LIVESTOCK: POLICY ISSUES IN TRADE,

PRICING AND MARKETING

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Introduction

1. This paper surveys a sample of issues which government planners and policy makers face when confronted with the need to supply growing amounts of meat and dairy products to their domestic markets. In resolving these issues difficult policy choices must be made between import substitution and trade, between farmer income and consumer welfare, between fiscal restraint and government subsidies, and between public intervention and market forces. This paper addresses these policy tradeoffs. It also examines the validity of policy instruments such as price controls in the context of a market economy, and assesses organizational arrangements for marketing of livestock products in the light of the experience accumulated so far in developing countries. Finally, it identifies research priorities that could guide the development of trade, pricing and marketing policies.

2. The discussion of trade and marketing issues is preceded by a brief overview of production, consumption and trade of livestock and livestock products in Asian countries.

(i) Production: the overall increase in livestock population of 5 percent during the decade of the 70s (of which cattle constituted almost three fourths) was insufficient to keep pace with the increase in human population, let alone the increase in demand. However, this overall picture masks some spectacular increases such as Korea where beef and pork production increased 6 and 4 times since 1960 and Malaysia where the output of the livestock industry more than doubled over the same period, almost entirely as a result of the expansion of the pig and poultry sectors.

(ii) Consumption: except for Korea, and to a lesser extent for Malaysia, the per capita consumption of meat and dairy products remained stagnant or declined over the period 1960-1975.

(iii) Trade: meat imports remain unimportant overall, but some countries of the region i.e. Korea, Malaysia and the Philippines have started to import significant amounts (92, 16 and 12 thousand tons respectively in 1978). On the other hand, South East Asian countries have become large importers of milk products; in fact six countries (Philippines, Indonesia, Thailand, Malaysia, Singapore and Burma) import about a quarter of the world's trade in milk powder.

Domestic Production vs Trade

3. The realization of this increasing dependence on imports to satisfy domestic needs of meat and dairy products is disturbing to most policy makers, and despite the fact that most Asian countries could not engage in beef or dairy production that could be competitive with the
New Zealand or Australian industries, they overwhelmingly choose to cut down imports and boost domestic production in order to satisfy their country's growing needs. This first section assesses the validity of such import substitution policies.

4. The need to save foreign exchange is often advocated as a major reason to boost domestic production. But, while restricting imports is an effective way of dealing with foreign exchange constraints in the short run, the argument is fallacious in the long run if these countries have no comparative advantage in producing dairy and beef, or in other words if they could earn more foreign exchange than they save by diverting the country's resources from livestock or feed production into areas of greater comparative advantage (e.g. tree crops in the humid tropics). This is the case for most Asian countries.

5. A more powerful argument is the desire by most government to be self-sufficient in strategic commodities. As incomes rise and urban population grows, the demand for these highly income elastic products rises very fast and there is an understandable tendency to regard livestock products as strategic commodities. In Korea, for example, milk demand is expected to be 7 times greater in 1990 than in 1975, while the demand for rice will only be about 40% greater.

6. In the case of livestock products though, self-sufficiency is often illusory. This is the case, if the bulk of the feed stuff have to be imported, as in Korea where an estimated 70% of the nutrients required would have to be imported in order to meet domestic requirements in meat and milk products by 1990; or as in Malaysia where self-sufficiency in pig and poultry now requires more than US$200 million worth of feed imports. Hence, self-reliance is often not a defensible argument either.

7. The third major reason to increased domestic production of high value beef and dairy products, and the one which has prevailed in many developed countries, is the need to narrow the gap between farm and non-farm income. Despite the economic advantages of trade, EEC countries have protected their livestock industries at the expense of their urban consumers. Thus, over the past decade, European buyers have had to pay 1.5 to 5 times the world price for milk powder, and twice the world price for beef. The most notable examples of such protective policies in the Region are Japan where consumers pay about 8 times the world price for beef, and Korea where meat and milk prices average two to three times border prices. An increasing number of developing countries (Malaysia, Indonesia, Philippines) have also opted for increased domestic production and reduced trade.

8. It is important to recognize the social value of such protective policies. In Indonesia, for example, 20% of the population lives in urban areas and consumes two-thirds of total private consumption or many times the average rural income. The outlet for nearly all livestock products which reach the market is in urban areas where the demand for these products rises very fast. Therefore, there is a strong
case for attempting to satisfy the growing urban demand from even a highly protected but not directly subsidized local livestock industry, if this industry is concentrated in smallholdings, thereby realizing an income transfer from urban to rural areas.

