ECONOMIC IMPLICATIONS OF CALIFORNIA AGRICULTURAL MARKETING PROGRAMS[1/]

by

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Introduction

"Economic conditions are constantly changing, and each generation looks at its own problems in its own way." So Alfred Marshall began the "Preface" to the first edition of his Principles of Economics. One may wonder why Alfred Marshall is brought into a discussion of agricultural marketing programs, other than to impress some naive listener with a flavor of superficial profundity. But in terms of the basic economic ideas underlying marketing programs, our generation draws heavily upon the system of thought commonly referred to as Marshallian analysis. This is to dispel the notion that marketing programs involve some new, unique, and all-powerful system of economic analysis.

The generic phrase we have used, "marketing programs," includes "marketing agreements" and "marketing orders," which differ in application of regulations but not in economic rationale. There are essential differences between milk marketing controls and those for other commodities. Time does not permit consideration of milk; hence, we limit our discussion to marketing programs for other products. Both federal and state governments have marketing control legislation, and here we must further limit our terrain by considering only California programs, although many of the economic implications are also pertinent to federal programs.

1/ Prepared for the joint annual meeting of the American Farm Economic Association and the Western Farm Economics Association, August 26-29, 1956, Asilomar Conference Grounds, Pacific Grove, California.

Attributes and Functions of Marketing Programs

Marketing programs were born as a result of problems engendered by the "great depression." But the economic embryo of marketing agreements and orders was gradually and experimentally developed by certain cooperative marketing associations during the 1920's. Their problems and tribulations need not be recited here; yet, those cooperative marketing associations became convinced that their own devices were not fully adequate to achieve the goals envisaged. New legislation and limited government participation were deemed to be essential adjuncts.

When experience with marketing agreements showed that their signees were "holding the umbrella" for the nonsigners, thoughts turned to a device whereby everyone in the industry concerned would be required to support the umbrella. Thus emerged marketing orders with their uniform and industry-wide application to all producers or handlers of the product concerned. Such industry-wide application of marketing orders has, however, often been misinterpreted. This does not mean that the industry has no choice as to whether an order will be introduced; it does not mean that the industry is powerless to change or even to eliminate the order; nor does it mean that the industry, with its order, can operate only as the industry desires.

Legislation clearly sets forth the procedural and administrative criteria to be followed. The many important details of such procedures need not be discussed here since we are interested only in setting the background for discussing certain economic questions. But several significant points must be underlined. [First, a clear and definite majority of the industry must approve an order before it can be effective.] [Second, the California Director of Agriculture is required to determine whether the available evidence indicates the need for an order and that the proposed order meets that need.] [Furthermore, the

Director has the authority to terminate an order which is in operation if, in his judgment, it is no longer consistent with the legislative standards.]

To assist him in operating a marketing order, the Director appoints an advisory board from a list of industry nominations. But the board cannot make decisions and act on all matters of any consequence. The board can only recommend to the Director and he either approves or disapproves.

The general goals of marketing programs are mainly oriented in the direction of improving returns to producers. Although the Director is required to give consideration to consumer interests as well as to those of the industry at large, [the legislation is clear that its primary concern is with the economic welfare of producers.] [This "economic welfare" of producers is measured in terms of "purchasing power" which is suggestive of, but not completely identical with the "parity price" or "parity income" notions embodied in federal legislation. Rather than referring to a specific per cent of some base, the California legislation expresses its objective in terms of purchasing power adequate to keep in business an adequate number of producers providing an adequate supply of the commodity to meet the needs of consumers.]

To attain the various objectives embodied in particular marketing programs, a set or battery of provisions and tools has been developed over the years. Some of these provisions are of the more obvious nature and supplement the type of marketing legislation prevalent in most states as well as in California. Yet, other of the marketing program provisions are unique in that they operate to any extent only because a program is effective. The major provisions or marketing tools, one or more of which are written in the various programs, include: grade and/or size regulation; pack and container regulation; mandatory inspection and/or certification; unfair trade practices; advertising and sales promotion; production, processing and/or marketing research; and volume regulation, with or without stabilization pools and funds.

