AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

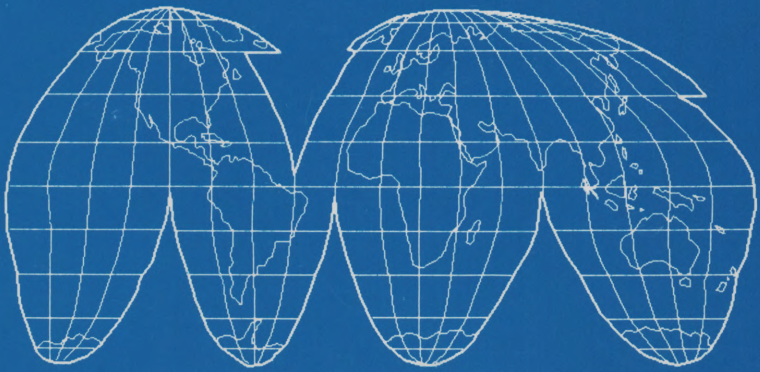
Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

Commodity Promotion Policy

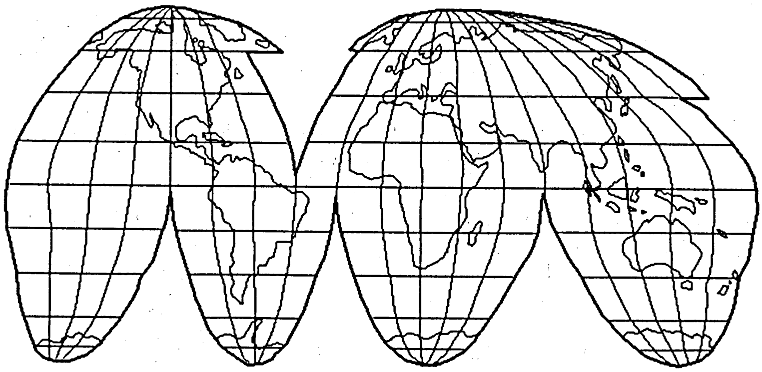


in a Global Economy

Proceedings of a Symposium
October 22-23, 1992

Arlington, Virginia

Commodity Promotion Policy



in a Global Economy

EDITED BY

Walter J. Armbruster and John E. Lenz

SPONSORED BY

NEC-63 Research Committee
On Commodity Promotion
Agricultural Marketing Service, USDA
Economic Research Service, USDA
Foreign Agricultural Service, USDA
Farm Foundation

PUBLISHED BY

Farm Foundation
1211 West 22nd Street
Oak Brook, IL 60521-2197
1993

CONCLUDING CHALLENGES

COMMODITY PROMOTION POLICY IN A GLOBAL ECONOMY: CONCLUDING CHALLENGES

Dennis R. Henderson
Ohio State University

Based on the presentations and discussion during the conference, my purpose is to identify key issues facing commodity promotion programs, and to present a view of these issues that challenges policy analysts, program administrators, researchers and educators to anticipate the concerns that will demand their greatest attention in the future.

To do this, I have classified my observations into five fairly specific groups of issues. I will comment on each in turn, but imply no ranking of importance by the order of discussion. Rather, I suggest that each deserves considered attention. Undoubtedly, my phrasing of the issues often varies from that of the preceding speakers; yet, I believe my taxonomy captures much of what has gone before. I hope my classification contributes to the process of distilling the essence of the excellent presentations and pointed discussions that have characterized the conference.

Institutional and Organizational Issues

It quickly became apparent that the institution of commodity promotion programs financed by industry checkoffs have given rise to what is, or at least is well on the way to becoming, an entrenched set of organizations. Most obvious are the trade associations that have been important instigators, managers and advisors of the various promotion programs. With mandatory checkoffs, these may be, in essence, mandatory-membership trade associations. Activities of such organizations can, and possibly do, extend well beyond commercial promotions. If not already here, political action is not far away. Examples of using such organizations to countervail public criticisms, such as those associated with the use of cosmetic chemicals and seemingly extraneous health concerns, have been mentioned frequently.

