ILLINOIS FARM AND FOOD OUTLOOK

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FOCUS ON MARKETING MARGINS

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THERE HAS BEEN A RISING CONCERN among farmer and consumer interest groups over recent increases in price spreads between farm and retail levels. Growing attention has been focused on the profits and performance of firms engaged in processing, transporting, and merchandising food products. This reaction is understandable in light of recent increases in retail food prices in a time when many agricultural commodity prices have actually decreased.

Figures compiled by USDA show that from the first quarter of 1974 through the same period in 1975, average retail prices of a market basket of average family food purchases increased by 6 percent. Over this same period of time, the spread between the farm value of this market basket and corresponding retail prices increased by 17.9 percent, or slightly less than three times the increase in retail prices. The farm value of products in the market basket fell by 8 percent during this period.

Most recently, there have been increases in farm prices not matched in retail prices; and thus the rate of growth of the farm-retail spread has slowed perceptibly, though probably temporarily. From May to June, 1975, a 2.2-percent increase in the retail cost of the USDA market basket was matched by a 4.7-percent increase in farm value, resulting in a modest 0.5-percent increase in the farm-retail spread. As higher, raw farm-product costs are passed along to consumers in the months ahead, an increase in the rate of growth of the farm-retail spread can be expected. However, this is not likely to reach the 17.9-percent rate of growth mentioned earlier, at least not for any sustained period of time.

Available data suggest that for the most part, increased revenues realized by food industry firms have been largely absorbed in to higher costs rather than adding materially to profits. A recent study by the Federal Trade Commission concluded that in case of food retailing chains, profit levels have increased during the past year but that this is more nearly a return to normality after the depressed earnings levels of 1972 and 1973 than a case of extraordinarily high earnings. This study shows that expressed as a percentage of gross sales, the net profits after taxes of selected large- and medium-sized, food-retailing chains increased from about 0.6 percent in 1972 to about 1 percent in 1974, compared to an average level of about 1.1 percent from 1965 through 1970.

Except for raw agricultural commodities, significant cost increases have occurred over the past year for every input used by the food industry. This has been especially true for energy-dependent items, such as utility costs and transportation. However, with approximately half of the costs incurred by food-processing and marketing firms going for direct labor, their costs are particularly sensitive to wage rates, which are largely determined by collective bargaining. Recent labor settlements with pay increases of about 12 percent, plus cost-of-living escalators built in to many food industry labor contracts, do not bode well for future narrowing of farm-retail spreads. Also, the adoption of new labor-saving technology in the form of automated checkout devices in retail stores is being retarded by resistance from unions and consumer groups opposing the elimination of price marking on individual grocery items.

Finally, food-marketing margins must be viewed as but one component in the overall economy. Record peacetime federal-budget deficits in the current fiscal year will likely increase general inflationary pressures during the months ahead. These pressures will affect food-industry firms through higher costs, which will be passed along to consumers in the form of yet higher retail prices. We will almost certainly see further increases in both retail food prices and marketing margins during the coming year.

The above material was prepared by Dr. T.E. Elam for this letter.

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