

AEC 841--MODULE 2

MARKETING AND ECONOMIC DEVELOPMENT

- I. Commonalities in the food systems of low-, middle-, and high-income countries
 - A. Last time we reviewed briefly the historical context in which marketing research developed as a field of study in the U.S. Beyond the specifics outlined in the handout I gave you, I hope that you got two other messages out of this discussion.
 1. Marketing research in a particular country evolves in response to the political-economic context of the time. So to some extent, it will always be site-specific.
 2. But there are also some predictable pressures that are put on marketing systems as economies go through the process of structural transformation that imply the need for market system improvement. We will focus on these today.
 - B. All economies are developing, in the sense that the structure of the economy is constantly changing, which implies evolving demands on the marketing or overall food system
 1. E.g., rise of fast food and supermarket deli sections in US in response to income growth and lifestyle changes.
 2. Therefore, we are talking about understanding the dynamics of food system development along an evolving continuum ranging from low-income to high-income, rather than looking at a dichotomy between "developed" and "underdeveloped" economies. Focus of the course on **understanding food system dynamics**. (Meisner Handout)

- C. Common features of food systems around the world (*Overhead*)
1. Spatial dispersion of agricultural production
 - a. Transport costs important for both input and output marketing
 - b. Coordination costs are higher across the dispersed producing units.
 - c. Increases asset fixity and hence risk and fixed rel. to variable costs.
 - d. Higher transaction costs imply that farm prices are more volatile than retail prices. (*Overhead on grain prices in Mali*) This raises questions of higher risks and who bears them within the system.
 - e. Often decisions need to be made in a very site-specific way given micro-climates, timing, etc.
 - f. Makes centralized monitoring more difficult, leading to need for a decentralized way to make production decisions and create incentives to coordinate across space and time.--Classical justification for reliance on a market system for agriculture. Cf. Bromley's discussion of food marketing reform in Russia.
 2. Sequential nature of production==>interdependence between stages of production
 - a. Often impact of actions taken at one stage are not apparent until later stages (e.g., walking on the bananas). Therefore:
 - (1) Need to have mechanisms to coordinate actions across stages of production

- (2) Need to create incentives system that make individual actors face the consequences of their own actions.
- b. Profitability at one stage depends on what happens in other stages==>uncertainty, and often the feeling by people at one stage of the system that they are being exploited by others elsewhere in the system.
3. Uncertainty of production--due to weather, insects, disease, etc.==>riskiness not only for farmer but also for merchants and processors, whose capital is at risk. Need to develop ways of decreasing risk and/or improved ability to manage it (insurance, futures markets, etc.)
4. Seasonality of production==>importance of storage (temporal arbitrage) and concerns about "speculation." (Aside on this term?)
5. Perishability of products--implications for risk, processing, and storage.
6. Increasingly unstable international markets and high costs of trying to insulate the economy from them.
7. Important role played by the public sector in:
 - a. Provision of physical infrastructure, e.g.
 - (1) Transport
 - (2) Market facilities

- b. Regulation (See Bromley, especially on provision of high-exclusion-cost [”public”] goods). I.e., the importance of policy in determining the level and types of:
 - (1) General legal system
 - (2) Consumer protection--e.g., health rules
 - (3) Trading practices (rules of fair trading)
 - (4) Grades and standards
 - (5) Market information
 - (6) Anti-monopoly rules
 - (7) Licensing
 - c. Direct Interventions
 - (1) Gov't purchase and storage
 - (2) Food subsidies
 - (3) Price Controls
 - d. Research and education--e.g., Land-grant system
- D. These common characteristics of the food system get manifested in **common problems in food systems**
- 1. Instability of supplies, and consequent price rationing. Who is hurt most by price rationing in periods of short supplies?
 - a. Poor consumers

- b. Those who use raw agricultural products as inputs--e.g., livestock producers, processors.
- 2. Chronic inadequacy of access to food by low-income households. Role of market vs. non-market mechanisms to gain access to food and the complementarity of the two types of mechanisms.
- 3. Importance of macro policies, which influence relative benefits derived by farmers vs. consumers. Macro policies often swamp sectoral policies.
- 4. Negative attitudes toward intermediaries. Perception that markets don't work well.
- 5. High cost of direct interventions--Perception that state often doesn't work well.