Clearly, such organizations can play important and powerful roles, facilitating the development of industry-wide strategies for dealing with public affairs and political considerations as well as commercial actions. Yet, because such organizations are a product of public policy, they must accept public oversight or regulation of their noncommercial, as well as commercial, activities. Relevant questions include: 1) What is the appropriate scope of activity for such organizations? 2) How important are noncommercial activities to maintaining industry support, e.g., to what extent do political and public affairs activities supersede product promotion in the mind's eye of those paying the bill? 3) How effective can public oversight be when such organizations enter into the arena of political action that affects the lifeblood of the regulating agencies?

Another side of the organizational issue is the institutionalization of oversight within the U.S. Department of Agriculture (USDA). One has to be impressed with the extent to which agencies such as the Agricultural Marketing Service (AMS) and the Foreign Agriculture Service (FAS) are involved in these programs. USDA is now a stakeholder; considerable employment and funding appear to be directly tied to the existence of such programs. Indeed, part of the articulated rationale for USDA support of these programs rests on their self-financing provisions as well as the fact that such programs allow agencies to leverage appropriated funds into larger and more comprehensive activities. A relevant concern is, where does the public interest of the bureaucracy end and the private interest of the bureaucrat begin? This is not a simple matter of graft or potential corruption, but rather of jobs themselves. Is it possible to have effective arms-length oversight in such an environment? The discussion on negative advertising is instructive in this context. I perceive a general public distaste for negative advertising. Yet the evidence that such advertising sells is persuasive. It will be interesting to see how the issue of advertising content is settled.

Distribution of Benefits

While there was not unanimous agreement that positive returns to investment in commodity promotion programs exist, I am left with the general sense that promotion pays. Demand for the promoted product increases. It was stated a number of times that one important justification for public authorization of these programs is they increase farm income, higher farm income presumably being in the public interest.

Yet, at least by implication, there seems to be a prevalent assumption that any increase in revenue resulting from an increase in consumer demand flows to farmers; moreover, not just to any farmer but those who foot the promotion bill. This seems to be a heroic assumption from at least two perspectives. First, the share of the value of any new consumer sales accounted for by downstream firms would be expected to be as large as on previous sales. With more than 70 percent of the value of food added beyond the farm gate, the assumption that all, or even most, of the value of new sales will accrue to farms seems, at best, unlikely.

Second, the distinction between profit-maximizing objectives of individuals and revenue-maximizing objectives of industries has been raised in an earlier presentation, the latter taken as the focus of industry-financed demand-expansion programs. Given the reasonable expectation of a supply response at the farm level in industries that approach the competitive industry model, it is equally reasonable to expect that revenue enhancement at the industry level will result in entry, not in rent extraction, by existing firms.

Thus, the issue of distribution of benefits has both vertical and horizontal dimensions. In the first case, benefits are distributed between farms and downstream firms and, in the second case, between present farms and new entrants. In neither case is there any guarantee that the present farms that bear the cost will receive all, or even a proportional share of the benefits. Gaining intelligence on who receives how much of the benefits will yield great insight into who should bear how much of the costs. It also might justify revision of the rationale for public involvement in these promotional schemes.

Advertising, Product Differentiation and Market Power

Even though the issue of market power has received only scant attention in earlier presentations, my longstanding interest in its occurrence and implications compels me to address it. I raise it is this context: Commodity promotion programs have been linked to new product innovations, specifically the introduction of product derivatives that fit unique or emerging consumer desires, e.g., low fat products. These are differentiated products, even though there is a base commodity from which they are derived. Downstream sellers may, as a result, achieve a degree of market power, i.e., the ability to price above marginal cost.

