream yogurt and ice cream, and Safeway's Seattle division produces milk, cheese and plastic gallon jugs. All in all, Safeway operates 10 milk plants and 6 ice cream plants in the U.S. and Canada (*Annual Report*, 1999).

Combine this processing of dairy products by large food retailers, with increasing concentration in the food retailing sector, and we see that retailers are now in position to begin challenging the processing firms. This is because one of the goals of a national retailer is to establish national brands. This requires huge supplies of product across the country that local and regional processors are not prepared to supply. Moreover, large retailers continue to support the dominant economic ideology of the large agribusiness firms and agricultural economists who argue that increased size and market share constitute a "natural system."

The second force for restructuring is the growing direct involvement of transnational firms in the dairy sector. The three largest food processors in the world (Nestle, Unilever and Philip Morris) were involved in the US dairy sector over a decade ago and continue to expand, but new firms want to enter. In March of 1993, Parmalat, a global dairy firm based in Italy, said it was beginning a major effort to become involved in the dairy industry in the United States. As its first acquisition, Parmalat purchased Atlanta Dairies, Inc. from Dairy Holdings, which had bought the property from Finevest Foods. However, Atlanta Dairies had started as a 100-member cooperative organized forty years earlier and sold to Finevest in 1987. Parmalat has also added Astro Dairies, Farmland Dairies and Sunnydale Farms to its portfolio of US operations (*Milkweed*, March 2000). Given the current political/economic climate, the global food system will continue to be a major force impacting food retailing and dairy.

A third force changing the dairy sector is the horizontal integration that has occurred in the past few years, especially the past two or three years. According to *Dairy Field* (July 2000), Kraft Foods Co. is still the top dairy processing firm in the US with \$4.39 billion in sales, but both Suiza Foods with \$4.24 billion in sales and Dean Foods with \$3.2 billion in sales are challenging Kraft. However, with cooperatives acquiring investor-owned firms (e.g. Mid-America Dairymen buying Borden); investor-owned firms purchasing cooperatives (e.g. Dean Foods acquiring operations from Land O' Lakes); and investor-owned firms and cooperatives forming joint ventures (e.g. Suiza and Dairy Farmers of America), the question becomes: What is the management unit?

## **The Emergence of Suiza**

Suiza Foods say it is the largest fluid milk processor and the leading manufacturer and distributor of dairy products in the United States (*Annual Report*, 1999). It entered the dairy sector in December 1993 by purchasing Suiza Dairy Corporation, a Puerto Rican firm. It became a publicly-traded stock firm in 1996. Suiza grew rapidly through mergers and acquisitions, completing 39 dairy acquisitions during its short history. The firm began by focusing much of its early attention on the Northeast, starting with the purchase of Garelick Farms, Cumberland Farms and West Lynn Creamery. It has acquired Valley of Virginia Cooperative Milk Producers, Southern Foods - the third largest dairy processor in the United States, Adohr Farms, and Broughton Foods. At the global level Suiza bought Leche Celta, the fourth largest dairy processor in Spain. It also has a 13.8 percent share in Horizon Organic, one of the largest organic processors in the US, which is now entering the UK market.

Suiza received considerable attention when it formed a joint venture with the cooperative Dairy Farmers of America (DFA), called Suiza Dairy Group. DFA contributed the majority of its capital in Southern Foods Group and Suiza contributed its domestic fluid dairy operations. Although it is called a joint venture, Suiza owns 67 percent of Suiza Dairy Group's stock, manages the operation, and says it will report the results of Suiza Dairy Group in its consolidated financial statements (*Annual Report*, 1999). With the combining of the two firms, they control 70 percent of the fluid milk processing and distribution in 13 Northeastern states (*Boston Globe*, 4/7/00). There are only six other significant fluid milk processors in the region including Crowley's Foods. Inc., owned by Wessanen, a Netherlands-based firm.

