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Meat Price Spreads Are Not Proof of Price Gouging

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The relationship between farm, wholesale, and retail prices for meats is often controversial. Data from USDA's Economic Research Service (ERS) show that retail beef and pork prices react faster to cost increases than to cost decreases. Wholesale and farm pork and beef prices also adjust more quickly upward than downward. In addition, wholesale-to-retail price spreads have grown faster than inflation over the past 20 years.

These facts have convinced some people that retailers or packers have, and use, market power to the disadvantage of consumers and producers. Increases in the price spread, for example, often lead to accusations by producer and consumer groups of price gouging and to Congressional calls for investigation of the meat industry.

The long-term trend, however, shows farm-to-wholesale price spreads increasing less than inflation. And, more labor-intensive services offered by retailers account for some of the widening in wholesale-to-retail meat price spreads.

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Price Spreads Monitor Industry Performance

ERS monitors farm, wholesale, and retail prices for Choice beef and pork and the spreads between these prices. Price spreads are designed to measure how the value

of an animal and its meat changes through marketing stages from the farmer to the consumer. