Consumption

no. 18

CONSUMER DECISIONS: PROBLEMS AND POLICIES

PUBLISHED BY THE
AGRICULTURAL POLICY INSTITUTE
NORTH CAROLINA STATE UNIVERSITY
AUGUST, 1965

THE CONSUMER AND MARKET STRUCTURE

Harold F. Breimyer, Staff Economist
Consumer and Marketing Service
United States Department of Agriculture

Perhaps the two anchor posts to economic endeavor are that mankind, which inherited dominion over a physical planet, has sought to maximize its material utility to him and to minimize his pain cost of doing so.

The very statement of that proposition puts the calculus of consumption at or near the forefront. Yet agricultural economists are manifestly guilty of neglecting it. Instead, we cater to production, just as though our nation were on the brink of destitution. The emphasis our profession gives production and consumption may be in the ratio of five to one. Even this estimate may temper accuracy with diplomacy.

More credit, then, to the Agricultural Policy Institute for staging this conference!

The failing of agricultural economists is not that of disregard of consumers, but of taking them for granted and of dismissing them with a few axioms. Ever since the time of Walras, Jevons, Menger and others of the Austrian school, economists have paid homage to the motive force exerted by marginal utility of consumption. More reverential than activist, we have been satisfied to reduce the consumption calculus to that datum-of-all-work, the Disposable Personal Income per Person; and (2) to assume that in some mysterious way economic processes invariably work out for the good of the consumer. The latter idea is often epitomized as the consumer's sovereignty.

Surely this is less than sophisticated reasoning. We can do better. This conference will help us to do better.

Yet, in our defense it is worth reminding that the consumer's active role is historically recent. Throughout the ages the capacity to produce was so circumscribed that consumers were necessarily confined to whatever each year's Providence granted them. The economic function concerned not so much directing production as allocating the fruits of each year's more-or-less happenstance production among hungry (or unclothed) claimants. Often, allocation was governed as much by status as by buying power.

Not until the Industrial Revolution did consumers gain enough buying power, or did productive capability become sufficiently versatile, for consumers to exert any really effective directional influence over economic enterprise.

Habits of thought change slowly, and we still are partly in that intellectual legacy. Consumers are still expected, to a degree, to be grateful, uncomplaining beneficiaries of the productive process. Not surprisingly, the attitude is probably more advanced in agriculture than elsewhere. The entire traditional production and pricing system is consistent therewith. Farm products are first produced, and they are subsequently valued by means of market pricing. Quite properly, we carefully protect the pricing process. Then the price determines who gets what.

The economics of price and value in agriculture thus is heavily recursive. The price that governs production is solely anticipatory, a price expectation. In recent years two methods have been devised for coupling farm production more closely to realized price. Conceivably, these methods could help to mesh production more exactly with consumption needs. One is forward pricing. It has won less than enthusiastic endorsement by economists. And its policy counterpart, support prices, are still viewed dimly not only by many economists, including some of its intellectual progenitors, but by a great many others. (To be sure, the particular form price supports have taken clutters up a judgment on the principles they incorporate.)

The second innovation, broadly known as specification production, has been achieved to date only under arrangements that often seriously compromise the farmer's managerial and bargaining position. In most cases, a contractual relationship is established under circumstances that do not begin to offer the farmer the range of choice that is his protection in open freely competitive commodity markets. If market requirements are to be met henceforth by specification production for a predetermined outlet, a whole new set of protective institutions will have to be devised--institutions equivalent to the services now given commodity markets. In my judgment, those institutions will include some kind of group action by farmers and some surveillance by government.

A Production Oriented Economy

The burden of my remarks is that ours remains a highly production-oriented economy. It puts emphasis on quantity of output. It shortchanges qualitative distinctions in goods and services. As a partial substitute for the latter it indulges in two practices: It makes superficial distinctions in products, often in the name of style; and it undertakes massive promotion to convince consumers that what is produced is what they want.

Three reasons, I think, explain why we are so production-oriented--three in addition to the intellectual legacy I have already cited. The first is the economy of mass production and mass distribution. This applies, obviously, to industrial products and, where farm products are concerned, primarily to the marketing system. Except in broilers, eggs, and some cattle feeding, mass production has not been introduced in farming.

