B3

Impact of Value-Based Marketing on International Trade

Lon Hatamiya, Administrator, Agricultural Marketing Service, U.S. Department of Agriculture

I am honored by the invitation of this distinguished group to participate in its symposium on the significance of value-based marketing in international trade. I am not a meat scientist, but a farmer. Before my appointment to administer the federal agency that sees to the quality of much of the food and fiber produced in the U.S.A., the Agricultural Marketing Service, I was growing nuts and fruits in northern California. The perceptions I share with you today reflect my experience at AMS, in food production, and international trade.

Value-based marketing -- transferring quality and price information from consumer to producer -- is about a decade old in the U.S. meat business, and still has not reached the production sector of that business. U.S. livestock are still sold primarily on a pen-averaged basis, with no price distinction between the superior and inferior animals.

This system offers no economic incentives to reduce overproduction of fat. It offers no penalties for a shortfall in quality; that is, in the sense that retailers, and ultimately, consumers, perceive quality. It makes for very wide yield and price differentials down the packing line, with packers having losses coming from animals not dressing out as well as the market desires, and with packers ultimately discriminating against such live animals. That results in the cost of production per pound of quality beef being higher than it should be. As a result, per capita consumption of beef falls because consumers do not want to pay for fat. They want value for their money, and value as they see it is lean meat that is tender, flavorful, and economical.

In summary, meeting the demands of the consumer is value-based marketing. It keeps -- or should keep -- products consumers reject off the retail market. Value-based marketing also has a predicate: it has consequences for production. I suppose you could call that predicate "value-based production," where one invests capital in producing what the market wants. That means culling and breeding with the consumer in mind. It also means having a price discovery system that communicates price signals of what sells, sending those signals all the way up from the retailer to the producer via six or seven market sectors.

Value-based marketing is old hat in the produce business, where at least ever since the inception of federal fruit and vegetable marketing orders 60 years ago low-graded product did not proceed through the wholesale route to retail at all. Rather, the lower graded product -- that is, the product which consumers rejected but which was otherwise wholesome -- ended up as juice or paste. Way back in 1933, we had an Export Apple and Pear Act, which allowed only our best apples and pears to be exported in volume. That was value-based marketing.

It is ancient stuff in the turkey business, where for the past 50 years, birds have been bred to yield white meat, which the public wants.

The U.S. tradition of pricing and grading carcasses at the packinghouse may partly account for delaying inception of value-based meat pricing of live animals here, and may be responsible for the packers passing on meat that was not always received well in the showcases. Advent of boxed beef in the 1960's initially just repeated their habits. In the beginning of boxing, the pack would be a run of mixed subprimals to anywhere trimmed from a quarter of an inch to up to an inch of external fat. As consumers rebelled against fat, boxed beef began to be trimmed leaner at retail. This economic signal is now being transmitted to packers and producers, whether that signal originates in Tokyo, Chicago, or Paris.

Boxing meat is not all there is to value, if you define value as what customers desire. Size of box, strength of internal plastic containers, even predictable markings on the box all figure into the term "value."

The greatest part of value is quality. What defines quality? Normally, we in the U.S. say "grade" and "specification." We have grades for practically everything -- meat, poultry, eggs, fruits, vegetables, tobacco, grain, cotton, wool, dairy products, legumes, and live animals. They facilitate contracting, dispute resolution, and dissemination of market information. And for the grades we have standards.

However, standards alone do not make for quality all along the production chain in the meat business, so we at AMS are developing a new service called a "Quality Systems Certification Program" which will enhance dissemination of customer signals throughout the marketing chain.

For firms signing on with us we would verify their quality management systems and, should they wish, their products, auditing them against the standards they themselves set. As part of the program, we would offer technical consultant support to assist the firm in developing its standards and in meeting the goals of accreditation. Benefits for the firms would be the benefits of any accreditation system: assurance to those purchasing the firm's output that the firms' products live up to their claims. The program applies the principles of ISO 9000.

Like our grading programs, the new program will be voluntary and fee-based. It should assist buyers abroad in purchasing exactly what they seek, assuring them that they will receive what they order. It will help reduce quality shortfall and prevent problems before they occur. It will work like a Hazardous Analysis Critical Control Point (HACCP) system, looking at quality checkpoints all the way from production to retailing. Certified members of the program will have demonstrated that they are breeding for value, selling only valued animals, packing only valued cuts, and shipping only what the customers want.

Other countries have their own grades and standards. With the significant rise of international trade in most agricultural products, countries recognize the need to harmonize those standards. Recognizing that need is one thing, and fulfilling it is another. Cotton is an example of the paradox. Since 1922, cotton buyers in most countries accepted the International Cotton Standards Act, which adopted existing U.S. standards. In the past several years, cotton-producing countries have raised the issue of revising them. Countries have vested interests in their own standards. Those standards distinguish their products in the marketplace. Nonetheless, if they are to trade, they will need a common trading language to facilitate contracting.

Partners in regional free-trading blocks such as NAFTA also are working on harmonizing standards within their regions. Meat standards are among those, and the challenge wrought by the world's move to "value-based" meat trade is an important component in development of these standards.

The United Nations -- Economic Commission for Europe (UN/ECE) beef and pork standards being developed contain general requirements facilitating trade and protecting sovereign voluntary standards of member countries. The key instrument to achieve these requirements is the International Article Numbering coding protocol, Code 128, or universal bar codes. In the U.S., the coding system is managed by the Uniform Code Council, or UCC. Meat standard harmonization rests on two items in the universal bar code protocol. One, "Application Identifiers for Shipping Containers," fully describes meat products, and is useful to meat buyers, who expect to find that code on boxes of beef they buy. The other is "purchasing option" data, which identifies a third party who can verify that the terms of the purchasing contract have been met. These two items should practically obviate the possibility of meat grading standards being a trade barrier. Nations will have to be willing to agree to use these two bar code items, however.

World Trade Organization (WTO) provisions call for use of international standards where they exist and for harmonization and equivalency of voluntary quality standards for products. The next five years will see organizations like UN/ECE and Codex Alimentarius attempting to comply with these provisions.

Trading in value-based boxed meat will most likely apply those provisions. With boxed meat becoming the trading standard comes a change in the kind of market information the meat industry needs. Carcass reports or even live animal reports may not be superseded by boxed beef reports, but boxed beef reports will probably be more significant than the others. Universal trading language will facilitate collecting and disseminating market news internationally. Underlying all of this will be one axiom: who best satisfies customers can export most. In that satisfaction will rest the ultimate definition of "value-based," and given differences in tastes there will be different concepts of value, country by country.

By virtue of three quarters of a century of experience in grading, standardization, certification, the Agricultural Marketing Service participates actively in international efforts to harmonize grading standards and to set special standards to account for differences in what countries find desirable. At the same time, we expect to maintain the integrity of our marketing language. We are eager to facilitate world trade, and we invite cooperation with individuals and agencies interested in that goal.