CONCEPT AND IMPORTANCE OF BARGAINING POWER

by L. B. Fletcher

Historically, farmers have maintained that they occupy an unequal and passive status in the market relative to firms in other sectors from which they buy and sell. Currently they see themselves with no bargaining power and in a squeeze between rising costs of purchased inputs and decreasing prices of products they sell. There is wide agreement among farm groups about the desirability of increasing farmers' bargaining power. This paper will consider (1) the meaning of bargaining power, and (2) methods and consequences of manipulating bargaining power, and (3) the relevance of greater bargaining power for farmers as an agricultural policy objective.

That all buyers and sellers in either product or resource markets do not meet on completely equal terms is recognized in the earliest economic literature. Adam Smith, for example, observed in 1776, "In the long run the workman may be as necessary to his master as his master is to him, but the necessity is not so immediate... Masters are always and everywhere in a sort of tacit, but constant and uniform combination not to raise the wages of labour above their actual rate." Marshall also found inequality of bargaining strength between employers and workers and concluded that the workers' disadvantage lowers their wages. Similarly, he thought, "Those sellers of commodities who are poor and numerous relatively to the purchasers are at a disadvantage in bargaining in the same way as are the sellers of labour."

The Meaning of Bargaining Power

Discussions of inequalities of bargaining power between the two parties of an exchange transaction have rarely attempted to explain the meaning of the term "bargaining power." Apparently it has often been assumed that everyone knows from personal experience in shopping or selling what it means to possess a distinct advantage or disadvantage. When definitions have been attempted, wide variation in usage has made it difficult to attach a precise meaning to the term; economic literature reveals a serious lack of agreement as to its definition and importance. While any internally consistent definition cannot be regarded as incorrect, a wide diversity of usage encourages misunderstanding of the concept and weakens attempts to deal explicitly and systematically with it.

A critique of alternative definitions of bargaining power. Marshall attributes the inequality in bargaining strength between the employer and the worker to a wide variety of factors, including inadequate training, immobility, perishability,

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and lack of reserve fund. Thus, Marshall views bargaining power—defined only implicitly—as a general concept which includes all forces determining the wage rate.

More recently, bargaining power was defined as the ability to obtain the most favorable price possible under conditions prevailing in all markets, either directly or indirectly involved. In other words the competitive situation in the market in which the transaction takes place and all restraints and repercussions each party must face in all related markets enter as determinants of bargaining power. The competitive price is the point of reference, and bargaining power is proportional to the deviation of the price obtained from the price that would rule for the quantity supplied under pure competition in all relevant markets.

Both of these definitions accept all the determinants of price as determinants of bargaining power. One emphasizes the factors which determine bargaining power; the other emphasizes the gain resulting from possession of bargaining power relative to a situation in which it is absent. The important feature is that both definitions use bargaining power to express a conclusion about the totality of market forces. Expressed in terms of ultimate market outcomes, the concept appears logical and unambiguous. However, the difficulty with making bargaining power equal to the whole of forces determining prices is relatively clear. "If we try to specify those factors which determine bargaining power, we find that we are merely enumerating and describing all the structural elements of the market."6

Others have attempted to name bargaining power as one factor among a number in price (or wage) determination. For example, one writer thought it influenced price determination through enhancement of one party's "power to withhold."7 Another held that it is more important to ask which of the parties would suffer a greater loss from such withholding. Consequently he defined bargaining power as the ability to impose loss on the other party.8 Similarly, the term may be defined as the power to organize and carry out a coercive device, skill in negotiation, monopoly power, supply control, or, as it is often used, an unspecified "other" factor in price determination.

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4 Ibid., pp. 560-569.
8 S. H. Slichter, "Impact of Social Security Legislation upon Mobility and Enterprise," American Economic Review, Vol. XXX (1940), p. 57. See also G. W. Ladd and J. R. Strain, "What About Bargaining Power for Farmers?" Iowa Farm Science, Vol. 16, No. 1 (July 1961), pp. 3-5. However, when these authors specify the conditions under which one party can impose a loss on another party, their determinants are merely a classification of all the forces which influence price.
Bilateral monopoly, negotiation, and bargaining power. Bilateral monopoly arises when two firms that want to deal with each other are both in a monopolistic position on their own side of the market. In this situation, the terms of exchange transactions—both price and quantity—are subject to bargaining and are settled by agreement. The quantity agreed upon may or may not maximize the sum of the two firms' profits; if it does not, there is always a possibility of adjusting the quantity exchanged to the amount which does. A stable agreement is reached only at the quantity which maximizes the sum of their profits independently of what price they agree upon, for the price determines only the share of the two firms in their combined profits.