The second reason relates to farm products only. It has old roots: It is the fact that farm production still resists total rationalization. It is technically impossible to regulate the output of a farm as precisely as that of a factory.

The third reason our economy is still production-oriented lies in its complexity. The economy is so complicated, and yet so interdependent, that it becomes difficult for consumers' signals to be transmitted accurately and to be responded to effectively. It is so difficult, as I have already suggested, that it is sometimes easier to persuade consumers to like what they get.

There is historical irony in the fact that a century ago when the Austrian school discovered the influence of consumer behavior, a simpler world made it easier for that influence to be felt. Small producers were then in close touch with consumers. The production-marketing-consumption system was close-coupled. The Austrians' neat mental picture of an economy self-regulated by marginal utility in consumption and diminishing returns in production thus was reasonably realistic. Scarcely had those scholars transcribed their ideas to manuscript than that world began to fade. It is now gone. For one thing, almost all self-sufficiency has vanished. Not only do city families no longer own a cow, but a great many farm families have none. I even understand that some farm wives do not know how to can vegetables. As a suburbanite I am far more self-sufficient than my neighbors just by virtue of raising two dozen green onions each year, and a bushel of tomatoes.

Nor do many farmers deliver meat, butter, cheese, eggs, fruits and vegetables door to door--or sell them in market stalls.

Consumers' wants are filled not directly or even close at hand, but through an infinitely complex interdependent system of production and distribution. How well consumers' wants are met depends on the precision with which that system is designed and functions. Moreover, virtually all communication throughout that system is confined to the mechanism of trading. Even at the retail end, the consumer is seldom in verbal touch with his grocer. No longer does the grocer solicit milady's approving smile. He curries her favor only by his choice as to what goods he stacks on the shelves, and the prices he stencils on them. The sole personal representative of the supermarket management is the checkout lady, who is too busy ringing up the sales to talk about them.

In other words, the question of how efficiently consumers' wishes are met nowadays is a question of market structure. The central issue as to consumers and market structure is this: Is the production and marketing system for farm products and food set up so as to serve consumers well?

Unfulfilled Potential

My judgment that our economy does not serve consumers as well as it might is not an indictment by any past standards. Compared with how men lived a few centuries ago a high fraction of our population is daily pampered in regal splendor. It is only in connection with how well we might do that we come up croppers.

The idea of consumer sovereignty, that the consumer is King (or Queen), is over-advertised. Yet it is not so much inaccurate as ingenuous. The consumer's wishes do carry much weight, but they are only one of the data to which the intricate machinery we call an economy responds. At most, if the consumer is sovereign his is a divided crown; he shares it with others.

The productivity of our economy rests on mass production. This is ideally suited to supplying the basic needs of the population en masse--and it serves best to supply them standard articles. Doubtless the pins Adam Smith's workers contributed to the Wealth of a Nation were good pins but all of a single kind. Mass production of itself is the enemy of serving the individual needs and tastes of each consumer. We hear a lot about the repressive effects of conformity, but the most gripping conformity is that of a machine which punches out articles by the thousands, all of them identical.

To mass production is added a second dimension, that of mass merchandising. Some scholars say we have emerged from an age of production to an age of merchandising. If so, we kept our habits of standardization, even of stereotyping, in the transfer.

Mass processing and mass distribution of food, like mass production, rest on uniformity of product and process. They have doubtless added to the quantity and generally improved the quality of the foods we consume, but they have in some respects also restricted the range of choice. This is true, I believe, despite the fact that the modern supermarket displays 5,000 or more items. Take beef for example. The supermarket, marvelous though it is, has led to what is known as "supermarket beef." This is beef of the range of high Good to medium Choice. It is ubiquitous product from San Diego to Boston. A suburbanite wanting Prime, or any grade below Good, must drive far to get it.

To illustrate the point further, the declining percentage of Prime in the total beef supply of the country is customarily ascribed to changing consumers' preferences. More likely it is due to changing grocers' preferences. Most new grocers, the supermarkets, do not choose to handle it.