9. The third Indonesian development plan includes considerable allocation of funds for a dairy program along these lines. This is also the strategy pursued for years in Korea where dairy development is based on small units of two to five animals per household. However, even on grounds of reducing income disparity between rural and urban areas, increased domestic production at any cost cannot be justified. Efficiency losses due to domestic milk production are of the order of 50% of the import price in the case of Indonesia and 100% in the case of Korea. Social benefit cost analysis with due regard to alternative sources of farm incomes would allow decision makers to make an objective assessment of whether the distributional benefits of such protectionist policies sufficiently outweigh the efficiency losses.

Producer vs. Consumer Welfare

10. A conflicting objective to that of protecting farm production and incomes is the desire to supply consumers with affordable dairy and meat products. In low and middle income countries urban consumers are more vocal than rural producers who do not have the political clout of organized producer groups in developed countries. Aside from the political motive, is the need to restrain increases in the cost of living in order to foster development of the manufacturing sector. An additional motive is the commitment by many governments to bridging the serious protein gap in the diets of the poor. For these reasons, while encouraging domestic production many governments also attempt to regulate prices of meat and milk products.

11. Consumer price controls are introduced as an attempt to help urban consumers at the expense of those who are thought to be making excessive profits out of the marketing process. In the same logic, it is wrongly assumed that lower retail prices, while resulting in lower profit for the trade, will not significantly depress producer prices. In reality the unavoidable effect of the long-term control of retail meat and milk prices at unrealistically low levels is that producers will not get the higher prices that would stimulate them to increase their output. Much different measures would be needed to effectively reduce marketing margins. This is discussed in a later section (paras. 26 and 27).

12. A further point that should be emphasized is the obvious one that price controls will not work unless governments intervene to balance out supply with demand at the official price, either by trade policies (increased imports in times of supply shortages, or export bans in times of surpluses) or by providing subsidies. In the absence of such measures setting prices at below market clearing levels will cause predictable problems. For instance, if official retail prices for meat and milk are too low in relation to free market prices, there will be
excess demand in relation to available supplies. The retailer is likely to react by cutting quality (e.g. adding scraps and bone to meat sale, or water to milk). Eventually only small amounts of meat and milk will be sold in official outlets, while the bulk of those commodities will be available on the parallel market at very high prices i.e. prices that reflect their actual scarcity plus a risk premium. Also, as mentioned above where official prices are controlled producers will be reluctant to produce. The original purpose of the price regulation is thus defeated. Meat is more scarce, consumer prices are higher, and profits are greater.

Fiscal Restraint vs. Government Subsidies

13. Where a major objective of government policies in the livestock subsector is to maintain producers' incomes and encourage domestic output, governments will often resort to subsidies in order to balance out supply with demand at the official price, rather than to trade policies which would depress producer prices. Subsidies may be provided in a variety of ways. In many countries subsidies on feed prices have been used to lower production costs and increase the incentives to raise livestock, thereby increasing supplies in the medium term. Alternatively, governments intervene in the market by procuring at one price and selling below cost. Thirdly, governments provide income subsidies, in order to increase the effective demand at the supported producer price.

14. Generally, however, subsidizing inputs has undesirable effects because it leads to wasteful use or it is ineffective. For example, supplies of the subsidized input may not be sufficient, with the result that the actual input price is higher than was intended. Government direct intervention in the marketing of livestock and livestock products also suffers from numerous problems which are discussed in a later section (paras 18 and 19), and which can all be traced back to the fact that extreme inefficiency does not ensure the disappearance of a public enterprise. Finally, given the drawbacks of other alternatives, income subsidies are generally regarded as more effective and less market distorting.

15. Overall though, most countries in Asia with the possible exception of oil producers such as Indonesia and Malaysia, cannot afford the luxury of subsidizing consumption of expensive dairy and meat products across the board, nor is it unequivocally desirable on social grounds. Across the board subsidies of food would be desirable only if these products were largely consumed by the poor, or if the poor constituted a very large proportion of the beneficiary population. Clearly these two qualifications do not apply to consumption in urban areas of high value items such as milk or meat. In fact, in Asia, milk and meat are not part of the diet of the poor and even at subsidized prices they remain luxury items for lower income groups.

16. The right policy is targeted assistance to the most vulnerable groups, by issuing subsidized rations to them, while the full
cost of domestic production and marketing of those products is passed on to the consumers at large. Meat being a much less cost effective source of protein, such targetted schemes should be limited to milk, which is available at low cost on the world market, and which is likely to benefit primarily children who need protein most. It should be further noted that subsidized milk distribution schemes do not make economic sense to countries that are calory poor, since milk is a very expensive source of calories. In such cases subsidized foodgrain programs should be given priority. It has been observed that in very poor countries (e.g. Sri Lanka) some beneficiaries of cheap milk distribution programs will in fact resell their milk ration to buy traditionally preferred and more calory rich food.

