The 2016 Economic and Product Market Databook for Bolzano/Bozen, Italy

Description: This study covers the outlook for products and services in Bolzano/Bozen. Estimates reported are given for the latent demand, or potential industry earnings (P.I.E.), for Bolzano/Bozen across hundreds of categories (in millions of U.S. dollars) and of the region and of the globe. These comparative benchmarks allow the reader to quickly gauge a Bolzano/Bozen vis-à-vis the world. Using econometric models which project fundamental economic dynamics, latent demand estimates are created. This report does not discuss the specific players in the market serving the latent demand, nor specific details at the product level. The study also does not consider short-term cyclicabilities that might affect realized sales. The study, therefore, is strategic in nature, taking an aggregate and long-run view, irrespective of the players or products involved.

What is Latent Demand and the P.I.E.?
The concept of latent demand is rather subtle. The term latent typically refers to something that is dormant, not observable, or not yet realized. Demand is the notion of an economic quantity that a target population or market requires under different assumptions of price, quality, and distribution, among other factors. Latent demand, therefore, is commonly defined by economists as the industry earnings of a market when that market becomes accessible and attractive to serve by competing firms. It is a measure, therefore, of potential industry earnings (P.I.E.) or total revenues (not profit) if a market is served in an efficient manner. It is typically expressed as the total revenues potentially extracted by firms. The "market" is defined at a given level in the value chain. There can be latent demand at the retail level, at the wholesale level, the manufacturing level, and the raw materials level (the P.I.E. of higher levels of the value chain being always smaller than the P.I.E. of levels at lower levels of the same value chain, assuming all levels maintain minimum profitability).

The latent demand is not actual or historic sales. Nor is latent demand future sales. In fact, latent demand can be lower either lower or higher than actual sales if a market is inefficient (i.e., not representative of relatively competitive levels). Inefficiencies arise from a number of factors, including the lack of international openness, cultural barriers to consumption, regulations, and cartel-like behavior on the part of firms. In general, however, latent demand is typically larger than actual sales in a country market. It should be noted that the estimates are "culture blind" and "climate blind", meaning that sales may in fact be lower than the latent demand due to cultural or exogenous factors, such as religion or climate (e.g. the presence of certain religions can effect the actual sales of certain food and beverage products, in the same way that climatic conditions can affect the actual sales of clothing and/or heating products). The estimates of latent demand do not explicitly control for either these long-run exogenous factors or shot-run exogenous factors that may be present from year to year (e.g. the effects of war, SARS, terrorist activities, civil wars, natural disasters, elections, or similar events).

Another reason why sales do not equate to latent demand is exchange rates. In this report, all figures assume the long-run efficiency of currency markets. Figures, therefore, equate values based on purchasing power parities across countries. Short-run distortions in the value of the dollar, therefore, do not figure into the estimates. Purchasing power parity estimates of country income were collected from official sources, and extrapolated using standard econometric models. The report uses the dollar as the currency of comparison, but not as a measure of transaction volume. The units used in this report are: uuuu.

For reasons discussed later, this report does not consider the notion of “unit quantities”, only total latent revenues (i.e., a calculation of price times quantity is never made, though one is implied). The units used in this report are U.S. dollars not adjusted for inflation (i.e., the figures incorporate inflationary trends) and not adjusted for future dynamics in exchange rates (i.e., the figures reflect average exchange rates over recent history). If inflation rates or exchange rates vary in a substantial way compared to recent experience, actually sales can also exceed latent demand (when expressed in U.S. dollars, not adjusted for inflation). On the other hand, latent demand can be typically higher than actual sales as there are often distribution inefficiencies that reduce actual sales below the level of latent demand.

As mentioned in the introduction, this study is strategic in nature, taking an aggregate and long-run view,
income can be operationalized in a number of ways, including gross domestic product (for industrial
has high aggregate income, but low income per capita and can not assumed to be efficient). Aggregate
markets reflect the best standards for “efficiency”. High aggregate income alone is not sufficient (i.e., China
have found the assumption that the world’s highest aggregate income and highest income-per-capita
of latent demand compared to others for which no known data are available. Of the many alternatives, I
near efficiency than others. These countries and cities are given greater weight than others in the estimation
have found that the optimal approach is to assume that certain key countries are more likely to be at or
“efficiently served”. Having implemented various alternatives and matched these with market outcomes, I
firms to serve a market, they must perceive a latent demand and be able to serve that demand at a minimal return. The single most important variable determining consumption, assuming
latent demand exists, is income (or other financial resources at higher levels of the value chain). Other
factors that can pivot or shape demand curves include external or exogenous shocks (i.e., business cycles),
and or changes in utility for the product in question.

ignoring, for the moment, exogenous shocks and variations in utility across countries, the aggregate relation
between income and consumption has been a central theme in economics. The figure below concisely
summarizes one aspect of problem. In the 1930s, John Meynard Keynes conjectured that as incomes rise,
the average propensity to consume would fall. The average propensity to consume is the level of
consumption divided by the level of income, or the slope of the line from the origin to the consumption
function. He estimated this relationship empirically and found it to be true in the short-run (mostly based on
cross-sectional data). The higher the income, the lower the average propensity to consume. This type of
consumption function is labeled "A" in the figure below (note the rather flat slope of the curve). In the 1940s,
another macroeconomist, Simon Kuznets, estimated long-run consumption functions which indicated that
the marginal propensity to consume was rather constant (using time series data across countries). This type
of consumption function is show as "B" in the figure below (note the higher slope and zero-zero intercept).
The average propensity to consume is constant.