Supermarkets are under constant pressure, to be sure, to add more lines. Their dilemma is understandable. Adding more lines adds the cost of the extra shelf space, though consumers doubtless are served better. In reality, I believe the trend to be in the other direction. This is one meaning of the tendency of supermarkets, and especially chains, to shift to their own brands. Each retail brand may replace several processor brands, saving retailing cost. But consumer choice is restricted in the process.

Mass merchandising levies other demands that may conflict with consumers' preferences. Both processors and distributors ask for products that work well in their machines, or transport easily, or fit into standard containers. The fruit shipper wants fruit with tough skin, so it will not bruise easily. Consumers often prefer thin skin. Fruit picked green ships best, but tastes worst. My favorite story concerns my being served double-yolked eggs for breakfast each morning by my Atlanta hostess. The eggs were obtained almost without cost, I was told. The reason they were cheap is not that consumers do not like them, but that they will not fit into a standard carton. This is not consumer sovereignty, but carton-makers' sovereignty.

Still another structural feature of marketing and distribution puts consumers under something of a handicap in expressing their preferences for goods and services. It is the offering of goods and services in almost fixed combination. This practice applies chiefly at retail but its impact permeates the marketing system. The supermarket itself is a single unit or package of products and services. Taking advantage of shoppers' reluctance to traipse from store to store, supermarkets design their pricing and their promotion to attract customers through the door marked "enter" that an electric eye automatically opens for them. Whether consumers want the self-opening door, and whether they ask acres of parking, and whether they prefer the kind of product mix offered, and what their attitudes may be toward new spaciousness in stores--that is, whether they truly are willing to pay the costs of these and countless other services--is a question that is extremely difficult to answer in the modern market structure. Recently, enough major food retailers have abandoned trading stamps to afford customers a choice between stamp and no-stamp stores. But not a choice between stamps and no-stamps alone; each store continues to attach its particular service package. And the other parts of that package are not susceptible of separate choice.

Product Differentiation

Again, I want to avoid overstating my case. Foods are now provided to consumers in greater variety than ever before. But our economy still falls far short of its heralded subservience to consumers' wishes.

One route by which to tailor products more nearly to consumers' wishes while retaining some advantage of mass production is that of product differentiation. This is simply the production of product of distinctive quality, with distinctive label. The brand and copyright laws facilitate the process.

Nearly all advertising rests on product differentiation.

There seem to be few smooth roads to any goal in this mortal world. Product differentiation is not a wholly facile route to more exact service to consumers. The first pitfall is that it is differentiated products that run into the limits of consumer knowledge. It simply is not possible for any consumer to select knowledgeably from among the thousands upon thousands of consumer articles placed before him--particularly when labels often seem designed to obscure as much as to identify. Again, beef is an example. After years of education only a fraction of consumers are familiar with the eight federal grades for fresh beef. How then can they distinguish accurately from among hundreds of processor and retailer labels that beckon in linotyped color from every linear foot of a supermarket shelf?

A second feature of product differentiation which can offset some of its highly desirable qualities is that it leads to elaborate and expensive merchandising and market-building devices known as nonprice competition. The ultimate objective of competition is to provide consumers with products they desire at the lowest price technology makes possible. Competition on the basis of price is therefore the preferred competition. Competition through promotion and advertising and couponing and ancillary services is of a different genre. I have already mentioned several of those services as parts of the composite package of goods and services that faces consumers. Whether a particular kind of nonprice competition pays its own way or is a burdensome extra charge upon the marketing system is always an appropriate question.

Advertising, for example, has the capacity to inform consumers, a highly valuable service. It also has the capacity to misinform, and to confound. Another instance of nonprice competition is brand promotion. My own preference is to avoid going too far toward retail brands; I doubt a customer buying at X supermarket should find exclusively X brand of peaches and X corn flakes and X soap powder. On the other hand, the incessant coupon-promotion of processor brands is a costly nuisance and I sympathize with retailers for resisting it. At some supermarkets I have seen checkout clerks spend almost as much time handling coupons and other brand bait, and dispensing trading stamps, as in calculating the bill.

