



Research paper

On the power and influence of the cooperative institution: Does it secure competitive producer prices?

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ABSTRACT

Institutional marketing plays key role in improving the economic incentives of smallholders to enhance their market participation and commercialization. Such incentives derived from marketing cooperatives include indirect benefits such as reduction in transaction costs arising from participation in imperfect factor and product markets. However, whether marketing through cooperatives also creates direct economic benefits as additional incentives by securing competitive producer prices is not empirically established in the relevant development literature to augment related policy debates and to rationalize investments on such institutions. Using a farm economic model on producer price data taken from Ethiopian smallholders who produce sesame as a traditional cash crop, this paper empirically tested the power and influence of the cooperative institution on the level of producer prices received by farmers. The results show the instrumental role of marketing cooperatives in terms of securing competitive producer prices to farmers. The evidence provides empirical support to justify the desirability of revitalizing institutional marketing schemes as appropriate mechanisms to improve the economic incentives of smallholders for better market participation and commercialization towards poverty reduction.

1. Introduction

Achieving poverty reduction and food security goals in the developing countries, including goals of the 2030 Agenda dubbed as “Sustainable Development Goals (SDGs)”, requires institutional innovations that improve smallholder productivity and market linkage (UN, 2015; World Bank, 2008). Collective marketing schemes such as cooperative marketing provide important institutional mechanism to improve farmers’ economic incentives for market participation, which eventually can lead to poverty reduction and food security. Reduction in transaction costs associated with farmers’ participation in imperfect product and output markets is one of such economic incentives, albeit indirect, that can incentivize farmers to continuous and increased use of improved production technologies to enhance agricultural productivity as a source of output growth, rural development, poverty reduction, and food security (Markelova, Meinzen-Dick, Hellin, & Dohrn, 2009; Poulton, Dorward, & Kydd, 2010). However, empirical evidence on the direct economic incentive creation role of such institutions through securing competitive producer prices to farmers is rare and inconclusive (Eastham, 2014; Morgan, 2008). This becomes an important caveat in policy debates to persuasively argue in support of investments and

promotional efforts that sensitize the revitalization of cooperatives as important institutional mechanisms fostering rural development and poverty reduction (ILO, 2014).

Agricultural marketing cooperatives in the developing countries are praised for playing crucial roles in terms of allowing farmers to participate in and take advantage of market opportunities and developments (Bacon, 2005; Varangis, Siegel, Giovannucci, & Lewin, 2003). However, the mixed nature of the marketing practices of farmers makes it uncertain whether agricultural marketing cooperatives play a competitive yardstick role to secure better producer prices to farmers to. Some farmers, while having access to cooperatives, sell their products to traders (Mujawamariya, D’Haese, & Speelman, 2013), instead of selling to cooperatives. This makes it dubious whether farmers loss any meaningful economic benefit by not selling to cooperatives. On the contrary, it is a common practice for non-member farmers to sell their products to cooperatives (instead of selling to traders) though it is not well known whether their motive is necessarily to secure better prices by so doing (Getnet & Tsegaye, 2012). Thus, empirical investigation of the price incentive creation role of cooperatives becomes relevant both from a theoretical and a policy making point of view due to lack of adequate explanation to such fuzzy actual marketing practices of farmers.

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IFPRI (2005) suggests the need for making empirical assessment on whether marketing cooperatives help to secure better producer prices to smallholders. Some empirical studies investigating the links include Sauer, Gorton, and White (2012) who modeled the determinants of farmgate milk price in the dairy sector of selected countries using cooperation as one of the possible explanatory variables. Morgan (2008) modeled the pricing behavior of coffee cooperatives and private intermediaries in Guatemala to understand whether smallholder coffee farmers benefit from cooperatives by receiving competitive prices.

This paper investigates whether marketing cooperatives, which recently experience renaissance as institutional responses to the market competition problems posed by liberalization and globalization and as arrangements whose services can be easily accessed by most of the rural poor, have the power and influence to secure competitive producer prices to farmers as an economic incentive. The main purpose is to empirically investigate whether promoting such institutional innovation is justifiable from the perspective of improved producer prices as economic incentives that enhance smallholder market participation and commercialization. Section 2 provides an overview of the role of the cooperative institution in rural development. Section 3 discusses the analytic method. Section 4 discusses the results of the study and Section 5 concludes by summarizing the main findings.

2. The economic role of the cooperative institution: an overview

Improving the productivity and market linkage of smallholder agriculture in developing countries is widely accepted as the engine for rural growth, providing a pathway to lift a large number of the rural poor out of poverty and hunger (Anríquez & Stamoulis, 2007; Hazzel, 2005; IFAD, 2011; World Bank, 2008). Supported by the appropriate policy, infrastructure, and institutional environment, smallholder market linkage improves farmers' economic incentives to adopt productivity enhancing technologies and to generate income for poverty reduction. Promoting smallholder commercialization needs appropriate institutional innovations to reduce transaction costs and risks to make it possible for farmers to generate adequate economic incentives. However, mainly impaired by institutional underdevelopment, smallholder productivity and market linkage in the developing countries are not significant hitherto (de Janvry, Sadoulet, Mcintosh, & Rosada, 2007; Obare, Shiferaw, & Muricho, 2006). Such trends slowdown the pace of smallholder commercialization and rural poverty reduction, suggesting the compelling need to create an enabling institutional and organizational environment to support smallholder market linkage in the framework of achieving the SDGs.