II. Characteristics of the Development Process (Link to the process of structural transformation discussed earlier.)

- A. Although there are commonalities, there are also significant differences in degree between the marketing challenges facing low-income countries and those facing high-income countries. These are best seen if we examine characteristics of the development process itself, using (1) Breimyer's analysis and (2) concept of structural transformation.
- B. Breimyer's analysis
 - 1. Marketing can be viewed historically in terms of:

- a. The nature of the participating unit (aggregative throughout much of history. Disaggregation began in middle ages, now moving back to aggregation)
 - b. The economic role of the market
 - (1) Distribute products to consumers
 - (2) More recently, allocate resources in production
 - c. The form of organization of the market
2. 4 Epochs in Marketing (*Overhead*)
- a. Self-sufficiency--within groups (e.g., tribe) some specialization and trade. Direction of economic activity by tradition and autocracy. Some limited trade among groups, but controlled by group leaders.
 - b. Agrarian Organization--e.g., middle ages in Europe. Current situation in parts of Sub-Saharan Africa. Systematic sale and consumption of food and other necessities. Trade primarily in consumer goods, often via fairs, but little impact of marketing on production. Trade in "accidental" surpluses. Markets simply help consumers take advantage in the variety of production occurring, with little impact on the nature of that production.
 - c. Agricultural Organization--Here, markets begin to give direction to production--i.e., force production to conform to measures of consumer demand.

- (1) This is the market and economic system of classical economics.
- (2) More responsive production technology and a commercial orientation of production.
- (3) Demand and productive resources are exogenous (e.g., no advertising).
- (4) Most disintegrative of all systems (corresponding to Hayek's model).
- (5) This epoch corresponds to the heroic age of markets, which is of recent origin--16th and 17th century in Europe, when merchants got enough political power to get courts to enforce contracts and allow them to be tradeable (still trying to achieve this in certain countries--e.g., Mali).
- (6) Breimyer argues that the market economy reached its highest point midway through the new industrial age (early 19th century in Europe and N. Am.). Doctrine of self-regulating system in which economic units of modest size interact in a market system. The resulting price of a product controls both its consumption and the income of its producer. Neoclassical economics describes this marketing

in this system as the "innocent harmonizing mechanism" of the economy (Vector of prices)..

d. Commercial Organization--Since the 1870s in Europe and N.

America. Rise of industrialized marketing. Key principle in this mode is reintegration of economic units, which compromises or eliminates the exogenous nature of consumption and production.

I.e., in this system, actors use resources to:

(1) Develop other resources--tooling resources, including people, to become more versatile (reduce their indivisibility and immobility)

(2) Influence demand--trying to change consumers' demands so that they want what is easiest to produce.

(3) This epoch is distinguished by making both production and consumption subject to management or development.

Therefore, this epoch broadens the marketing role. In previous epochs, marketing was subordinate to production and final consumption; in this epoch, it drives them.

(4) This epoch is also characterized by increasing aggregation in production and consumption

- (a) Aggregation in production (e.g., integration and conglomeration) have eliminated a large amount of market exchange--replaced by internal transfers.
 - (b) Aggregation of consumption--e.g., school lunches.
 - (c) Large aggregations of economic power within the food system (firms, unions, etc.)==> no necessary identity of firm's interests and society's interests==>heavy need for public policy to assure good market performance.
 - (d) Broadens the scope of what marketing economists have to investigate, which implies the need for broader models.
- (5) Some futurists (e.g., Toffler) argue that we are moving to a new era of disaggregation based on personalized, computer-based service?
- C. Define **structural transformation**. (3 ways of viewing structural transformation)
- 1. Decrease in relative role of farming in the economy (both in terms of share of employment and GDP)
 - 2. Process of movement away from household-level production to one of more integrated production and intersectoral links. Concept of **intersectoral linkages**--Most often articulated through markets.

3. Linking in the farmer and others in the food system to the information system of the wider world. Markets as part of the information system.
4. Economic development and structural transformation involve moving from largely subsistence farming and household-level production to a more integrated, round-about, production system. See Breimyer. (E.g. of a prof. selling lectures for food rather than producing it him/herself.)
 - a. Process of economic growth almost invariably involves a process of specialization (Smith, Reynolds). There are obvious gains from specialization, but to capture these, specialization has to be accompanied by expanded exchange. For example, ag. development involves a narrowing of the scope of activities of the farmer and a shifting of activities off the farm:
 - (1) Production of many crops shifted to other farmers--esp. as means to manage risk other than diversification develop.
 - (2) Production of major inputs shifted off the farm (e.g., mechanical power for draft power).
 - (3) Processing of ag. products
 - (4) Production of consumer goods
 - (5) All this requires greater reliance on markets for outputs, inputs, and consumer goods, including food

- (6) This process can proceed very far. E.g., in U.S., only about 10% of total value added in the food consumed originates on the farm. ==>statement that 1 US farmer feeds 68-70 others is entirely misleading and obscures the nature of ag. development in this country.
- (7) **Key point: if low-cost mechanisms of exchange are not instituted, high transaction costs can block this whole process of transformation**
 - (a) Important for mobilizing domestic resources for specialization --e.g., farmer or trader deciding to invest
 - (b) Important equally for attracting foreign capital. Given mobility of global capital, it will flow to where TC are lowest.
 - (c) Also can affect path of development. Where transaction costs are high, are more likely to get vertically integrated enclaves with few links to the rest of the economy.
 - (d) Also critically important to determining the real wage and real incomes in low-income economies.