Therefore, even economists who have concluded that the quantity which will be exchanged in this market situation is determinant—and equal to the "optimal" competitive output9—agree on the theoretical indeterminateness of the price of the product passing from the monopolist to the monopsonist. Whatever the price, limited only by the range from the low monopsony to the high monopoly prices, it will not affect the quantity produced but only the division of the combined profits. To the extent that the two parties can be expected to face each other on equal footing, a price outcome closer to the competitive level than under either one-sided monopoly or monopsony is suggested.

Similar to considering bargaining power as one among many factors accounting for price, another approach is to identify it as the ability to settle price within the range of theoretical indeterminancy in bilateral monopoly. That is, when competitive influences are too imperfect to compel price and quantity outcomes at equilibrium levels, firms with bargaining power will be able to exercise discretion in finally establishing a price. This suggests a dichotomy between competitive or market forces on one hand and discretionary power in settling theoretically indeterminant prices on the other. In practice, use of bargaining power in this sense will lead some people to see price determination through development of bargaining power as an alternative to prices determined by market forces. It is reasonably clear, however, that all of what has been called bargaining power by the various writers is present in market situations where prices are theoretically determinant; hence, bargaining power involves in large part the use of competitive influences to establish prices more favorable than those otherwise prevailing.

Likewise, it does not seem that the concept can be limited usefully to mean negotiation. In fact, ability and willingness to bargain probably have little to do with bargaining power. Consider a monopsonistic firm buying from a competitive

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9 See J. A. Nordin, "Resource Allocation in Relation to Partly Competitive System," in this report. For a convincing argument that bilateral monopoly at best appears to result only in the simple monopoly output, see McKie, J. W., op. cit., pp. 15-20. Whatever the quantity outcome, both authors agree that price only distributes profits (according to relative bargaining power.)
industry. This is a classic case of unequal bargaining power; bargaining, as haggling or negotiation, is not necessary at all in this situation.

Objection can also be entered against identifying bargaining power with monopoly power. Monopoly or market power results from the ability of one firm to restrict competition through control over its own and its competitors' market behavior, most often involving influence over the supply of a product. A firm's monopoly power extends over its competitors on the same side of the market; a seller has monopoly power over competing sellers, a buyer over competing buyers. However, bargaining power must be defined and measured relative to firms on the other side of the market. Monopoly power may be necessary to the existence of bargaining power, but it is not sufficient. Thus, a monopsonist has bargaining power relative to competitive sellers. Organization of the sellers into collective monopoly will not change the degree on monopoly on the buying side, but can be expected substantially to reduce the monopsonist's bargaining power.

The main purport of this discussion is that it well may be impossible to specify bargaining power as a factor in price determination and necessary to accept the term as summing up all forces which influence prices. This conclusion has been strongly stated by Lindblom. "The confusion over the meaning of the term is regrettable, the need for the term is doubtful, and the implication that bargaining power necessarily has something to do with bargaining is false. Relative strength in bargaining power must simply be read as a general advantage over an opposing buyer or seller in establishing on the market the terms desired, any attempt to narrow the term to consider it as a distinguishable factor among others being doomed to failure." 10

Methods and Consequences of Manipulating Bargaining Power

If it is agreed that bargaining power expresses a conclusion about the totality of all market forces influencing prices, then manipulation of bargaining power would include any action by which a firm attempts to establish more favorable prices than those previously prevailing. Frequently firms accept or reject the first price offered without considering the possibilities of altering the terms of exchange—conduct which economists associate with pure competition. In other cases, firms attempt to secure a more advantageous position in buying and/or selling transactions which significantly influence income flows.