Public vs. Private Marketing Enterprise

17. Governments set up public marketing agencies to deal with the following problems:

   (i) to run a welfare scheme,

   (ii) to provide services which the private sector does not provide, or seemingly provides at too high a cost.

In major producing countries public boards have also been established to provide a degree of income stability for producers faced with price risks. But this is not an important consideration to East Asian countries where livestock is more often a sideline farming activity.

18. Whatever the objectives of government intervention, the general experience of public marketing agencies in livestock and livestock products throughout the developing world has not been encouraging. Numerous problems have arisen. First, public enterprises which have heavy overhead costs operate on a higher margin than middlemen in rural areas. Small, labor-intensive private enterprises have competitive advantages in collecting milk or assembling livestock from scattered producers, partly because they benefit from flexibility in operations, close managerial control and on-the-spot decision making. Second, livestock and meat marketing calls for professional skills and knowledge of the trade which are not easily acquired by public enterprises. Third, while the size and resources of public agencies lend themselves better to large scale operations such as wholesale marketing and processing, in practice, they are inefficient because they operate in an environment largely devoid of competition.

19. The final and most intractable problem is the lack of authority, lack of incentives and lack of independence of most public enterprise managers. Typically, governments keep a heavy hand on the running of state enterprises, especially with regard to price setting, staff appointments and salary levels. For instance, the flat price system, which governments often prefer as appearing more equitable to milk producers in all areas, involve national dairy boards in heavy losses on milk purchased and transported from distant areas, besides
encouraging uneconomic milk production in unsuitable locations. In Sri Lanka, for example, for some years panterritorial pricing at the farmgate, coupled with government ceiling on the Dairy Board's selling price made it impossible for the Board to cover its costs. Rapidly increasing annual losses had to be underwritten by a general subsidy. With regard to staffing, the public organization will often be under pressure to provide exaggerated number of new jobs and to accept senior staff who may be unqualified for their duties. Turnover of senior staff is also high. For instance the milk schemes in Lahore had five successive managers in its first three and a half years of operations.

20. Because of these comparative disadvantages, marketing and processing margins which should have been reduced by public intervention, tend up increasing, sometimes dramatically, and shortages appear in the market. The agencies budget falls systematically short of operating costs, and despite huge and rapidly increasing government subsidies, operations remain hopelessly unprofitable, thus destroying any remaining incentive for efficient operations.

21. Given this unfortunate record, it appears that direct public intervention in the marketing of livestock and livestock products is not an efficient way to provide better marketing services, or even to run a welfare scheme. In the event that governments nevertheless choose for political reasons to set up state marketing agencies, problems can be minimized if the welfare and commercial objectives of the agency are clearly distinguished. Governments should direct state agencies to run the welfare scheme (e.g. supplying milk at low prices to ration shops) as their agent, and should pay them the full cost of the operation. Other operations not classified as welfare ought to be handled on normal commercial lines.

22. In most cases though, governments should be encouraged to seek alternatives to public sector marketing enterprises in order to improve the marketing of livestock and its products. If the private sector is unable to provide adequate marketing services, governments should make it worthwhile for it to do so, by providing better infrastructure, and a better policy environment (e.g. price and tax policies). It may also be that under any circumstance it would be uneconomical for the private sector to provide the required services. In such cases, provision of these services should be considered as welfare and dealt with accordingly (see above para 21). If the private sector provides the required marketing services but at too high costs, governments can take measures to reduce gross and net margins without intervening directly. This issue is reviewed in the following section.

Reconciling Consumers and Producers Interests by Reducing Marketing Margins.

23. Livestock and Meat. The assessment of traders' margins and profits is difficult, because prices are not usually related to defined weights and standards of quality, and because livestock traders are apt
to be secretive about their operations. Very little systematic work has so far been carried out in Asian countries on this subject. Nevertheless from the few studies available in Asia and around the world it is clear that planners and policy makers often underestimate the full costs of marketing operations because transport distances and the difficulties of movement as well as the cost and difficulty of holding livestock and storing meat are not sufficiently appreciated. Also, they tend to overestimate net profits because quality and weight losses, risks, and financial charges are insufficiently recognized.

24. Nevertheless, especially in an outmoded and fragmented marketing system, traders may actually be in a position to take too large a margin for their services i.e. profits in excess of opportunity costs of the management and capital they put in. This happens when a local trader deals with producers who have insufficient knowledge of market prices and a limited choice of buyers. It may also happen at the wholesale stage of marketing where large scale operations are possible and a few important traders may control the market and form a ring.

25. Notwithstanding the lack of detailed knowledge of marketing margins, one can safely recommend measures that would reduce existing margins; either by increasing the efficiency of the system or by placing the farmer in a better bargaining position via a vis the trader.