Received microeconomic theory tells us that, if a downstream firm exercises market power, its derived demand function for the factor input needed to produce the final consumer product equates with the firm's marginal revenue function, not its average revenue function. Recalling elementary geometry, this is a downward rotation of the demand curve from its point of axis in the vertical dimension. In short, it is a reduction in the demand function for the factor input equal to the magnitude of the price-cost wedge extracted by the downstream firm. Conceptually, suppliers of the factor could be worse off as a result of the promotion that encouraged the product innovation; a smaller quantity of the factor input is sold to the innovative firm at a lower price than in the absence of the innovation and the downstream sale of a homogeneous product. The case of manufacturing milk, branded butter blend, and commodity butter comes to mind.

By contrast, at least one speaker suggested that generic commodity promotion may reduce the effectiveness of brand advertising. While I am not convinced, in such event, downstream market power could be reduced, resulting in a more-than-proportional upstream gain to the factor suppliers.

A relevant issue is, what is the relationship between commodity promotion programs, the structure of the markets downstream from the farm, and the strategic behavior of firms therein? Theoretically, it is possible that the farm producers could be worse off as a result of the promotion effort. Further, it is not out of the realm of possibility that there could be a direct impact on industry structure at the farm level. Assume that public oversight results in restrictions on promotional activities that are particularly good at generating a sales response, e.g., negative advertising. A downstream firm might be provoked into vertical integration in order to obtain factor inputs that are not subject to such restrictions.

Performance Criteria for Policy Choices

Fundamentally, this set of issues deals with the question, what is the public's interest in commodity promotion? Even accepting the presumption that promotion pays (else it would not be done as a commercial activity), the question is still begged, does mandatory promotion of farm commodities add to the economic welfare of the nation?

The rationale for many commodity promotion programs appears to rest on the "free rider" principle, i.e., using the power of government to assure that none of those in a class that potentially benefits from promotional activities are exempt from paying for those activities. At best, this is a partial equilibrium response. If a group of farmers benefits, that group should share the cost. In a general equilibrium context, such promotion may, or may not, be the optimal use of resources.

Perhaps the issue can be illustrated most clearly in case of export promotion, essentially a form of export subsidy or what is now called "strategic trade policy" in the new international trade theory. Recent developments in that theory unambiguously show that a nation's economic welfare is increased by the use of export subsidies *only* in situations in which scale economies in production are so large relative to the size of the global market that just one firm can produce efficiently; under those circumstances an export subsidy that gives the home firm a first mover advantage enhances domestic welfare at the expense of foreign countries. It is difficult in the extreme to conjure up such a condition in agriculture. Perhaps there is a reason why the manufacture of wide-body airframes is about the only example of this condition that can be found in the strategic trade policy literature.

Methodology for Research and Evaluation

While the dominant theme of this conference has related to publicly-sanctioned commodity promotion programs, other concerns have been mentioned, particularly those regarding the measurement of advertising effectiveness. Methodological contrasts have been made between econometrics and controlled experiments using techniques such as split cable, scanners and consumer panels. The relative value of estimating a demand shift parameter compared to measuring recall of advertising content has been debated. It seems we agreed that the sign on estimated beta coefficients when promotional expenditure is regressed on sales (either at home or abroad) is positive, but have no consensus on the size of the coefficient itself. It seems we agreed that controlled experiments remove ambiguity in measuring the effects of specific promotional activities on buyer behavior, but have no consensus on the design of such experiments. It seems we agreed that more evaluation of effectiveness is needed, but that advertising agencies are biased, that producers do not have the necessary analytical skills, and that academics do not have access to sufficient data. It seems we agreed that a new organization could add measurably to the efficacy of evaluation, but know not who would provide funding, personnel and other essential resources.

Commodity promotion programs are clearly a thing of the present. They will not disappear tomorrow even if we willed them to do so; they will persist in light of poor evaluation and unmet expectations. Yet, history teaches us that they will eventually be viewed as a passing phase. To put it in the vernacular, the worm always turns. Somewhere along the line, with much hard work and a bit of luck, we will develop a definitive analysis that lays to rest our concerns and uncertainties regarding what such programs really contribute to economic growth and world prosperity. This conference has taken us closer to that goal.