Potential gain from manipulating bargaining power depends on the extent to which a firm can limit the alternatives available to its market opponents or extend its own alternatives. For example, a selling firm can initiate a new product or differentiate his product by endowing it with some unique characteristic, or it can incorporate into its product some characteristic previously

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offered by competing sellers. It can advertise to uncover alternative buyers, reducing the necessity to sell at terms on which agreement is possible with current buyers. It can attempt coercive actions against buyers to force agreement on more favorable terms.

The ability to get more implies not merely the chance to ask for more (recognition and freedom from institutional constraints) and the ability to hold out and fight for more (staying power), but also an ability of the other party to give more.\(^{11}\) Consider a group of agricultural producers which has always accepted the price buyers first offer. Now the producers get legal sanction to form a cartel, secure a full-supply contract with buyers, and possess unlimited funds to divert supplies to surplus usage. In other words, they have what it takes to get substantially more than is first offered. How much more can they get?

This question can only be answered in terms of a specified time period. In the short run, the potential price gain for the sellers depends primarily on the increase in prices the buyers of their product can charge without much affecting volume...also the extent to which the buyers are able to hold their expenditures in line by lowering prices they pay to suppliers of other products or complementary factors of production. Perhaps if buyers may not be able to pay another cent they will be forced out of business. The increased bargaining power of the sellers would then be of no avail. Expressed in the extreme, "Even if you take from the other fellow all he has you can't get much if he hasn't got anything!"

In the longer run conditions of substitutability provide upper limits on the potential gain. Such substitution is possible at the point of final consumption (shift in level of demand due to substitution of competing products) or at the point of first sale (entry of new producers or foreign imports). Possibilities of substitution at one or more levels mean that potential gains may be relatively great in the short run but almost nonexistent when long-run considerations are introduced.

This point explains one reason why the concept of bargaining power gives rise to so much confusion. Because the scope of competitive factors increases with the shift from short-run to long-run analysis, potential gain from increased bargaining power must be estimated with reference to a specified period of adjustment. In this connection, we observe that attempts to identify different kinds of bargaining power often involve nothing more than implicit recognition of the time dimension.\(^{12}\) In the long-run, competitive forces obviously impose stricter conditions for the acquisition of bargaining power and narrower limits upon its exercise. The forces involved are always the same; their relative importance may vary depending on the time period involved.

\(^{11}\) Compare Ladd and Strain, op. cit., pp. 4-5.
Manipulation through horizontal combination. Possibilities may exist by which firms can unilaterally attempt to obtain and exercise power over price. There is, however, a second method by which bargaining power can be manipulated; whether the number of competitors is large or small, they might improve their position in the market by agreeing to act collectively. That is, a seller can gain relative advantage to the extent to which elimination of interseller competition insures that others do not undercut the terms he offers to buyers. By restricting interseller competition, such agreements reduce the possibility of substitution among products of participating firms. The sellers, acting in concert, and thus incurring no risk of losing customers to each other, improve their prospects for obtaining more favorable terms. Clearly, much of the current discussion about bargaining power for agriculture would involve some kind of collective action.

There are several ways in which rival firms can, by agreement, rule out competition among themselves and enhance their market power. Such agreements may take a variety of forms ranging from informal rules on business practices to detailed regulation of all facets of market behavior. One type of agreement restricts total output by limiting production of each party to the agreement (marketing quotas). Another type divides the market into several parts and practices price discrimination (fluid milk). A third sets prices and permits buyers to choose quantities (labor unions).

As a general rule, the more comprehensive the alliance, the greater the increase in bargaining power and the larger the potential gain. This principle is related to the substitution possibilities discussed above. If alternative supplies are adequate and readily available, buyers can turn to other sources, leaving an organized group of sellers with no bargaining power.

But bargaining power is not assured even if an organization embraces all producers of a certain product. Collective action must be based on prior bargaining among those who are participating. What happens when the parties to the agreement operate under different cost conditions, have different values, and appraise the market situation differently? This situation is like when large numbers of producers in widely scattered areas are involved. Under such conditions the common terms to be offered to sellers require compromise. Since each seller is anxious to receive a "fair" share of the total gain, the market offer adopted will be subject to the constraint that each firm maintains a satisfactory share of the total sales. The larger the number and the less homogeneous the members of the coalition, the greater the likelihood of disagreement on common terms and the tendency to disintegration.