Suiza says, "Our primary strategic focus has been to expand the geographic coverage of our dairy business to better serve an increasingly national customer base" (*Annual Report*, 1999). Suiza understands the importance of the changes at the retail level and feels its opportunity comes in trying to meet the needs of the evolving structure. As noted in *Dairy Field* (10/99), "The company's dairy customer base is comprised mainly of supermarkets and about 50 percent of the product mix is customer brands." Customers include top food retailers like Wal-Mart, Ahold, A&P, SuperValu, Topco and Costco. Although it continues to serve regional markets, its major focus is on national markets. It hopes to "... parley supermarket and retail consolidation into national category management leadership as a single-source supplier" (*Dairy Field*, 10/99).<sup>10</sup> In addition to the joining of production and processing, the alliance (or seamless system) engineered by Suiza is extended to the retail level with the long-term supply agreement between Suiza and Ahold's Stop & Shop.

## **Dairy Farmers of America**

Merger mania is not limited to investor-owned firms. In the early 1990's, Mid-Am was a regional dairy cooperative headquartered in Missouri with 13,000 dairy farmers in 15 states. Like other regional cooperatives watching its membership decline as the result of the loss of dairy farms and changes occurring in the dairy sector, Mid-Am felt the need to expand its geographical area. In 1993 it began construction of a new milk-processing plant in Portales, New Mexico. The site was

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<sup>10</sup> Category management is a term used in the retail industry to imply management of product categories as a whole, rather than individual products being managed on a brand-by-brand basis.

selected because New Mexico was expanding milk production at a 13 percent annual rate, the most rapid rate in the country, and Portales was experiencing the most rapid increase in milk production in the area (*Feedstuffs*, 6/14/93).

In 1994, Mid-Am merged with two other dairy cooperatives, State Dairy Association of California and Gulf Dairy of Louisiana. Later in the year Mid-Am merged with Dairymen Inc. from Kentucky. Although these were mergers, with the board being reconstituted to fold in some board members of the original cooperatives with those from Mid-Am, the Mid-Am name was maintained. In June 1997 Mid-Am acquired Borden/Meadow Gold and with it the licensing rights to Borden, and the accompanying Elsie the Cow trademark. Late in the year it bought the Borden cheese operation, including a cheese plant in Plymouth, Wisconsin (*Refrigerated & Frozen Foods*, June 1997).

Finally, the string of mergers led to the evolution of a new national dairy cooperative called Dairy Farmers of America (DFA). In January of 1998, DFA was formed when four major regional cooperatives were combined – Mid-America Dairymen, Inc., the Southern Region of Associated Milk Producers, Inc., Milk Marketing Inc., and Western Dairymen Cooperative. DFA now serves 22,000 dairy farmers in 43 states.<sup>11</sup>

Because Borden belongs to DFA, its ownership creates some interesting problems and criticism for the new cooperative. DFA, the largest dairy cooperative, was drawn into James Servais et al v. Kraft Foods, a lawsuit that seeks billions of dollars in damages for dairy farmers who received lower milk prices because of Kraft's manipulation of the National Cheese Exchange. One of the suit's defendants, along with Philip Morris (Kraft), was Borden – now owned by DFA who was liable for Borden's actions. This past summer an attorney representing DFA joined Kraft in asking the judge handling the case in Madison, Wisconsin to dismiss the case because the suit involved dairy farmers suing dairy farmers. In what may become a class action suit, many of the DFA members feel betrayed by their cooperative.

Moreover, Borden is involved in the importation of cheese. *The Milkweed* (Nov. 1999) says that "imported cheese is flooding into the Borden cheese plant at Plymouth, Wisconsin from all over." They suggest that the cheese is coming from countries such as New Zealand, Australia, Poland, Denmark and Great Britain. Consequently, dairy farmer members of DFA have to be asking how such maneuvering is helping to improve their bottom line.