It is questionable whether all these schemes are truly in the interest of consumers. Although genuinely undertaken in an attempt to please consumers, their proliferation is best explained in terms of the market structure of food retailing. Supermarket retailing is the kind of business that is subject to cyclical if not chronic overexpansion. This is true because it involves a heavy fixed investment, yet produces a standard service and is not protected by any effective limit on freedom of entry. Yet some stores or chains in any community have enough resources to discourage aggressive ("cut-throat") price competition. The customary reaction is price leadership, price competition only by nibbling at the edges, and an outpouring of ingenious schemes of nonprice competition.

Not only consumers raise questions about so much nonprice contesting. Farmers do too. They wonder if those practices add unnecessarily to costs of marketing and distribution, to farmers' detriment. Probably no feature of the present marketing system has so much potential for good, but leads to so much welter of confusion, as does differentiation of products. It classes as one of the many tools of man that he needs to learn to use to his advantage.[1]

---

[1]A nice philosophical point ranges promotion and advertising against consumer sovereignty. Are consumers being served when their wishes are remolded through advertising to "prefer" what is being produced? Without opposing all the game of trying to sway consumers, it seems to me we should avoid the extremes of sophistry. A great many needs of consumers are objectively based, and are not subjective illusions. It is more in the social interest to meet them than to divert them.

Furthermore, the trend toward larger size in market firms may lead to more standardization and less diversity of products. That concentration has increased in retailing is beyond question. Whether it has increased also in food processing industries is less certain. My own conclusion is that it has increased in all except one or two industries. To the extent dominant firms grow in size and influence, the tendency toward mass handling of standard products probably is accentuated. This is not invariably the case, however.

Consumer Grade Standards

The foregoing comment about federal grades for beef reminds us of the entire system of federal grades and standards for farm products. This is the responsibility of the Consumer and Marketing Service cooperatively with State Departments of Agriculture.

Well designed grade standards are a significant help to consumers. They are a direct help when grades are applied to consumer product. They are an indirect help even when used only at wholesale level, for they facilitate the marketing of products on quality standards.

Over the years, farm products have been subjected to more and more processing. Very often the federal grade is lost before the product reaches retail sale. Nevertheless, the C & MS has tried to keep its grade standards in tune with the wishes of consumers. Often this means narrowing or tightening the standards, as consumers become more discriminating.

The new beef grades, due to go into force June 1, partly separate criteria that have meaning at wholesale from consumer grade criteria. The new grade structure is optional, however. We cannot know in advance how much of beef grading will include the new cutability scores.

Performance in Farm Markets

Farmers have surely performed nobly in feeding and clothing our population. To them too, however, I apply my universal judgment: They do not do as well in serving consumers as they might.

Their performance falls short of what could be done. Even though farm products cannot be produced to blueprint specification, ever since Luther Burbank led the way it has been possible to tailor them genetically more precisely than before. Likewise, many cultural techniques can be used to control quality to appreciable degree.

One change in farm markets may actually offset some of the advantage that could result from better quality control in farm production, at least initially. It is the demise of the wholesale market. Despite all heroic effort, farm products will always be somewhat heterogeneous. The next best thing to producing to specification is sorting to specification. This the wholesale assembly market did beautifully. It matched up the variations in kind of goods offered with the range of differences in what buyers wanted. Presumably, with a good set of grade standards the consist (mix) of what was produced and offered was not too far askew from the spectrum of demand.

Now direct buying has replaced a sizable part of wholesale assembly. Although direct buyers necessarily accept a range of quality, they are pressing ever harder for more uniformity. They want uniform product that will fit into their machines, or that will give them "repeatability" in their merchandising. They are leading the parade toward specification production, often through integration. In principle, production to specification could be in the direction of making production serve consumers more faithfully. In reality, it may not always work toward that end. The first reason has already been given--that farm products are sure to continue somewhat heterogeneous. The second reason is that to date specification production has been used more in pursuit of market-wide uniformity than of diversity--or for quality differences that are hardly more than nominal. The integrated broiler industry turns out a good chilled product (though a bit watery) but it is a uniform product; only recently has an effort been made to diversify the broiler products put on the market. It is possible that the variety of consumers' wishes was met better in the era of wholesale assembly markets than in the present era of direct trading.

