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Agricultural Economics
Staff Paper No. 83-46
Aug. 1983

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OCT 10 1984

Evaluation of the Tart Cherry Marketing Order
Regarding Some Issues of Firm Size

by

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Regarding Some Issues of Firm Size

During the last few years there have been questions raised about the economic effects of fruit and vegetable marketing orders. Critics allege that some marketing orders have had a number of undesirable effects, while proponents assert that there are many desirable results of marketing order programs.

Part of the issues regarding marketing orders involve the impact of marketing orders on small vs. large firms. Some critics maintain that certain marketing orders are detrimental to small handlers and/or growers. Critics allege some marketing orders impair firm growth, or prevent potential economies of scale, or limit market access of small firms. Marketing order supporters assert that some marketing orders help small firms by providing an environment which is conducive for small firms to maintain their market share. They also emphasize that some marketing orders benefit both small and large firms through more stabilized prices or by aiding firms to increase their profits through means such as increased system efficiency or reduced risk.

Other questions which have been raised regarding marketing orders include: (a) Have these programs had differential impacts on various organizational structures such as co-operatives and proprietary firms? (b) Have some programs become outdated for the contemporary industry structure? and (c) Are there provisions that could be modified for improved performance of certain marketing orders? While these are relatively broad issues, there are some related sub-issues regarding the impacts on small and larger firms.

Each specific marketing order program can be evaluated in regard to its provisions and performance on the issues mentioned above as well

as on other criteria. To do this, the evidence and specific industry setting associated with each marketing order need to be considered. The purpose of this paper is to provide some evaluation of the cherry marketing order in regard to certain performance issues which have been raised by others--with emphasis on issues related to small vs. large firms.

Firm Growth

Although some critics maintain that certain marketing orders have impaired firm growth, this is not a major issue with the tart cherry marketing order. The impact of the marketing order upon firm growth and size has probably been minimal.

The industry designers of the marketing order were very careful to try to develop the provisions so that the impact would be size-neutral in regard to handler-processors. Experience with the market order to date indicates that the designers of the program were fairly successful in achieving that goal.

When there is a marketing order regulation, it is based upon a percentage of the quantity handled by the processor that year and is unrelated to that processor's previous history of quantities handled. So if a processor expands or contracts the firm's business, the marketing order takes that as a given condition. There is no historic base of volume as is the case with some other marketing orders.

From the aspect of the handlers, there are two aspects of the marketing order that have probably tended to encourage processor firm growth. The intent of the marketing order is to expand long-run demand by stabilizing supplies particularly through making more cherries available in shortage-supply years. To the extent that demand is

expanded this will provide a basis for processor firms to expand their size of operations. Because of the time lag between grower plantings and substantial production from new orchards, this factor hasn't yet been of major proportions. It is expected to be of greater significance in the future.

Processor-handler firm growth has also been encouraged by the provision in the cherry marketing order that reserve pool processing, storage and financing costs must be paid by the growers, not the handlers. This has improved the cash-flow situation of processors, and some processors say this has aided their profit position. This feature has been particularly advantageous for processors during periods of high interest rates and during the recent period of years during which processor profits for many commodities have been under downward pressure. This marketing order feature has probably been an encouragement for processor firm growth. On the other hand, although it is an advantage to the processor-handlers, this feature does not seem to have been a major factor causing processors to grow. Probably more likely it has contributed to some firms staying in business or not curtailing their size of operation during difficult times.

For growers the requirement for them to finance the pool causes a cash flow difficulty--particularly in times of high interest rates. This in itself might be expected to limit grower firm growth. On the other hand, the experience has been that with each use of the marketing order, the pool cherries have returned net profits over and above all costs for processing, storage and financing. Even more importantly during the latter 1970's and early 1980's cherry grower firm size and total industry production potential has increased considerably. This

has occurred primarily because of the reasons other than the marketing order. It does indicate, however, that the marketing order has not impaired firm growth of growers.

The goal of expanded demand through supply stabilization under the marketing order would be expected to cause grower firm size and total industry output to expand. Although this may have been a factor in expanding grower plantings in recent years, the evidence indicates that probably it was a minor factor. Other non-market-order factors were more important. In the future, success of the marketing order in regard to expanding demand through the supply stabilization program will be very important in order for growers to be able to maintain firm size and total industry output on an economical basis.

Economies of Size

The main sources of economies of size for both processing and growing are unrelated to the marketing order. This is not a major issue with the tart cherry marketing order. As mentioned above, the financing of the pool by growers has probably enabled some processors to more easily achieve economies of scale in years when the marketing order is used. The sale of pool cherries in short-crop years has also probably aided processors in achieving some of their marketing economies of scale.