- b. Therefore, the challenge is to drive down real price of food to consumers in order to increase real incomes (fight poverty) and competitiveness in the economy **while at the same time** maintaining incentives to produce and distribute food. This implies for cost reducing technologies and institutions throughout the food system.
- III. Critical Role of food systems in development of LICs--Marketing also becomes more important as economic development proceeds because demand for marketing services increases with the structural transformation.
 - A. Labor released from farming now relies on markets for food, both in urban and rural areas. E.g., many countries have urban pops. growing at > 5%/year.
 - B. As incomes increase, consumers demand more diversified diets with more services attached to them
 - 1. Many of these commodities are highly perishable and therefore require special marketing arrangements (Mellor)
 - 2. Increasing opportunity cost of consumers' time (esp. women, who often do most of food preparation) leads to demand for more highly prepared foods.
 - C. Economic growth requires increased use of purchased inputs for new technology in agriculture.
 - D. A-C imply a rapid increase in the demand for marketing services, both on output and input side, as economy develops. See Meisner handout.

- E. At same time, price of food plays an extremely important **dual role** in the economy as more people (farmers and consumers) depend on the market rather than are self-sufficient:
1. Incentive to producers throughout the food system to produce--guides production (quantity, location, mix). [Breimyer's shift from agrarian organization to agricultural organization]
 2. Determinant of the real income of the poor, who may spend over half of their income on food. Through its effect on cost of living it therefore also affects real wage rates and hence the competitiveness of non-ag. enterprises (**wage good** effect).
 3. This leads to Timmer, Falcon, and Pearson's **food price dilemma** (explain), which makes "getting prices right" difficult, because of need to ask "right for whom?" Politically sensitive issue, especially as the political power in a country shifts increasingly to urban areas.
- F. Pricing performance of output and input markets affect intersectoral resource flows and generation of foreign exchange (export crops and import demand for food that derives from poorly functioning domestic marketing systems).
- G. Potential for employment generation in marketing vs. the informal market as a parking lot for the poor.
- H. For these reasons, ag. markets, are under increasing strain.

1. When you look at how food and fiber production changes during development (increased specialization, shifting activities off the farm, etc.), the dichotomy between production and marketing breaks down
 - a. What we are talking about is a vertical chain of production activities
[OVERHEAD]

IV. Characteristics of marketing systems in LICs (*Overhead*)

- A. Large differential between farm price and consumer price (**back to Mali grain price overhead**)--related to high marketing costs due to:
 1. Diversified production in large lots, which leads to high assembly costs
 2. Small market areas due to low volume may not support more than a few traders, which may lead to oligopoly power.
 3. Poor transportation infrastructure
 4. High physical losses due to poor transport, lack of standardized handling, pests, etc.
 5. Risk in system (including both physical and regulatory uncertainty), leading to reduced competition and demanding of risk premia.
- B. Large seasonal price and quantity fluctuations.-- Due to storage, transport problems and high opportunity cost of capital. (*Mali overhead*)
- C. Large year-to-year price fluctuations (particularly for nontraded goods, but even for some traded goods like rice, whose world market is thin)

- D. Large number of market "traditional" participants, buying and selling goods throughout market chain rather than 1 integrated organization (easier for gov't to control). Aside on the term "traditional"?
- E. These characteristics have the following consequences.
 - 1. Large gross margins often perceived as representing large element of monopoly profit (rather than purely high costs). Private traders seen as exploiters of both farmers and consumers
 - 2. Low farm prices combined with risks generated by price fluctuations to generate a vicious cycle:
 - a. Depressed rural incomes
 - b. Reduced incentives to specialize and produce for the market. The household diversifies production and concentrates on production for home consumption.
- F. Other perceived problems
 - 1. Pointless buying and selling drove up prices and precluded capturing economies of size in marketing (note inconsistency of this argument with argument of monopoly profits)
 - 2. High prices are seen as exploiting consumers
 - a. Political consideration (Bates)
 - b. Welfare considerations for poor consumers

- c. Concern re effects of food prices on level of real wages and hence level of urban employment and of the state's budget if state is major employer.
- G. Attempts to improve food system development has followed the fads in development (*Overhead*)
- 1. Industrial fundamentalism of 1950s and early 60s, which continued later in many socialist countries, with its corollary of large-scale ag. production-- Attempts at parastatal marketing due to:
 - a. View that traditional marketing was inefficient, exploitative, and “irrational”
 - b. Need to assure secure, cheap supplies to urban gov't employees.
 - 2. Planning fad through the 1970s, including creation of many parastatals
 - 3. Expanding farm-level production--Green revolution emphasis of 1960s and early 1970s, in which marketing was seen largely as a constraint. (Farm-gate, what happens? approach)
 - a. Creation of input and output parastatals, often lined to top-down co-ops, created by the state
 - b. Number of marketing studies leading to “costly but efficient” conclusion, similar to “poor but efficient” hypothesis of Schultz regarding traditional agriculture.