For my part, I am not willing to concede too much to integrated control over production as the way to serve consumers best. There is much to be said for the wholesale function of servicing diverse demands for farm products. Moreover, the quality of farm output could be controlled better than now done by refining the price signals given farmers. It is regrettable that some market firms which want to sell by specification--their own, if possible--want to buy without paying adequate price premiums for quality. A system of forward prices, carefully structured with price incentives for desired quality, might do wonders to guide farm production better.

What Can Be Done

In summary and conclusion, in our complicated interdependent economy the process of producing and merchandising farm products is kept in alinement with consumers' wishes not through any direct personal communication but through the coldly impersonal mechanism of the economic system. The structure of the system therefore becomes governing. There is no reason to assume that consumption goals will be met to the optimum irrespective of the kind of structure that exists. On the contrary, if we do indeed want to accord a degree of priority to consumption goals, it is both prudent and necessary to give heed to the kind of structure we have collectively created. Unless we do that, we will remain overly subject to economies of mass production and mass merchandising, to the limitations on consumer knowledge, and to imperfections in communication. Unless we do that, we could fail to give expression to the true wishes of consumers, in a milieu in which it is not possible for consumers to express them through selectivity in buying alone.

As a general rule, whatever helps to keep the market structure efficient and freely competitive, I believe, helps it to serve the consumer. My agency more than any other is charged with improving efficiency, equity and competitiveness in the marketing of farm products. For some products our responsibility extends well forward in the marketing sequence. My agency sometimes wonders whether it acts most in behalf of farmers, marketers or consumers. By a recent change of name we certified that consumers' interests are not overlooked. Yet in the longer view this is a pointless parlor game. If we do our job well we benefit all three; and ultimately, in line with the fundamental goal of an economic system, our actions may redound to consumers most of all.

Surely in this day there is no need to go on the defensive regarding inspection of food for sanitation and safety. This responsibility the C & MS shares principally with the Food and Drug Administration of the Department of Health, Education and Welfare. Our biggest inspection service is of meat and poultry.

Also hardly in dispute is the need to assure at least minimum accuracy in identification of products. Our meat inspection service, for example, requires that when it has inspected a meat product the processor must thenceforth identify it accurately. Likewise in meat grading: To mislabel Choice or other federal grade of beef or lamb is a criminal offense.

Grading of farm products is clearly in the joint interest of farmers and consumers. My agency strives to keep its grade standards up to date. It sometimes encounters apathy or even opposition--occasionally from the groups it benefits most. If the farm economy is to serve consumers better, more exact design of grade standards is an essential aid.

To the extent farm products are produced in vertical arrangements, it is less certain that federal grades will prove applicable.

Similarly, regulation to forestall noncompetitive market organization and injurious market practices helps to make the marketing system operate better in the service of consumers. Nevertheless, much market regulation was drawn up to fit an older system and to correct older ills. Anti-trust can prevent monopoly but it does not touch the potential wastes of nonprice competition in a monopolistically competitive market structure. My agency finds it hard to regulate practices in integrated arrangements in livestock and poultry and their products, in the way it has done for years in open market trading.

Finally, may I call attention to the investigation now being conducted by the National Commission on Food Marketing. It is a highly significant inquiry into structural questions of food marketing. The Commission's initial hearing on the subject of food retailing was confined to costs and margins and did not consider other issues such as branding. The remarks of Mr. Warren Sharfman, the Commission's project leader for retailing, bear closely on how the retailing structure may affect both services performed and costs incurred. Said Mr. Sharfman:

> "If it is true that this increased expenditure for food retailing is buying additional services, it is within the public interest to know what these services are and what they cost. If it is true that competition between large national food distribution firms builds unnecessary promotion or other costs of competition into the system, it is within the public interest to know about that also. To what extent are the gains in human productivity offset by unnecessary costs of competition? Do retailer profits represent an excessive component of retail margins? On the other hand, if increased margins reflect only prudent expenditures for desirable services and only fair returns for capital invested and labor performed, then it is in the public interest also that this fact be ascertained and publicized."