Cooperatives and other forms of collective marketing schemes provide appropriate institutional mechanism to improve economic incentives for smallholder market participation (Markelova et al., 2009; Ouma, Jagwe, Obare, & Abele, 2010). They do so by pooling risks, by increasing bargaining power, and by providing market information and by reducing transaction costs (Chowdhury, Asfaw, & Torero, 2005; de Janvry et al., 2007; DFID, 2010; Holloway, Nicholson, Delgado, Staal, & Ehui, 2000; Lopes, Santos, & Teles, 2009). Such a role of cooperatives is well-established in the development literature (Chowdhury et al., 2005; Holloway et al., 2000; Reardon, Barrett, Julio, & Swinnen, 2009; Staatz, 1987; Valentinov, 2007). Moreover, cooperatives are considered useful to make smallholders (as members) worthy business partners for the market actors operating down the agricultural market supply chain. This is because cooperatives pool products from individual farmers to create scale economies (unit transaction costs become low)¹ and provide an institutional entity, on behalf of farmers, to make binding and enforceable contracts with (Holloway et al., 2000). Such roles bestowed

¹ It is expected that search costs, bargaining costs, monitoring costs, transportation costs, and risk become low to the advantage of both the farmers and traders when products are pooled through cooperatives.

cooperatives a special institutional importance, especially during the era of market liberalization and globalization, to promote smallholder market linkage and commercialization (Shigetomi, 1992).

Economic theory of cooperatives such as the competitive yardstick school (Cotterill, 1984; Levay, 1983) label cooperatives as competitive ideals setting a pace of competition that assures efficient services at true costs and benefits. This includes setting and paying fair prices for the products of their service users. Accordingly, cooperatives can also be considered as institutions that secure competitive producer prices as economic incentive to their service user farmers to promote market participation and commercialization. Since benefits from competitive product prices are direct and more visible for service users than benefits generated in terms of reduced transaction costs, empirically establishing and asserting such a role of the cooperative institution becomes relevant for advocacy in sensitizing the revitalization of cooperatives and other institutional marketing schemes among smallholders.

However, evidence about the role of cooperatives in linking farmers to markets is mixed as there are varying levels of success in the past (IFPRI, 2005). Bernard, Alemayehu, and Eleni (2008) and Francesconi and Heerink (2010) found that producer cooperatives have smallholder commercialization impact with potential contribution to agricultural production and marketable surpluses in rural areas. Gideon, Davis, Ulrich, and Felicity (2007) underscore the importance of producer organizations in terms of enhancing members' returns from local and international market participation, including markets for traditional cash crops. In contrast, Barrette and Mutambatsere (2005) and Maghimbi (2010) argue that cooperative systems have not lived up to expectations in most developing countries. Such limitations often stem from problems related to weak management and rent-seeking behavior of members. Akwabi-Ameyaw (1997) mentions how producer cooperatives are made unproductive by the organizational culture in which leading members seek individual self-interest and private gain.

3. Method for empirical analysis

3.1. Modelling approach

According to standard farm household economic models, farm households are production and consumption units maximizing utility (and profit) from the production and consumption of a set of commodities, subject to cash and technology constraints (de Janvry, Fafchamps, & Sadoulet, 1991; Singh, Squire, & Strauss, 1986). Such models recognize the important role price plays in the production, marketing, and consumption decisions of farm households (Hazzel, 1988). Through such decisions, the price of farm products affects the supply response, income levels, and poverty dynamics of farm households.

In this paper, it is hypothesized that the level of price (and income) received by farm households is endogenously determined by the institutional environment in which the farm households operate. Whether farmers sell their products through local assemblers and/or through traders as traditional market institutions or through cooperatives as collective marketing schemes makes a difference in terms of producer price levels received by farmers. The empirical analysis in the paper tests the validity of such hypothesis using farm level data collected from Ethiopian smallholders who produce and sell sesame as a traditional cash crop. We used a farm income model with survey data collected across 81 sample farm households in Diga district (western Ethiopia) to empirically test the power and influence of cooperatives (as institutional marketing channels) on the level of producer prices received. The analysis is based on the instrumental variable estimation technique in which a two stages least square estimation technique is used to test whether cooperatives play an instrumental role and influence producer price, which is treated as an endogenous explanatory variable. Evidence on endogeneity of producer prices to cooperatives can lead to the conclusion that cooperatives play institutional role to secure competitive prices to smallholders.

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