Market Access

The overall goal of the marketing order has in effect, been to expand total market access, particularly for certain kinds of cherry uses and in certain markets because of greater supplies available in the short-crop years. Some of the smaller processors, who are almost all

freezers, have found expanded market access because some of the larger processors buy their pool cherries from the small processors rather than process their pool themselves.

While a few growers express frustration that they cannot sell all of their cherries immediately in the large crop-year, the overall effect after the pool is sold is for increased market access for growers. In one year when the marketing order was used there was probably a greater processor volume handled because growers were financing a pool in comparison to the volume that would have been processed had the marketing order not been used. In that year, market access for a number of growers was expanded, even in the large crop year.

Price Stabilization

The evidence is overwhelming that the cherry marketing order has somewhat stabilized both grower prices and prices of processed cherries, in comparison to prices which would have occurred had it not been for the use of the marketing order storage pool. Even so, prices of frozen cherries and grower prices have fluctuated considerably. This was caused primarily by the fact that the economy experienced substantial inflation since the mid 1970's, and during part of this time there was a major recession. High interest rates and substantial fluctuations in cherry supplies even with the market order storage pool have also influenced the price fluctuations to a large extent. One of the goals of the marketing order is to reduce price fluctuations to an even greater extent if possible in the future than has resulted in the past. Rising production potential for large-crop years may make this more difficult in the future than in the past.

Some have suggested that the marketing order program can be evaluated by comparison of the cents per pound price fluctuations before the marketing order to price fluctuations while the marketing order has been in existence. This is, however, an invalid analytical approach for evaluating the marketing order in regard to price stabilization. Economic conditions before 1972 when the marketing order was first used were extremely different from economic conditions and general price levels in the late 1970's and early 1980's. Much of the overall change, and hence price fluctuations per pound were due to inflation in the economy. A valid basis of comparison is to analyze the price stabilization impacts with the marketing order in comparison to prices which would have occurred in recent years without the marketing order. Use of this basis of analysis clearly shows that the marketing order helped stabilize prices, although it did not completely alleviate the instability problems. (It is unrealistic to expect the marketing order to completely stabilize prices, although it can reduce the extreme fluctuations somewhat.)

Price Improvement

Grower prices have been increased somewhat in the large-crop year each time the cherry marketing order has been used. Processor margins have also been more assured each time the marketing order was used. The impact of these effects has been basically size-neutral for both growers and processors. When the pool cherries have been sold in times of shorter supplies, the marketing order has had an effect of lowering somewhat the prices of processed cherries and hence grower prices. This effect has probably been quite small. The overall net effect has been somewhat of an increase in grower prices.

The overall impact on retail prices of cherry products has probably been negligible. Higher grower prices in the large crop year probably have not been sufficient to be reflected significantly at retail, particularly in view of retail pricing practices of manufactured consumer products such as cherry pies. The blunting, through the sale of pool cherries, of price increases which would otherwise occur in short-crop years can have an important effect on retail prices because shortage-induced price increases are likely to be definitely reflected at retail. This blunting of price increases offsets, to a degree at least, any reflection at retail of higher grower prices from the marketing order. The overall effect on retail prices either way has probably been quite small.

Small Firms' Market Share

There has been an increase in the number of cherry processor firms, almost entirely by small firms, during the period of the marketing order. This occurred primarily due to reasons other than the marketing order. The marketing order may have encouraged this somewhat, although its impact is probably quite small. It was mentioned earlier that the grower financing of the pool and the fact that some large processors buy pool cherries packed by small processors are factors encouraging small processor-handlers. The growth in small processor firms, however, has occurred primarily because of (a) the advantages of coordinating mechanical harvesting and on-farm processing, and (b) the fact that some larger established processors are going out of business due to economic pressures associated with factors other than the marketing order. This has led to more processors becoming cooperatives or with other forms of grower ownership. The grower financing of the pool has probably encouraged somewhat the maintenance of more

proprietary processors than if there had been no marketing order, since with a cooperative, the grower is going to finance the pool one way or another anyway.

The marketing order has probably been size-neutral in regard to market shares of small growers. A few small growers say that the marketing order has caused them to have reduced market shares because they elected non-harvest diversion rather than participating in the storage pool. This could occur. However, the evidence is that the impact must be very small, since 99% of the restricted tonnage was processed into the reserve pool with only 1% going to non-harvest diversion the last time the marketing order was used. Hence, this point seems to have impacted upon only a few growers who have elected non-harvest. It is more related to their financing and cash flow than to actual size of grower. (Since the marketing order is intended to be primarily a storage program with little or no non-harvest diversion, industry leaders are not very sympathetic to disadvantages which accrue to those few who elect non-harvest diversion.)