## **Dean Foods**

Dean Foods was founded in 1925 as a small Midwestern dairy. Today it ranks third in dairy sales. Dean Foods is a Fortune 500 food company with dairy revenues of \$3.0 billion during 1999 (*Annual Report*, 1999). The dairy products division represents 75 percent of the company's total revenues (*Dean Foods Company Fact Book*, 1998). In 1998, Dean Foods provided a 34 percent total return on investment, including stock price appreciation and reinvested dividends (*Dean Foods Company Fact Book*, 1998). In the past few years Dean Foods has grown very rapidly as a result of a host of acquisitions, including the completion of "26 acquisitions in the last five fiscal years" (*Annual Report*, 1999).

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<sup>11</sup> Merlo, Catherine. 1998. "When cooperatives combine." *Rural Cooperatives*, September.

During fiscal year 1998, Dean Foods acquired eight dairy processing firms. These included Meyer Dairy Co. in Cincinnati, Ohio; Purity Dairies in Nashville, Tennessee; Penn Traffic Co.'s Sani-Dairy unit in Johnstown, Pennsylvania; Milk Products LLC in Albuquerque, New Mexico; and Maplehurst Dairy in Indianapolis, Indiana. Maplehurst manufactures a full line of fluid milk, ice cream, nutraceuticals and other dairy products that it markets through retail stores and supermarkets throughout central Indiana.

In its 1999 fiscal year, Dean Foods completed nine dairy purchases. It expanded to the West Coast with the acquisitions of Berkeley Farms in the San Francisco Bay area and Alta Dena in southern California. Alta Dena is an organic dairy processor. Other purchases included Barber Dairies in Birmingham, Alabama; U.C. Milk in Madisonville, Kentucky; and Hillside Dairy in Cleveland, Ohio. As of the end of May 2000, Dean Foods listed 35 subsidiaries of which about two-thirds were dairy processing and distribution operations (*Annual Report 2000*).

### Dean Foods and Land O'Lakes Unite

On July 10, 2000, Dean Foods Company announced the purchase of Land O'Lakes Upper Midwest fluid milk operation. Although this is a relatively minor part of Land O'Lakes total operation, it is significant because an investor-owned firm is coming between the dairy farmer and the consumer. It was the control of the processing sector and the brand name that gave the dairy farmer insulation from the domination of the processing sector emerging in most other major farm commodities. According to Chairman Howard Dean, "Dean Foods is acquiring a strong and successful fluid dairy business that commands the leading position in its regional market" (*PR Newswire*, 7/11/00). The operation markets a full line of fluid milk, yogurt, creams and sour cream and cottage cheese. Eighty-five percent of the product will be sold under the Land O'Lakes brand name. As part of the negotiations, Land O'Lakes obtained a long-term agreement to supply the raw milk. Although this arrangement provides market access for the farmer members, it also represents a major structural change for dairy farmers in the region because they no longer have management control over the processing stage.

Accompanying the sale of its Upper Midwest operation to Dean Foods, Land O'Lakes also formed a joint venture with Dean to nationally market and to license certain value-added and cultured dairy products. Thus, Land O'Lakes is sharing its well-known brand with an investor-owned firm. As Land O'Lakes forms alliances with other cooperatives and investor-owned firms to strengthen its position in the agricultural input stage (e.g. feed, fertilizer and seed), it is now "sharing" its brand name – a name that was one of its major strengths in the processing and retailing of its farmers' commodities.

These combinations create questions about who is the dominant actor in the dairy sector. Is Kraft with \$4.4 billion in sales the largest dairy unit? With \$2.1 billion in dairy sales in 1999, DFA is ranked as the fifth largest firm in the dairy sector. However, if one combines the total of Suiza (4.2 billion) and DFA in what *Dairy Field* (July 2000) called "the strong link forged between them," the total comes to \$6.3 billion, greatly exceeding leader Kraft's \$4.4 billion. In addition, Land O'Lakes ranks fourth in dairy sales with \$2.7 billion in sales. Adding this sum to Dean Foods' \$3.2 billion totals \$5.9 billion for the joint venture that *Dairy Field* (July 2000) refers to as "a less-inclusive

partnership” than the Suiza-DFA alliance. The question is what is the management unit? Which firm makes which decisions? Are the cooperatives equals with Suiza and Dean Foods?

## **The Threats of Consolidated Retail Markets for Producers**

This case study from the dairy sector underscores how retailer dominance, or vertical integration, in the food system presents challenges for farmers, processors and distributors. As retailers grow larger through acquisitions and mergers, they develop their own vertically integrated distribution systems that tend to shut out wholesalers, small processors and smaller retailers – the supply problem that regional dairy processors tried to overcome. These large retail firms are able to develop one-on-one relationships with dominant food manufacturers that can service their far-flung systems. “With consolidation, it becomes much more important [than before] for manufacturers to maintain good working relationships with the large consolidating companies,” said one consultant.<sup>12</sup> The food manufacturers find themselves in a new position in the power relationship because the retailers can start dictating terms to food manufacturers (*Supermarket News*, 1/10/00).<sup>13</sup> Thus, food manufacturers become more focused on serving the interests of food retailers rather than the interests of farmers.

## **The Challenges of Retailer Fees**

Another challenge for smaller food producers and processors is the retailer fees that many large chains demand. One observer estimates that *between 50 and 75 percent* of total net profit for large retailers comes from “slotting allowances, advertising fees, unsellables [and the like].”<sup>14</sup> For instance, \$50,000 would place one jar size of specialty pickles on the shelves at all four major grocery chains in Tampa, Florida (*Tampa Tribune*, 9/27/99). There are a whole range of “trade promotions” that manufacturers pay retailers, including slotting allowances (which are supposed to be for new product entry only), display fees, presentation fees, “pay-to-stay” fees and failure fees.<sup>15</sup> Presented with information that retailer fees generate \$9 billion annually, one smaller food manufacturer calculated this to be “around 2.5 percent of the total volume of the market [\$350 billion annual grocery sales nationally], which I think is pretty much equivalent to the profit margins of the grocery business.”<sup>16</sup>

Retailers argue that slotting fees are a way to manage risk and recover the costs of introducing a new product including labor time in redesigning the store, restocking, and reprogramming computers.<sup>17</sup> On the other hand, some are concerned that these fees are simply an exercise of market power by retailers who have consolidated and adopted new technology. Fees can function as a mechanism for discrimination between large and small firms, and can also be a way to drive smaller competitors out of business thereby undermining established distribution “channel” relationships and efficiencies. Certainly regional dairy cooperatives found these fees problematic as the focus shifted to national brands.

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<sup>12</sup> Kuhn, Mary Ellen. 1999. “Coping with consolidation.” *Food Processing* Vol. 60:29-31.

<sup>13</sup> Mehegan, Sean. 1999. “When worlds collide: Part I, the supermarket universe today.” *Baking Buyer*, March.

<sup>14</sup> Stanton, John. 1999. “Rethinking retailers’ fees.” *Food Processing* 60(8):32-34.

<sup>15</sup> Federal Trade Commission. 2000. Transcript of “Public Workshop on Slotting Allowances and other Grocery Marketing Practices.” Pp. 9-24. Washington, D.C. May 31.

<sup>16</sup> Federal Trade Commission. 2000. Transcript of “Public Workshop on Slotting Allowances and other Grocery Marketing Practices.” P. 159. Washington, D.C. June 1.

<sup>17</sup> FTC. May 31, 2000. Pp. 46-47.

## ***In a dynamic system, who has power?***

In these constantly changing relationships, who has *power* in the manufacturing/retail channel? The balance of power may be shifting to the retailers, but the basic point is that smaller entities in any part of the chain are being left out. Retailers seem to have an edge in the power relationship, with bigger chains charging higher retailer fees.<sup>18</sup> However, retailers are at the mercy of those manufacturers who have successful brands because branding is one way to create leverage with retailers. Larger manufacturers, for instance, can negotiate deals across a range of products if they have some strong brands. They can become “category captains,” meaning they are the dominant firm in a particular product category, and thus can influence other manufacturers in that category.