26. In order to improve the efficiency of the system, government should provide or stimulate the provision of better infrastructure, such as improved transport facilities to reduce time delays and associated death, weight losses and deteriorating quality; or such as small market places to cut down the assembling costs. The government of the Philippines for instance has organized 40 country livestock markets in recent years. Keeping in mind that quick turnover is vital to the profitability of trading operations, Government should also review existing legislation which may place illegitimate costs and inhibitions on the marketing systems (such as quarantine and transport regulations).

27. In order to place the farmer in a better bargaining position vis a vis the trader two conditions should be satisfied: (a) that dealing is largely done on open markets so that current prices are better known, and (b) that there is relatively free entry in the trade. Here again it should be emphasized that public ownership is an inappropriate answer to excessive marketing margins since it limits entry in the trade. Thus to defend producers' interests, the following measures suggest themselves:

(i) establishing accurate and timely market information services. Use of the media is an effective way of delivering information on market prices. In most Asian countries, these specialized marketing facilitating services for livestock and meat are practically non-existent or have reached only a rudimentary stage; and
(ii) Foster competition among traders and thus give the farmer alternative marketing channels. In this respect it is important that legislation that limit entry in the trade be reviewed. Licenses to trade livestock and to operate slaughterhouses, and zonal restrictions on the transport of livestock have too often been abused and have served to give monopolistic powers to few selected traders. The Thailand market for cattle and pigs is a case in point.

(iii) The creation of farmers' cooperatives is also a popular proposal to improve the bargaining position of small farmers. However, with few exceptions it appears that hardly any livestock and meat marketing cooperatives in Asian countries have succeeded in operating as a fully viable concern either financially or institutionally. Meat marketing is a difficult business. The commodity is highly perishable, difficult to standardize and the market supply situation fluctuates strongly from day to day and from week to week. It has proved difficult to find a sufficient number of qualified managers to operate in a marketing system for such a difficult commodity. Hence numerous constraints on the development of effective farmer cooperatives for livestock and meat exist, which in most situations prevent them becoming competitive with established private traders.

28. Dairy. As indicated earlier the traditional trade in dairy products is efficient and competitive. However, it also has shortcomings in terms of hygiene, and more importantly in terms of scale of operation. Large modern dairy industries need to be established in order to supply the needs of rapidly growing urban populations.

29. In most Latin American Countries, milk schemes have successfully been developed under private management. In Africa and Asia, however, private enterprises are not prominent in this area of business and many major milk schemes are part of the public sector development programs. But in a few cases such as Korea and India large milk schemes have been successful on a cooperative basis. In Korea milk supplies for Seoul have been rapidly developed through the Seoul Cooperative Milk Scheme, and the Indian Amul system in one of the world's poorest countries is one of the most widely acclaimed milk cooperative. In developed countries as well, from Scandinavia to New Zealand large modern dairy industries have been largely developed on a cooperative basis.

30. From that record it is clear that cooperation among milk producers in collection, storage, transport and processing give special advantages and incentives to efficiency, especially where dairying is based on small scale farming and provided good management is assured. The first stage is the formation of simple cooperatives based on collecting centers. The ultimate aim is that these village units will coalesce into large cooperative unions capable of acquiring and managing their own plant.
31. Thus, perhaps developing countries should adopt the Scandinavian view that, in dairy development the cooperatives are "the only way" to satisfy consumers' needs for large quantities of reasonably priced dairy products while meeting the objective of giving producers a fair price.

32. Topics for Research. In order to guide the development of trade, pricing and marketing policies for the livestock subsector, attempts should be made to monitor and evaluate the effects of government interventions in the market of livestock and its products on the patterns of production, consumption and income distribution. The central issues which the research should address are briefly outlined below:

(a) What are the prevalent kinds and what is the extent of government intervention?

(b) What are the theories and goals which underlie the interventions?

(c) To what extent are actual interventions in harmony with stated objectives? and to what extent are interventions reinforcing or conflicting?

(d) In the short and long-run how do interventions affect:

(i) producers' incentives and supply responses;

(ii) resource allocation;

(iii) employment;

(iv) income distribution;

(v) public savings;

(vi) trade;

(vii) how to solve the conflict between cheap food for the poor and fair prices for the farmers?

33. The findings of the research would allow policy makers to anticipate the effects of manipulating various policy tools such as administered prices, taxes, subsidy, direct market intervention, etc., thereby providing an objective basis on which to decide the most appropriate set of policies. In the absence of such policy studies, livestock intervention measures will continue to develop haphazardly as a result of various pressures, and frequently will have little coherent rationale, and internal inconsistencies and conflicts.