TOWARD A NEW EUROPE: OBSERVATIONS ON ECONOMICS AND THE FOOD SECTOR

Dennis R. Henderson
Ohio State University

My brief comments draw on recent experiences at Ohio State University (OSU) as some of my colleagues have prepared to conduct economic and commercial business education in Eastern Europe, specifically Czechoslovakia, and observations by the World Food Systems research group's task force on EC 1992 regarding implications of completion of the EC single market initiative for U.S. food industries.

Economic Education in Eastern Europe

An initiative has been mounted by OSU to assist Eastern European universities with the development of courses and faculty expertise relevant to the evolution of those countries from centrally planned to market economies. The Department of Agricultural Economics, the College of Business, and the Center for Slavic and East European Studies have provided leadership, and advance teams of faculty and administrators were in the region during the spring and summer, 1990. The most extensive initiatives to date have been in Czechoslovakia, where, beginning in late September, members of the OSU faculty are lecturing and conducting university short courses.

It is instructive to examine the subjects in which lessons were being put together as faculty prepared to go to Czechoslovakia this fall. This gives us some insight into the perceived needs for economic and business education.

Much emphasis has been on basic economic principles — concepts such as supply, demand, how prices are determined and discovered, and the functions of organized commodity exchanges. A major concern appears to center on developing both conceptual and operational understandings of how firms treat price and output as strategic decisions. Related to this are the selling functions — how firms go about identifying potential buyers, determining what and how much they will purchase, and at what prices. Logistics of product distribution and traffic management are also prime subjects. By contrast, relatively little attention has been given to production economics or plant management.

Implicitly, this subject matter emphasis suggests that Eastern Europeans have a pretty good grasp of optimization and management principles regarding how to utilize available resources to meet known output goals. But, they less well understand the processes of determining what should be produced and how to get it to buyers. In short, a principal need seems to be to develop a working understanding of how enterprises function within the discipline of market demand and supply costs. As every economics instructor knows, these are concepts that even many Western students, who have functioned as part of a market system as a birth right, have a difficult time grasping.

We need to be cautious, therefore, in projecting the speed with which such concepts will be understood, much less operationalized, by the many Eastern Europeans whose entrepreneurial drive must be harnessed in order for these countries to emerge as full-fledged competitors in the global world of commerce.

Food Industry Implications of EC 1992

A task force of the World Food Systems Research project, NC-194, has been examining the implications of market unification in the European Community countries for the food manufacturing industries and other parts of the agricultural and food sector. Analysis is in early stages and no definitive answers are yet in hand. Nonetheless, a sense of the nature of some more likely impacts is beginning to emerge.

Our assessment rests in part on an assumption that the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) negotiations will be successful in terms of furthering the development of a global market. This is not to assume that barriers to international trade will fall away entirely; more that national boundaries will continue to become incrementally smaller restraints on the movement of goods and services.

Macroeconomic analysis done for the EC Commission indicates that the combination of market rationalization and economies of scale and size brought about by the merging of twelve separate national economies into a single market will result in an appreciable increase in national or Community-wide income. The value of aggregate EC gross domestic product has been projected to show a one-time increase of 5 to 7 percent. However, primarily because of the low income elasticity of demand for food relative to other goods and services in high-income countries such as those in the EC, the aggregate increase in demand for food is expected to be much smaller — perhaps more in the range of 1 to 2 percent. Thus, for the food sector, the growth impacts of completing the single EC market initiative look to be minor.

Much of our assessment, therefore, has focused at the microeconomic level, with particular attention to the organization of firms and industries. As a general observation, there appear to be two major categories of food manufacturing firms: (1) dominant global firms and (2) a localized fringe. The former are large entities that tend to operate simultaneously in a number of geographic and product markets, with numerous transnational commercial ties such as wholly or partially owned foreign subsidiaries, licensing arrangements and joint ventures, as well as product sales across national boundaries. Examples of such firms include the Philip Morris/Kraft General Foods/Suchard combine, Unilever, Nestle and Kellogg. These firms view their theater of operation in a global context, with national boundaries little more than convenient definitions of managerial territories and sometimes-troublesome barriers to the smooth flow of capital, labor, inputs and/or products. They benefit from economies of size, scale and scope, and typically hold dominant market shares in several product lines in different local, regional or national areas, although in any given market they may not own the leading brand.

Many of the dominant global firms are U.S.-based. Indeed, twelve of the twenty largest food manufacturers operating in the EC are so-called U.S. firms — Pepsico, Heinz, Sara Lee, Campbell Soup, and CPC International to mention a few. However, nationality doesn't have much practical meaning. Their stockholders can be found around the world and they are involved in a seemingly endless process of acquiring, investing in, merging with and/or divesting operations in virtually any country where such behavior fits into their global strategy.

On the other hand, the localized fringe is made up of somewhat smaller firms that operate primarily within a specific product and/or geographic market. Often these firms make across-border sales, but as an adjunct to domestic operations. That is, their strategies tend to be oriented to local, regional or national markets. In many cases, these firms hold leading brand positions in their specific product and/or geographic market. Frequently these are niche or specialty markets, but sometimes regional markets for highly perishable products such as milk and baked goods.

We expect that the process of creating a single EC market through the removal of internal border restrictions such as different standards of product identity and harmonization of product testing and inspection procedures will allow, indeed encourage, some of the larger and more aggressively managed food manufacturing firms in EC countries to expand their operating theater from a national to a Community-wide basis. That is, more European firms will become pan-EC operations, competing with existing dominant firms. The share of leading EC food manufacturers with a U.S. "home" will decline, and the ranks of globally oriented firms will increase. The number of firms in the localized fringe, whether in the EC, the United States, or third countries, will inevitably decline as the competitive pressure and acquisition activity of the larger, global-directed firms intensify.

In the end, both the national interests and national orientation of the prevailing food manufacturing firms will diminish. Thus, the EC 1992 process looks to enhance the global characterization of the food manufacturing industries. This means that our foundation for economic analysis, and indeed for public policy toward the food sector, must also shift from a parochial, national orientation to a truly global perspective.