At this point it is advisable to pause a moment and destroy a false notion which is prevalent in the minds of many persons, including some who have a superficial familiarity with California marketing programs. Too often the unfounded thought is expressed that marketing agreements or orders are synonymous with quantity restriction and that without that provision there would be no programs. Such a view may be a throwback to the early days of programs when quantity regulation was the primary, although not the only, reason marketing controls were initiated. In recent years, however, the situation is drastically different. Quantity control, as such, is incorporated in only 10 of the 28 marketing programs currently in effect under California legislation; but even for those 10 programs, quantity restriction is permitted only with the approval of the Director rather than being mandatory or automatic.

In view of the economic significance and implications of quantity restriction as a part of the marketing programs, however, we shall later consider this topic again. Now, we continue with the other types of provisions. The most prevalent provisions include "sales promotion and advertising" which is embodied in 23 of the programs, and "production or marketing research" which is incorporated in 22 of the programs. "Grade or size" regulation and "inspection or certification" are next in order of frequency. Then comes "quantity regulation," followed by "pack or container" regulation, with the "unfair trade practices" provision the least frequent. Also, one may note that there is no fixed or standard formula setting forth which particular provisions are to be incorporated. Each separate marketing program is tailored to meet the considered needs of the commodity concerned, and there is complete flexibility as to which provisions are excluded or included. Various combinations of marketing tools may be drawn upon in the development of programs. Also, a single commodity may have more than one program in operation simultaneously.

It is important to recognize that neither by legislative criteria nor by administrative procedures need the provisions or operational objectives of marketing programs be static or unchanging over time. As long as the broad general criteria written in the state legislation are met, and the Director makes a finding to that effect, a proposed program or an amendment to an existing program may be approved by him. The various industries having marketing programs have taken advantage of this flexibility. As with a biological organism, the institutional organism of a marketing agreement or order undergoes mutational and evolutionary changes.

As one studies the evolution of marketing programs and surveys their changing objectives and emphasis, one sees a moving picture of institutional development. Each program has its own special existence as does each individual in a population. But the societal group gradually takes on new characteristics as the older ones change emphasis and form. The process of institutional mutation and evolution may with considerable articulation be identified in the history and development of marketing programs. In the early days of marketing programs, their primary provisions pertained to quantity control and regulation which in practice meant volume restriction. Later, provisions for grade and size regulation, mandatory inspection, and certification assumed increased relative importance. And still later, sales promotion and advertising along with the sponsorship of research received relatively increased attention. This does not mean that the older provisions were necessarily dropped as new ones were adopted; rather, it means a change in relative emphasis and balance. The development of marketing programs fits in well with Marshall's "Principle of Continuity": "The new doctrines have supplemented the older, have extended, developed, and sometimes corrected them, and often have given them a different tone by a new distribution of emphasis; but very seldom have subverted them."

One may question how extensively used are the California marketing programs by the state's agricultural industries. Whether the answer is "considerably" or "little" depends upon the yardstick of comparison. Since 1933, some 70 different programs have at one time or another been in operation. A number of the programs were effective for only a single season, and others have operated in some form for as long as 20 years. The average length of life of those 70 programs is about six years, although that figure cannot be actuarially interpreted as an index of life expectancy.

At the end of last year, some 28 different marketing programs were in active operation under the authority of California legislation.[1/] These 28 programs reflect an average length of life of nine years, with individual programs ranging from less than a year's duration to as much as two decades of operation. But a figure of 28 programs may not be impressive when compared with a total of over 200 commercial crops and products marketed by the state's agricultural industries. Such comparison, however, may be misleading. A more meaningful set of indicators of the role of marketing orders in the state's agricultural economy may be that in 1955 the total farm value of all commodities having orders amounted to $390,000,000—15 per cent of the state's total cash receipts from farm marketings or 23 per cent of the cash receipts from crops. Another statistic is that close to 35,000 producers, 33 per cent of the state's farmers, were directly affected by those programs, and a substantially larger number were affected indirectly. These figures are not cited to impress you with the dimension of bigness, a Californian trait of which you must by now be well aware; the intent, rather, is a serious one to place before you in proper perspective and balance the economic position and role of marketing programs.

