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THE ECONOMICS OF THE RED CHILI PEPPER PRICE SYSTEM: MARKOV SWITCHING APPLICATION

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Abstract

Red chili pepper farm business remains one of the fastest growing segments of the retail food market in Indonesia. The high demand and seasonal nature of red chili peppers form the behavior of the nonlinear threshold pricing system, whereby there is a probability of transition of high price movements to low prices vice versa from the retail level to high or low price to the farm level. We apply Markov Switching model on error correction term to detect unknown threshold behavior price system during regime 1 (low price) and regime 2 (high price).

The result of the case study on monthly chili price sample from January 2009 to December 2013 shows that the behavior of red chili pepper price system is established at the retail level, thus the price transition of red chili regime 1 at retail level to farmer level (p_{11}) of IDR 18150 and at high price regime (p_{21}) IDR35750. Thus, the threshold behavior of the red chili pepper price system is nonlinear which reflects the transaction costs of the shadow price of farming costs.

Keywords: Price System, Error Correction Term, Non-linear Threshold.
