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Journal of Development Economics 71 (2003) 417–433

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JOURNAL OF
Development
ECONOMICS

Vertical price leadership on local maize markets in Benin

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Received 1 May 1999; accepted 1 July 2002

Abstract

This paper considers vertical price relationships between wholesalers and retailers on five local maize markets in Benin. We show that the common stochastic trend and the long-run disequilibrium error must explicitly be considered to correctly interpret the restrictions on the error-correction structure in terms of economic power in the channel. Interesting differences between markets are found. In the two major towns, retailers play a more prominent role in the price formation process than generally assumed in the literature on development economics. In the two larger rural centers, however, wholesalers involved in arbitrage among urban markets do influence price formation.
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JEL classification: C32; D40; L10; O18; Q13

Keywords: Vertical price leadership; Marketing channels; Cointegration; Common stochastic trend; Benin

1. Introduction

In the literature on industrial organization, retail prices are often assumed to be determined by wholesale market conditions (see, for example, [Tirole, 1988, Chapter 4](#); [Martin, 1993, Chapter 12](#)). Likewise, in the marketing literature on the functioning of food markets in tropical countries, the vertical price leadership of wholesalers is often conjectured but not empirically tested. In contrast to the vertical case, much empirical

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research on spatial price linkages between agricultural commodity markets in developing countries is available (e.g., Ravallion, 1986; Baulch, 1997; Badiane and Shively, 1998; Kuiper et al., 1999; Abdulai, 2000). Most studies on spatial price linkages focus on two issues: are markets integrated and are prices dominated by a central market? Most results confirm that markets are competitive and integrated, although less than perfect. Transaction costs hamper market integration and not all spot markets perform equally well. Moreover, as Baulch (1997; pp. 478–479) rightly points out, “market integration does not itself, however, imply that food markets are competitive. The spatial arbitrage conditions are also consistent with such oligopolistic pricing practices as basing point pricing (Faminow and Benson, 1990)”. Consequently, tests for market integration should also be accompanied by an investigation of the wholesale–retail price relationship in order to assess the power of wholesalers being involved in spatial arbitrage. Accordingly, we want to draw attention to the wholesale–retail price relationship. Can we find evidence for vertical price leadership of wholesalers or do they lack the market power to impose prices on local retailers? To put it differently, can we find some empirical support for the popular complaints regularly expressed by retailers and local market authorities about the market power of wholesalers?

Looking at the Benin maize market, Lutz (1994) found that retail and wholesale price series in the same market place cohere, which implies that retail margins are stationary. This result suggests that retailers are indeed passive decision makers, following wholesale prices without taking local supply and demand conditions into account. However, other evidence provided by a survey among traders does not support this conclusion and shows that a large number of wholesalers supply the urban market from different surplus regions, while urban retailers actively search for wholesalers proposing the lowest price (Lutz, 1994). Moreover, in rural areas retailers can choose to buy either from wholesalers or at the farm gate. Buying directly from farmers may provide retailers some freedom to set prices. Consequently, it is not a clear matter whether wholesalers or retailers or both have some market power and are able to influence price formation.

In an earlier study on price arbitrage in the wholesale segment of the maize market, we concluded that all wholesale markets played a role in the price formation process (Kuiper et al., 1999). None of the price series of any of the wholesale markets were found to be dominant: all price series were interdependent. The arbitrage process corresponded to a network with a number of interdependent wholesale markets; there were no autarkic markets and transportation costs did not show a stochastic trend. The study, however, did not incorporate the price series observed on the retail segments. In the present paper we focus on this omission, questioning the relationship between prices in wholesale and retail market segments in various markets for the same sample period as in Kuiper et al. (1999). The questions we set out to answer are: is there a difference in wholesale–retail price relationships in towns and rural centers, and is there any evidence for wholesale market dominance vis-à-vis the retailers?

Most studies on vertical price relationships published to date in marketing and industrial organization (see, for example, Gerstner and Hess, 1991; Lee and Staelin, 1997 and the references they cite) have used comparative statics to study channel behavior; the long-run relationships derived have not been empirically tested. Our

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