Economic Implications and Inferences

To finance the 28 marketing programs operating in 1955, the producers and handlers directly concerned with those programs provided all of the necessary funds. This amounted, in 1955, to almost $6,900,000. These expenditures were borne entirely by the industries through assessments on the participating producers and handlers or processors. The term, "self-help," is applied to these types of programs. But it is somewhat misleading. A more appropriate descriptive phrase would be "self-financed," and even this phrase would refer to direct immediate expenditures; for if the programs are successful, over a period of time they presumably yield sufficiently increased returns at least to offset their direct costs to the industries.

The question about the phrase, "self-help," is raised here not only because of clarity in nomenclature. There is also the important issue of joint participation between the state represented by the Director of Agriculture and the industries concerned represented by their respective advisory boards whose function is to assist and advise the Director. The industries presumably initiate the promulgation of the programs; but once such action is taken, from then on the state assumes definite functions and has certain weighty responsibilities. Aside from the matter of direct financial costs, the state is definitely one of the necessary parties. Hence, marketing programs of this type are not the result of industry autoinsemination and self-gestation; rather, such orders result from the institutional cohabitation of the state government and the industries.

To suggest the heavy responsibilities borne by the Director, the following sections from the Agricultural Code (1955), State of California, are cited:

> "3183. . . .the director shall not issue such agreement or order for the written assent of producers or handlers unless he finds after public hearing that all of the following are true:

"(a) The supply of the commodity available for marketing exceeds or is likely to exceed the demand therefor at prices which will provide a reasonable return to producers of the commodity.

"(b) The return to producers of the commodity will tend to be increased through the operation of the proposed marketing plan.

"(c) The proposed agreement or order may be administered without permitting unreasonable profits to producers of the commodity and without unreasonably enhancing prices of the commodity to consumers.

"(d) The proposed agreement or order will tend to prevent disorderly marketing of agricultural products within the State.

"(e) The proposed agreement or order will tend to provide consumers with a more stable and adequate supply of agricultural commodities.

"(f) The proposed agreement or order will tend to establish or maintain such relationship between the quantity of the particular agricultural commodity marketed and the demands of the market for the commodity as will tend to continue in production such volume of the commodity as is probable will be needed over a reasonably long period of time to supply the requirements of the commodity and to provide an adequate standard of living to the farm operator and his family."

From those economic standards flow various economic implications and inferences. First, it may be noted that nowhere are the economic standards expressed in precise numerical or quantitative terms. No specific percentages of some sort of "parity price" or "parity income" are directed. The Director is not bound either to a simple or a complicated numerical formula. On the contrary, the legislation imposes upon him a tremendous burden in the exercise of judicious wisdom compounded with economic thought.

In the judgment of what are "reasonable" and "unreasonable" returns to producers, in the determination of "unreasonably enhancing prices--to consumers," in the specification of "such volume as is probable will be needed over a reasonably long period of time," and in the measurement of "an adequate standard of living to the farm operator," the Director is given no guide in the legislation.

One must admit with candor, moreover, that the economic science we have at hand can probably help little in such normative classifications, particularly for an economic system that is characterized by growth, change, dynamic structural variations, uncertainties, and the vicissitudes of various degrees of hot and cold wars. Only restraint, supported by naïve preconceptions, deters one from suggesting that perhaps the Director might consider supplementing his staff of administrators, economists, and lawyers with a bold and articulate philosopher.

These questions about the Director's responsibilities with respect to volume restriction cannot be dismissed with only cavalier recognition. Although weighted with normative values, the standards certainly involve economic relationships and for that reason alone we must be concerned with the economic implications and inferences. [The standards are based in large part, although not entirely, on a conventional static and partial equilibrium setting where for each of the products the demand functions facing consumers and producers, the short- and long-run supply functions of producers, and the rest of the Marshallian kit of analytical tools, concepts, and functions are known or can be estimated sufficiently accurately to serve as operational devices.] Would that we, whether conventional economists or econometricians, could have at hand all of that economic information in usable form so that at any time it could be drawn upon for policy considerations and program decision making!