In the dairy sector, cooperatives like DFA (e.g. Borden) and Land O’Lakes had strong brands they brought to their joint ventures with investor-owned firms. As one marketing consultant noted, “. . . it’s cheaper [for a company] to buy than build a brand” (*Knight Ridder/Tribune Business News*, 8/28/00). It takes significant investment to launch and maintain national or international brands, as Unilever – one of the largest food manufacturers in the world – indicated earlier this year by its announcement to slice its number of brands from 1600 to 400 (*Financial Times*, 2/23/00).

Brands can be tricky, however, because they “are built on their connection to the consumer, not the company’s connection to the consumer” (*Knight Ridder/Tribune Business News*, 8/28/00). In Europe, retailers sell a large amount of private label products (i.e. store brands) some of which are manufactured by firms that have their own strong brands, like Unilever’s stable of brands. Private label accounts for almost 45% of grocery sales in the United Kingdom and over 30% in Germany and Belgium (*Supermarket News*, 10/2/00). Thus, brand loyalty in Europe begins to be associated with the name of the retailer rather than the manufacturer.

While not as widespread in the US, private labeling is significant for some. As we noted above, about 50 percent of Suiza’s product mix is produced under private label (*Dairy Field*, 10/99). Kroger estimates that private labeling accounts for about 25% of grocery sales overall (*Kroger Annual Report*, 1999). Moreover, retailers like Safeway are putting more private label on the shelves because store brands are more profitable than outside brands (*Los Angeles Times*, 12/26/00).

## **The Challenge of Finding Alternatives for Farmers and Consumers**

Despite the above description, exclusion from the dominant global food and agriculture system might actually present new opportunities for smaller entities in any part of the food chain. Farmers, small processors and independent retailers – all of whom are faced with increasing concentration throughout the system – can join forces and create new relationships that build the infrastructure for alternative food systems. These systems could help farmers capture more of the food dollars, and could encourage the development of small processing businesses that form the backbone of rural community development. However, it is important to avoid the pitfalls others encountered when attempting alternatives by carefully examining their experiences.

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<sup>18</sup> FTC. May 31, 2000. Pp. 108-109.

## ***Opportunities for Alternative Organizations?***

For years, their cooperatives provided dairy farmers with an alternative to private investment firms, but as the restructuring of the national food system evolves, cooperatives are struggling to survive. Today the future is very challenging for cooperatives seeking to operate in a global food system that is both vertically and horizontally integrated. Many questions about alternative organizations arise as we look at the dairy sector.

Cooperatives competed well when the dairy sector was organized locally or even by region, and when the capital requirements were relatively small and could be met by farmers in a community. Moreover, the physical facilities were located in the community and the members had some sense of the cooperative's business and felt some loyalty to it. Does all of this disappear when the cooperative builds a costly facility in some other part of the country or the world?

Moreover, cooperatives have always faced a capitalization problem. As cooperatives have grown larger, what has happened to the millions of dollars of equity farmers have built up in their cooperatives? Will they ever see it again? Or, as the cooperatives continued to accumulate assets in order to compete, did they also accumulate huge indebtedness that dairy farmers' equity could be consumed? In cooperatives with large debts, do lenders become involved in the decision of how the current profit or retained earnings get paid to farmers and when? When a cooperative uses farmer equity earned in one commodity to build facilities for another commodity sector, how do the profits get shared between the two sectors when they are different farmers?

Besides capitalization, another set of questions arises around the relationships between cooperatives and investor-owned firms. Will dairy farmers who were producing for an investor-owned firm that then joined with a cooperative (through a joint venture or some other arrangement) be forced to join the cooperative? While considerable public attention was generated by the huge transfer of equity from hog farmers to national and transnational firms in the past couple of years because of the extremely low prices farmers received, has a similar transfer of equity occurred in the dairy sector with no one raising questions?

Still other issues arise around the workability of transnational cooperative relationships. When cooperatives in the United States formalize relationships with cooperatives in other countries with lower production costs, do dairy farmers in this country benefit – especially if products are then moved to this country and blended with US produced products? Such activities do improve the bottom line of the cooperative. As cooperatives become involved in global activities and turn much of the management in the processing, distribution and retailing over to investor-owned firms will farmers be treated like entrepreneurs? Or will they be treated like broiler growers who provide about half of the capital in the broiler sector, but have no role in major managerial decisions?