A corollary of the difficulty in arriving at common terms is the tendency for combinations to be directed at limited objectives. For instance, a national association of livestock producers might attempt to bargain with packers over minimum prices to be paid for livestock of various kinds, weights, grades, and location, but leave packers free to choose how many head and from whom to buy. Competition among members of the association over other aspects of their market
offers might actually be stimulated as an indirect result of the agreement on one or more limited objectives.

In summary, combination among competitors for collective action is one means of shifting relative bargaining power. The more comprehensive the coalition—both in number of participants and scope of the agreement—the greater the potential gain, the more competition is transferred from the organization and its market opponents to a struggle among firms within its limits, and the more competition may be redirected along other lines not covered by the agreement. Interestingly enough, the source of its strength is the source of its weakness as well.

Consequences of shifts in relative bargaining power. A shift in the distribution of bargaining power among economic groups is manifested through relative price changes. Prices in turn are related both to resource allocation and to income distribution. Hence, manipulation of bargaining power involves two major areas of social concern with the performance of the economy.

With regard to resource allocation, the important question is the effect of shifts in relative prices on the level and composition of real output. Does aggregate demand decrease because quantities demanded of some commodities contract more rapidly in response to the changes in relative prices than others increase? Is the movement in relative prices likely to lead to a more or less preferred allocation of resources under existing restraints? I am aware of no generally accepted analysis which permits definitive answers to questions about the effects of relative price changes on the demand and supply of real output.

Relative price changes in favor of the products of one sector also imply an increase in total income accruing to resources used in that sector. Reactions in exchange relationships themselves and broader political considerations impose limits on the concentration of income in the hands of groups with increased bargaining power. Combination may be met by countercombination, restraining potential gain beyond upper limits set by possibilities of substitution and internal competitive struggles. Those whose economic position is weakened can seek government action to curb the coalition or redress the unfavorable distribution of bargaining power. In general, public policy is opposed to the development of bargaining power by some firms and industries relative to other parts of the economy. Participation by government or the granting of a special status by statute would appear to be a prerequisite to collective action to improve bargaining power, as illustrated by such cases as labor unions, farm cooperatives, and utilities.

Relevance of Increased Farmers' Bargaining Power as an Agricultural Policy Objective

This paper argues that the concept of bargaining power is most logically used to sum up overall advantages or inequalities in price-influencing abilities. Recognition of this comprehensive nature of the concept could explain why most persons
concerned with agriculture seem to agree on the desirability of increasing farmers' bargaining power, although they cannot agree on the means to accomplish this end.

However, this comprehensive concept is probably not the thing most people are talking about when they say that farmers are at a disadvantage in the market relative to the marketing and supply firms with which they deal. Here, the overall concept includes too much; what is needed is a concept which concentrates on the relative positions of buying and selling firms in specified markets. There appears to be a significant difference between the statement that "farmers have no bargaining power" and the claim that "farmers have less bargaining power than the firms from which they buy and sell."

This point can be expected to play an important role in consideration of any proposals to give farmers more bargaining power. The narrower question is whether producers as a group are at a relative disadvantage to marketing and supply firms as a group. Even if this question is answered in the affirmative, a choice must still be made whether to equalize the situation (1) by giving farmers more bargaining power or (2) by reducing bargaining power in the marketing and supply sectors. Choice of the latter course of action is clearly most consistent with general public policy in matters of competition and monopoly. However, it appears that the public might be quite willing to grant considerable freedom to farmers to act collectively to strengthen their market position based on the narrow justification of inequality in price determination relative to industrial firms to which they sell and from whom they buy. Perhaps the most relevant example here is the freedom granted labor unions and their exemption from antitrust legislation.

The broader question is the extent to which collective action by farmers will be made permissive for the purpose of gaining sufficient market control to raise prices and increase income. Programs designed to accomplish this end may be operated by government or by farmers themselves on a do-it-yourself basis. Certainly, the latter would necessitate a substantial exemption to farmers from antitrust and related regulatory statutes. If the government does not operate the program, the public may be unwilling to concur in this large a grant of monopoly power to farmers. At a minimum, some fairly specific rules to limit the methods to be used and the extent to which prices can be increased are likely to be established.