Yet, some of us might shrink with horror from such a thought. One can already hear shouts of protest. The objections might be for various reasons among which we would likely hear the following: you should use a general equilibrium analysis and not partial equilibrium; you should have a dynamic model which incorporates uncertainty and expectations; you should be concerned with total welfare and not primarily producers; you must use a simultaneous equations approach; you should use activity analysis of production and allocations, or at least linear programming; how are you going to measure welfare and handle interpersonal as well as intertemporal comparisons; and so on. And from one corner, someone might inaudibly mutter, "If you could only get the right isoquant, isorevenue, and isocost maps so you could set up the right Edgeworth-Pareto box diagrams, you could get the equilibrium solutions."

The point I want to make is that, on the premise there are marketing programs with economic standards of the type briefly indicated earlier, the Director or a comparable administrator can obtain from economists only a very limited amount of the economic information compared with what he should have in order to do his job as set forth in the legislation. Yet, one should not be overwhelmed with doubt and pessimism. Economists can and do contribute in the consideration and operation of programs as marketing orders. I venture to say that without what the economist can honestly offer, both the Director and industries would err more often and to a greater extent; in other words, we do help them to make smaller or less frequent mistakes.

In addition to the legislative economic standards which guide the Director, there are other economic considerations. These may be considered in terms of the major functional activities which take place in the operation of the orders: administration, inspection, promotion, and research. Time permits brief comments on the economic implications of only promotion and research.

"Promotion" provisions are part of 23 of the 28 currently effective programs. The term "promotion" includes advertising, trade and consumer "education," the employment of fieldmen for retail point-of-sale displays, and similar activities. In addition to the large proportion of programs which use promotion provisions, another indicator of their role in California marketing programs is that of the total expenditures, for all activities under all programs, made in 1955, 67 per cent is classified under "promotion." Sales promotion and advertising are carried on to affect consumer demand, hence, affecting the derived demands at the handler and producer levels. In conventional economic analysis, consumer demand is generated by the interaction of consumer utility surfaces, income, and prices. Advertising attempts to change the structure of the consumer's preferences, thereby altering in certain directions his utility surface. Although we now hear much about depth interviews, hidden desires, and impulse buying, and advertising experts talk in terms borrowed from social psychology and group dynamics, the objective of advertising remains one of shifting demand upward by affecting the consumer's utility preference system.

One may ask what is gained by marketing program sales promotion since advertising can and is done by many private firms and organizations. The answer involves a basic feature of marketing orders noted earlier; if sales promotion is carried on under the authority of a marketing order, everyone in the industry must contribute to the financial support of the advertising. If the advertising is effective, each participant gains in a sense corresponding to the benefits a firm derives from the influence of Marshallian net external economies. Although Marshallian economies are generally associated with long-period cost and supply functions, corresponding effects on the revenue and demand functions can be considered to flow from influences external to the firm and which yield benefits common to all firms in the industry.

Marketing order advertising programs generate nonprice competition among products. Since, in the short run at least, the "human stomach is inelastic" and the total consumption of a group of products closely related in demand is relatively fixed, a situation can develop where industries believe they must advertise if only to hold their historical share of the market. In such a case, advertising is resorted to as a buttress against the industry's demand function shifting downward. This type of interaction between industries bears much resemblance to what, in a different context, Joan Robinson termed "beggar my neighbor."

For reasons we need not pursue here, most producers and handlers seem to have an immeasurable amount of faith in the effectiveness of promotion and advertising expenditures. Yet, objective and substantive results to support such faith are extremely difficult to develop. The disentangling of short-run and long-run results as well as multiplier effects, raise tremendous analytical problems. To answer simple questions often asked by industries, such as, "should we advertise" or "how much should we spend on advertising," requires the boldness and confidence of an advertising account executive. The economists might reply in terms of short-run and long-run net marginal revenues and net marginal costs of advertising; but unless those functions can be operationally specified for the industry, it is helped very little.