To really understand dairy farmers' frustration and anger, one must understand the role cooperatives play in the restructuring of the sector. Will history suggest that the cooperative system simply organized the farmers, set up a very efficient system and then through joint ventures turned the entire system over to large corporations? Perhaps there is some warning here for those eager to establish new generation cooperatives. Some farmers feel betrayed by their cooperatives. But perhaps the forces encouraged and legitimized by neo-liberal economics were so powerful that even

the best farmer-organized food sector has had to follow the same route as all other commodity sectors have, or soon will, as they become a part of the global food chain clusters.

### **Opportunities for Alternative Products?**

To survive and thrive in the global food system, most US farmers need new or alternative markets. To that end, many farmers, as well as processors, have looked to the rapid expansion of organic food sales – an almost \$5 billion market that is growing at 20% a year – for alternatives (*Supermarket News*, 12/27/99). Many times, though, the organic sector mirrors the horizontal and vertical integration of the conventional food sector rather than creating new relationships that enhance communities economically, ecologically and socially. In the past, consumers obtained organic products through independent natural foods stores or food cooperatives. Now, the largest retailer in the world, Wal-Mart, carries organic food products and the nation's largest food retailer, Kroger, has developed organic sections in many of its stores. Moreover, Whole Foods and Wild Oats, the two dominant natural foods retailers, have continued to open stores and acquire independent stores at a rapid rate (*Supermarket News*, 12/27/99).

Consolidation in the organic sector is not limited to supermarkets. Many companies see the burgeoning market in organic and natural foods as a high growth area and have moved to take advantage. As we noted earlier, Suiza Foods has a 13% stake in Horizon Dairy, one of the largest organic dairies in the country (*Suiza Annual Report*, 1999), and Dean Foods recently bought Alta Dena, another major organic dairy processor. Meanwhile, General Mills bought Small Planet Foods which owns such popular organic brands as Cascadian Farms and Muir Glen (*Minneapolis Star-Tribune*, 12/16/99). This suggests that organic or other alternative markets are subject to the same forces that have reorganized the conventional system.

### **The Food System Remains Dynamic . . .**

Despite this rather grim analysis of the dominant food system and possible alternatives, the food system remains dynamic. In the short term, the direction of change is predictable, but in the long-term, such trends as horizontal and vertical integration in the global food system are probably not sustainable. Moreover, one of the interesting changes receiving little attention is the emergence of European-based retailers as opposed to American retailers as the major global competitors in the food retailing sector. This is in direct contrast to the trading and processing of raw commodities, both of which are becoming increasingly controlled by American-based transnational corporations.

While this increasing market concentration in the food system has caused relatively little concern, recent activity by the Federal Trade Commission to stop supermarket consolidation could signal new interest in antitrust issues in food and agriculture. Ahold's bid for Pathmark in New Jersey and New York, as well as Kroger's bid for Winn-Dixie stores in Texas, were both stopped because of FTC actions. Contrast this with the Department of Justice's allowance of the Cargill/Continental merger in the grain business. In the first cases, the mergers were thought to negatively impact consumers, an important consideration given the Federal Trade Commission's priority to protect consumer choice and price without stifling product innovation.<sup>19</sup> Food retailing is much closer to the consumer than agricultural commodity processing, and may therefore be more closely

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<sup>19</sup> FTC. May 31, 2000. P. 25.

scrutinized by those in charge of US antitrust enforcement. In the long term, however, consolidation of grain handling may have more serious implications for more people around the globe.

Finally, although “successful” merger strategies seem to be paying off for many food retailers, their stock prices have struggled to reflect this. Until the past couple of months, supermarket firms were trading close to their 15-month lows – but so were large commodity processors like ADM and ConAgra. Before the panic about technology stocks, investors seemed uninterested in “low-margin” food businesses even though everybody eats. As Safeway noted in its 1999 annual report, “. . . unfortunately, as many of you know, these achievements were not reflected in our stock price. The supermarket industry, typically a ‘stable’ sector, seemed to be out of favor in 1999 as investors found other sectors more attractive.” The recent dips in the stock market due to problems for the high technology sector might alleviate some of the risks for investors in food system stock, but it does little to help farmers or consumers.