Firms' Profits

The marketing order has clearly helped both growers and processors improve their net profits each time the marketing order was used. In each year in which the cherry marketing order was used profits for most growers would have probably been negative if the market order wasn't used. Most cherry growers maintain that their overall profit picture was near the break-even level or somewhat below with the use of the marketing order, although the marketing order reduced their losses (negative profits) in years in which it was implemented. The impact per pound of cherries has probably been size-neutral. The large growers and processors, however,

with their greater volumes, have more pounds to multiply by the price gains and hence they have potentially greater aggregate gains for those firms.

Most gains to the industry have accrued to growers. This seems appropriate since growers finance the pool and take the risks involved in it. A major issue in the industry is: Who should finance the pool, and hence get the gains from it? This issue, however, is more related to a processor vs. grower issue and not primarily related to the size of firm either of growers or processors. This financing issue is of particular concern to proprietary processors and growers who sell to proprietaries. It is of less concern to cooperatives and their growers.

Small Firms vs. Large Firms Choice of Sales Outlets

This is not a major issue for the cherry marketing order. The marketing order has probably had very little impact on this. The marketing order pools have been only in the form of frozen cherries with a provision in the marketing order that there cannot be a canned cherry pool--a provision which was insisted upon by the canner-processors. Since freezer-processors tend to be smaller firms, this aspect has probably helped small firms more than large firms--although again the impact is probably small.

A current issue with some in the cherry industry is that they say that marketing order storage pools should be permitted to include cherry products other than frozen cherries. Others in the industry are strongly against this. Changes in regard to product forms in the pool may occur in the future, although the issue is not primarily one of small vs. large firms.

The Cherry Administrative Board has recently approved the sale of cherries for juice, dried, wine, concentrate, and other minor uses for restricted cherries when the marketing order is used. This could aid some small firms who process these products such as juice. However, the impact is more dependent upon the type of product than on size of firm, since some large firms also process juice and other minor products.

Differential Impacts on Various Organizational Structures

During the 1970's and early 1980's there has been a very significant shift in the cherry industry from proprietary processors to co-op and grower-owned processors. The reasons for this are primarily not related to the marketing order. This kind of shift is also occurring in other regions of the U.S. and for other fruit and vegetable commodities. It is only coincidence that this change in processor ownership pattern occurred during a period in which the marketing order was in existence. In fact because of the financing of the pool by the growers the marketing order probably aids independent proprietary processors more than cooperatives.

It is interesting to note that most cooperatives in the industry are strong proponents of the cherry marketing order since they recognize that it benefits their growers and the industry for long-run market growth. Some of the few remaining independent processors do not support the marketing order. This seems to be primarily because of philosophical reasons, the fact that they cannot sell their entire output in the big crop year, and it reduces somewhat their ability to "freely wheel and deal" as the saying goes. To a large extent, however, it boils down

to their philosophy. On the other hand, a number of independent processors do recognize that the financing of the pool by growers is an advantage to them as processors.

Appropriateness for Contemporary Industry Structure

Because of the increasing production potential from expanding cherry acreage, the goal to stabilize and help expand long-run demand by the storage program is even more important now and in the future years than it was during some of the years in which the marketing order has been in operation. Hence the marketing order is even more relevant today than during some of its previous use-period.

Some aspects, such as handling of the pool to encourage new product uses and a reevaluation of financing arrangements in view of high interest rates and changing economic conditions, are issues which are receiving considerable industry attention. The industry has a need to discuss these and other issues and hopefully to find specific ways to make the operations of the marketing order most appropriate in view of the changing situation. The industry is devoting considerable attention to this. The fact that the Cherry Administrative Board recently approved sales of restricted cherries into many minor uses is one example of specific actions which have been taken to modify the operations in view of changing industry situation. The Board also is in the process of evaluating the best strategies and methods of operation to sell the pool in the most appropriate ways in order to achieve long-run gains to growers and to best meet consumer needs. This issue is receiving considerable discussion and attention by the industry, although there are varying views on the best way to handle this in view of the changing industry situation.

Provisions that Might be Modified for Improved Performance

Some provisions which could be modified for improved performance have been discussed briefly above. There are a number of other suggestions which have been made by industry members as possible means to improve the effectiveness of the marketing order. Most of those suggestions deal with (a) most effectively moving the pool back into the market in short-supply situations, (b) financing arrangements for the pool, (c) geographic area to be covered and (d) Board representation. Some of these suggested changes have substantial potential to improve the performance of the marketing order regarding certain aspects. Other suggested changes do not seem likely to improve its performance.

One suggested change which generated considerable industry controversy and substantial support from some quarters in the cherry industry this last year was the idea of a handler pool such as is employed by the almond marketing order. Some analysis and discussion of this approach and how it might work with the cherry marketing order has been made. It may continue to be an issue in the future, although other alternatives have also been discussed. The industry is considering a number of alternatives as possible steps to most effectively keep the marketing order performing well in a general environment of economic change.