4. Integrated rural development and poorest of the poor (1970s thru early 1980s)--Generally not sustainable, due to lack of emphasis on the productive base to support the social services.
5. Current emphases on:
 - a. Market liberalization and structural adjustment
 - b. Internationalization of the food system
 - c. Food security through
 - (1) Technological change in agriculture--implies greater role for both input markets and output markets (to pay for the inputs)
 - (2) Increased attention to effective demand for food through income enhancement, e.g., through non-farm employment. Food system as a way of generating and articulating intersectoral linkages. Serving the off-farm population.
 - d. Role of NGOs and how they interact (positively and negatively) with the market.

V. Implications for designing marketing policies and programs

A. Collins and Horton

1. Main points:
 - a. Marketing systems often plays a passive role in development, but has the potential to play a leading role, by directing production in

response to evolving consumer demands and changing production technology. I.e., role can change from that of Breimyer's Agrarian Organization (distribution of "accidental surpluses" to that of "agricultural organization", where markets help allocate production resources).

b. Yet this more productive mode of organization of marketing systems is unlikely to evolve spontaneously. Developing it requires active public facilitation.

c. Reasons it is unlikely to develop spontaneously (see Bromley)--

Nature of system-wide problems:

(1) Absence of certain types of "public goods" --i.e., those with high exclusion cost, which could increase efficiency of

exchange:

(a) grades and standards that permit trading on the basis of description rather than personal inspection

(b) enforcement of contracts--(see Breimyer)

(c) adequate information.

(2) Scale economies for certain innovations may require the entire industry to convert to be profitable (e.g., standardization of packing containers)--system-wide rather

than individual decisions have to be made in some instances to increase productivity.

- (3) Certain innovations require a scale beyond reach of local entrepreneurs (capital market constraint)
- (4) Asset fixity/opportunism problem if innovation requires investing in human or physical capital of trading partners, who can then freely sell to original investor's competitors.
- (5) Lack of adequate managerial talent for new innovations.
- (6) Externality problem if innovation requires channel-wide coordination, over which innovator has little control.
- (7) Differences in optimum scale of production and marketing, which may require simultaneous changes in both (related to externality problem)
- (8) Complicated licensing procedures, which may create barrier to entry and protect the old guard.

2. Possible facilitative actions:

- a. Direct subsidies to innovators in terms of:
 - (1) tax breaks
 - (2) preferential access to credit
 - (3) import protection

- b. Creation of co-ops if there is a potential monopoly if optimum scale is large relative to the size of the market.
- c. Reform of licensing
- d. Public information
- e. Mixed corps, a la public utility
- f. Creation of alternative employment opportunities elsewhere in the economy to reduce the role of the marketing system as a parking lot for the underemployed.

B. LAMP Approach--Key concepts

- 1. Food Systems approach
- 2. Multi-dimensional nature of performance
- 3. Framework of Analysis--Figure 5.1. Emphasizes necessary changes at 3 levels and need to coordinate these:
 - a. Firm
 - b. Channel--set of institutions that handle a product or group of products through various stages of production to consumption. Focus is on the interrelationships among firms that are bound together, either tightly or loosely, by a common objective, typically servicing consumer demand at a profit.
 - c. Food system--the interrelationships of all institutions involved in market-related activity.

4. Concept of channel captain
 - a. Innovator/risk taker
 - b. Someone who has more of a systems view rather than just an individual-firm view--e.g., a larger wholesaler.

5. Operational approach to action-oriented marketing research (This is still evolving--see Tefft paper):
 - a. Task forces defined around specific problems rather than national overview.
 - (1) But problems analyzed in a systems context. Challenge is to keep a systems view, yet make the problem manageable by delimiting it.
 - (2) Inclusion of policy makers in the task forces.
 - (3) Analysis takes place at all 3 levels--firm, channel, and food system. E.g., if one were looking at the problem of how to deal with highly seasonal supplies of a commodity:
 - (a) Firm level--issues of credit and storage
 - (b) Channel--problems of transport
 - (c) System--rules of the game--e.g., concerning pan-territorial pricing.
 - b. Combining rapid appraisal/survey research with case study approach to get more in-depth appreciation of nature of problems

facing marketing firms. "Riding the trucks, " rather than overly broad surveys that are too costly and not manageable (see Tefft paper)

- c. Linking technical assistance to local research institutions.
- d. Descriptive/diagnostic research, with intermediate outputs.