Obviously, power is ever shifting in the food system. Two years ago, it appeared that access to biotechnology and the resulting seed stock was an important indicator of power. Consumers – Europeans in particular – proved more unwilling to accept genetically engineered food than the firms may have predicted. It could be that new nodes of power are developing in the global food system based on who has access to the consumer and who has the ability to condition consumer wants. Thus, food manufacturers and retailers might end up struggling for dominance in the consumer arena for some time. At this time, it is difficult to predict which actors are going to structure the food chain clusters of the future. The question still remains, though – where is the farmer in this emerging system and what decision-making power does he or she have? Furthermore, where is the consumer and what decision-making power does he or she have?

### **. . . but, the Trends Continue**

Most likely, farmers will continue to be at the mercy of cost cutting and profit-improvement strategies of more dominant firms in the food chain clusters.<sup>20</sup> Food retailers and food processors wanting to increase their profits are going to have to squeeze costs out of the system somewhere. A Safeway vice-president noted that “cost reduction is a bottomless pit...” and reducing the cost of goods sold is a key focus of its cost-cutting strategy (*Supermarket News*, 11/13/00). Those with the least power – the farmers and the smaller processors producing the goods retailers sell – are most likely to get the hardest and longest squeeze.

Farmers really cannot look for help from trade either. Despite the dominance of food processing firms headquartered in the US, the US balance of trade in agricultural exports is declining. For instance, in the dairy sector, on a skim solids basis, the US imported enough cheese and dairy ingredients last year to replace some 10.6 billion pounds of domestic farm milk (*The Milkweed*, April 2000). On an equivalent basis, the US exported about 4.3 billion pounds. The net trade imbalance was equal to about 4 % of total US production. There exists considerable disagreement about the specifics of these numbers, but the pattern is clear – *dairy imports are larger than exports and are growing much faster*. In fact, in the last couple of years dairy exports declined. The pattern of slow, if any, increase in the value of exports and a major increase in the value of imports over the past couple of years follows the same pattern, as do total imports and exports of agro/food products.

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<sup>20</sup> Heffernan, *et al.* 1999.

In the past three years, the difference in the economic value between total agro/food exports and imports has dipped from about \$22 billion to less than \$11 billion.<sup>21</sup> Imports of dairy products that face few restrictions on entry into this country are increasing rapidly. For example, January 2000 imports of casein, a milk protein used primarily in cheese manufacturing, were up 52% from a year earlier. Why are imports increasing? Even a quick comparison of US dairy prices to global prices suggests that the US is not the low cost producer. Moreover, estimates indicate that if all barriers to trade were eliminated, the global price would not reach the cost of production for US farmers (*The Milkweed*, April 2000).

With such dismaying statistics, one might ask what has happened to the much-lauded efficiency of American agricultural producers? While dairy farmers in the United States may be the most “efficient” producers in the world, this depends on how one measures such a problematic concept as efficiency. If one asks, whether we produce the most milk per hour of human labor, we probably rank high because we have substituted capital for labor. If we look at the cost of the labor or compare the total resources used in production to the resources produced, the conclusions may be different. But regardless of how we measure the nebulous concept of efficiency, the United States is not the low cost producer of milk in the world. If the dairy lobby is successful in opening up global trade through the World Trade Organization (WTO), we will find most of the remaining 90,000 US dairy farms exiting rapidly.