Is it declining or is it constant? A number of other economists, notably Franco Modigliani and Milton
Friedman, in the 1950s (and Irving Fisher earlier), explained why the two functions were different using
various assumptions on intertemporal budget constraints, savings, and wealth. The shorter the time
horizon, the more consumption can depend on wealth (earned in previous years) and business cycles. In the
long-run, however, the propensity to consume is more constant. Similarly, in the long run, households,
industries or countries with no income eventually have no consumption (wealth is depleted). While the
debate surrounding beliefs about how income and consumption are related and interesting, in this study a
very particular school of thought is adopted. In particular, we are considering the latent demand across
some 230 countries. The smallest have fewer than 10,000 inhabitants. I assume that all of these counties fall
along a "long-run" aggregate consumption function. This long-run function applies despite some of these
countries having wealth, current income dominates the latent demand for products and services. So, latent
demand in the long-run has a zero intercept. However, I allow firms to have different propensities to
consume (including being on consumption functions with differing slopes, which can account for differences
in industrial organization, and end-user preferences).

Given this overriding philosophy, I will now describe the methodology used to create the latent demand
estimates for this study. Since the author has asked me to apply this methodology to a large number of
categories, the rather academic discussion below is general and can be applied to a wide variety of
categories and cities.

Step 1. Product Definition and Data Collection
Any study of latent demand across countries requires that some standard be established to define
“efficiently served”. Having implemented various alternatives and matched these with market outcomes, I
have found that the optimal approach is to assume that certain key countries are more likely to be at or
near efficiency than others. These countries and cities are given greater weight than others in the estimation
of latent demand compared to others for which no known data are available. Of the many alternatives, I
have found the assumption that the world’s highest aggregate income and highest income-per-capita
markets reflect the best standards for “efficiency”. High aggregate income alone is not sufficient (i.e., China
has high aggregate income, but low income per capita and can not assumed to be efficient). Aggregate
income can be operationalized in a number of ways, including gross domestic product (for industrial
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categories, however, the reader must realize that the numbers will reflect a
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aggregate consumption function, but also over time (i.e., not all cities are perceived to have the same
effect is not necessarily same for all cities). This assumption applies across cities along the
parameter cross-sectionally pooled time series model”. Simply stated, the effect of income on latent demand
is assumed to be constant unless there is empirical evidence to suggest that this effect varies (i.e., the slope
of the income effect is not necessarily same for all cities). This assumption applies across cities along the
aggregate consumption function, but also over time (i.e., not all cities are perceived to have the same
income growth prospects over time and this effect can vary from city to city as well). Another way of looking
at this is to say that latent demand for products and services is more likely to be similar across cities that
have similar characteristics in terms of economic development (i.e., African cities will have similar latent
demand structures controlling for the income variation across the pool of African cities).

This approach is useful across cities for which some notion of non-linearity exists in the aggregate cross-city
consumption function. For some categories, however, the reader must realize that the numbers will reflect a
city's contribution to global latent demand and may never be realized in the form of local sales. For certain
category combinations this will result in what at first glance will be odd results. For example, the latent
demand for the category “space vehicles” will exist for “Togo” even though they have no space program. The
assumption is that if the economies in these countries did not exist, the world aggregate for these categories
would be lower. The share attributed to these countries is based on a proportion of their income (however
small) being used to consume the category in question (i.e., perhaps via resellers).

Step 5. Fixed-Parameter Linear Estimation
Nonlinearities are assumed in cases where filtered data exist along the aggregate consumption function.
There will always be those cities, especially toward the bottom of the consumption function, where non-
linear estimation is simply not possible. For these cities, equilibrium latent demand is assumed to be
perfectly parametric and not a function of wealth (i.e., a city's stock of income), but a function of current
income (a city's flow of income). In the long run, if a city has no current income, the latent demand is
assumed to approach zero. The assumption is that wealth stocks fall rapidly to zero if flow income falls to
zero (i.e., cities which earn low levels of income will not use their savings, in the long run, to purchase goods
and services). In a graphical sense, for low income cities, latent demand approaches zero in a parametric
linear fashion with a zero-zero intercept. In this stage of the estimation procedure, low-income cities are
assumed to have a latent demand proportional to their income, based on the city closest to it on the
aggregate consumption function.

Step 6. Aggregation and Benchmarking
Based on the models described above, latent demand figures are estimated for all countries and cities of the
world, including for the smallest economies. These are then aggregated to get world totals and regional
totals. To make the numbers more meaningful, regional and global demand averages are presented. Figures
are rounded, so minor inconsistencies may exist across tables.

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