In terms of frequency of appearance in currently effective programs, research ranks about equally with sales promotion and advertising. But in terms of total funds expended, research accounts for only 4 per cent, compared with 67 per cent for promotion. Such comparison is misleading, however, as an indicator of the relative importance of research in the operation of marketing programs. [A very substantial amount of research is drawn upon by the marketing program industries from sources as the state university and for which no cost account is reflected in the figures cited.]

The research activities in which marketing programs are interested or which they sponsor not only are economic in nature but often are technological, although the latter have economic implications. Technological research projects include, for example, improved processing methods for canned fruits, disease and pest control, improved varieties, development of new utilizations, improved equipment, and similar studies carried on by technical departments and organizations. In terms of economic terminology and implications, such researches have the objective of discovering and developing new production functions. Their economic relevance is bound in with the analytical concept of cost functions being generated by the interaction of production functions and their derivative functions with the cost rates of productive services. As cost-reducing methods of producing "old" products affect industry returns through the cost side of the profit equation, methods of producing "new" products affect industry returns through the revenue side of the profit equation. The industries with marketing order provisions for research are well aware of the economic implications, and to them production, processing, or marketing research is a source of increased profits or decreased losses.

Economic and statistical research is drawn upon by a number of the marketing programs. Of particular concern to those programs having a volume regulation provision are the [economic characteristics of the demand functions facing the industry.] Knowledge concerning price and income elasticities, for example, as well as measures of demand relationships among various products are necessary for a rational operation of the volume-regulation provisions. This is not to suggest that all programs have at hand, or seek to acquire, such economic relationships. The range of "economic awareness" varies among the programs; some ignore economics in its analytical sense and some "play by ear"; but several reach for, probe into, and consider rather sophisticated and technical economic relationships.

In addition to economic researches pointing to the demand side of the market, increasing attention is being given to supply. For purposes of planning marketing policy, several of the programs--cling peaches, bartlett pears, and lemon products, for example--are helping to finance researches in objective preharvest sampling forecasts of the prospective supplies available for marketing. Reliable and timely forecasts of supplies to be harvested are of particular concern to the orders utilizing the volume-regulation provisions.

All of the various types of quantity control have as their primary objective the increasing of returns from the sale of the crop. But in each case, the particular effects on prices and returns depend upon the nature of the relevant supply and demand functions, their price and income elasticities, their stability over time, and their sensitivity to developments in related products. The economic rationale, in the most elementary case, involves price elasticity; while less simple cases involve economic theories of price discrimination, market segmentation, and multiple products.

The problem of multiple products stems from the interaction of crops which are competing in demand, or which are produced and marketed in competing areas. Interregional and interproduct competition cannot be ignored in the operation of volume control. A marketing program which disregards the indirect as well as the direct economic effects on competitive products or competitive regions is eventually likely to find its objectives frustrated and its long-run relative market position affected.

Some Observations

The operation of California marketing programs, with their apparent "success" in the opinions of many participants and observers, has attracted rather widespread attention from various commodity groups in other states. Information seekers often suggest that if they "only could have a marketing program," their problems would be solved. Such generalization, however, may be ill-founded.

Valid economic generalizations about joint industry-state marketing programs are difficult, perhaps impossible, to formulate in meaningful and helpful terms. There are so many different types of programs which can be developed and each commodity has its own particular problems and circumstances. One generalization, however, can be noted with some confidence. Joint industry-state marketing programs certainly are not a mystical and all-powerful curative of marketing problems. Rather, such programs are institutional economic devices effective only for certain types of problems under particular circumstances.

[Much too often marketing programs are viewed as acceptable substitutes for necessary production adjustments.] Where chronic and persistent "overproduction" occurs, marketing programs are at best only a palliative to provide time and aid for easing into the basically necessary production adjustments. Where cyclically depressed demand imposes producer returns less than out-of-pocket costs, marketing programs can help to retain productive capacity appropriate for the time when the business cycle turns up again. In this respect, an example is that of tree fruits from orchards representing capital which can be reproduced only over a period of years.