This loss of US farmers makes little difference to transnational corporations, whether they are headquartered in the US – as are many of the dominant agro/food processors, or in other countries – as are most of the emerging retail firms. They travel the world to find where they can “source” the product with the least cost and then move the product where it can be sold for the highest price. In many of the poor countries, workers in rural areas receive less than five dollars a day. Health and environmental regulations, if they exist, are rarely enforced so firms can operate with lower costs in these countries. Transnational corporations are experts at reaping the economic benefits of globalization while pushing the economic, social, environmental and other costs onto the public. If regulations in this country are implemented to prevent corporations from shifting costs to the public sector, but nothing is done to prevent them from shifting the cost in other countries, then farmers in this country automatically become high cost producers.

Indeed, some economists are pointing out what many farmers are beginning to understand, namely that US farmers *are* high cost producers. In his book, aptly titled *The End of Agriculture in the American Portfolio*, economist Steven Blank concludes that consumers in the United States no longer need farmers because we can import food from poorer countries cheaper than we can produce it.<sup>22</sup> Clearly, this is the direction the current agro/food policy is moving. The dairy sector is beginning to embark on this global journey, even though most attention is paid to national dairy policies. In addition to predicting the changes global trade will cause, economist Blank presents the neoclassical economic justification for the new food system which economists and transnational corporations use to legitimize the current restructuring.

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<sup>21</sup> USDA, Economic Research Service. 2000. “U.S. Agricultural Trade Update.” February 29.

<sup>22</sup> Blank, Steven C. 1998. *The End of Agriculture in the American Portfolio*. Westport, CT: Greenwood Publishing Group.

One of the examples Blank uses to justify purchasing food from other countries is tied to the use of land. He says that if our land is more valuable for purposes other than food production, then we should use it for those alternative purposes, and simply import our food from other countries. Given the relatively low world dairy prices, US dairy farmers cannot outbid developers in the path of rapid urban, or even rural, expansion. Even ranchers in more isolated areas of the Great Plains cannot compete with recreational and sport enthusiasts for land on which to raise cattle.

Just a half-century ago, economists were justifying and promoting a decentralized agriculture production and processing system. As the economic system changed, so also did the economic theory that justified it. Today, much economic theory defends a highly centralized monopolistic or near monopolistic system.

What are American farmers to do? Free trade favors low cost producers. Again, efficient producers may not necessarily be the lowest cost producers. At some point, citizens must ask what kind of food system we want, and then design our food and farm policies to create and encourage that system. A growing chorus of voices from a wide variety of political backgrounds is beginning to challenge the ideology – the assumptions, beliefs and values – of neoclassical economic theory that underpins the current economic system.<sup>23</sup> Many feel that the loss of economic democracy may also lead to a loss of political democracy – and nowhere is that more apparent than in food.

## Where Do We Go From Here?

The massive consolidation in food retailing that has taken place in the last few years seems to indicate that power is shifting toward the retail sector, as the structure of the agricultural system is determined by what consumers are conditioned to eat.

Long protected from the ups and downs of the commodity markets, consumers are now beginning to see a direct economic impact from this near monopolistic food system as they experience increases in their food prices even when prices farmers receive for a commodity – in this case milk – declines. An August 2000 lawsuit claimed that two of the Chicago area's dominant grocery chains conspired to keep the price of a gallon of milk about one dollar higher than in other parts of the country (*Chicago Daily Herald*, 8/25/00; *Chicago Sun-Times* 8/25/00). Similar activities affecting the price of milk in New Jersey were reported about the same time (*The Star Ledger*, 8/29/00). At what point will consumers become more proactive in challenging this emerging system?

For all of us, the question remains, who is going to have the power to make decisions about *what* food is produced, *who* will produce it, *where* and *under what conditions* it will be produced, and ultimately *who* will get to eat?

The food system has become more like the other sectors of the economy, but food remains different than other goods and services traded in the international arena. Because everyone must eat to sustain life, food is a necessity that is needed on a regular basis. Thus, it is not surprising that issues concerning the evolving economic order are being raised first in the food sector. Is it possible that food is so unique that it requires exceptional public policies?

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<sup>23</sup> Korten, David. 1999. *The Post-Corporate World: Life After Capitalism*. West Hartford, CT: Kumarian Press, and Derber, Chales. 1998. *Corporation Nation*. New York: St. Martin's Press.