Although marketing programs were "depression bred," with the passage of time they have become "prosperity fed." Of the 28 marketing programs currently effective in this state, definite expiration dates now prevail for only four programs, and they may be continued with reinstitution; the other 24 programs have "continuous" terms of operation and continue on until a contrary decision is made by the industry or the Director. It is clear that marketing programs have become a permanent part of our marketing institutions.

The characteristic of being "depression bred and prosperity fed," however, is not unique to marketing programs. More or less similar degrees of metamorphosis are evident in many other of our economic and social institutions: unemployment, old age and survivors' insurance; federal and state employment offices; bank and building and loan deposit insurance; home-mortgage insurance; labor-management legislation; and many others, including the federal loan and storage price-support programs. But an important institutional difference between the California marketing programs and the federal price-support programs is that the latter are a victim of political controversy.

California marketing programs, however, are not a subject of political debate in the state. This does not mean, however, that they are completely noncontroversial. Conflict of interests often prevails within an industry, and it is not unusual for producers and handlers or even different groups of producers to take different positions on the acceptance of proposed marketing orders.

The conflict of economic interests within an industry can be resolved, for administrative and operational purposes of marketing programs, through a voting procedure specified by legislation. But the conflict of economic interests among consumers, producers, and handlers cannot be resolved by that procedure. Consumers, as such, have no direct vote in the acceptance or rejection of marketing programs, although consumers do have a powerful and telling voice when they register their votes with dollars and cents at the cash registers of retail outlets. The legislation clearly specifies that consumer interests are to be represented and considered by the Director in his judgment and administration of marketing programs. The proposal that consumers be given an independent voice in the promulgation and operation of marketing programs is not heard as frequently in recent years as in the past. One may suspect, moreover, that such a proposal would not be given serious attention in light of the still remembered experience with the Consumers Council of the prewar Agricultural Adjustment Administration.

Marketing programs were not discovered in a social science laboratory, developed in a pilot economy, and brought into practical use only after perfection through market tests. On the contrary, the forerunners of the present marketing programs were put together and into effect under the pressure of current problems needing attention in a depression-ridden economy. Among early participants, agricultural economists are well familiar with the names--alphabetically: Elmer Braun, Chester Davis, Bud Holt, Bill Kuhrt, Si Smith, E. A. Stokdyk, Jessie Tapp, Howard Tolley, Fred Waugh, Harry Wellman, and Fran Wilcox.

During subsequent years, in considerable part through trial and error, marketing orders were developed in their economic, legal, and administrative dimensions into an articulate and flexible institutional organism.

Although marketing order programs now have various types of provisions, that of volume control has always attracted the most criticism. Yet, economists have continuously been aware of the double-edged features of volume control. Almost twenty years ago, Harry Wellman cautioned that, "Marketing control schemes which are designed to limit the total supply marketed for the season as a whole are . . . essentially a palliative and should be . . . used only in acute situations . . . to go beyond that is to court disaster."1/

Over the years various economists have attempted to introduce and develop rational economic consideration of long-run as well as short-run impacts of the programs. In order to understand fully the marketing programs institutions, economic analysis is necessary although not sufficient. Also necessary are phases of law, administrative science, statistical analysis, political science, social psychology, and perhaps a bit of psychiatry. It appears that economists will continue to work thus with marketing programs until the Ford Foundation produces full-blown "behavioral scientists."

As commodity groups work with marketing programs, considering but not always following the counsel of economists, the industry participants gradually learn economic principles and come to appreciate economic analysis. In some programs the industry participants have accumulated a rather sophisticated understanding of the economic principles involved. Such industry people may not use professional jargon, but they are learning the significant economic

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1/ Wellman, H. R., Controlled Marketing with Special Reference to California Fruits and Vegetables (Berkeley: University of California, College of Agriculture, Agricultural Experiment Station, November 16, 1938), pp. 9-10. Processed.

relationships. It may well be that in the long run the spread of "economic literacy" will prove to be the most significant result emerging from the institution of marketing programs. As Marshall has said, "Economic laws and reasonings in fact are merely a part of the material which Conscience and Common-sense have to turn to account in solving practical problems, and in laying down rules which may be a guide in life."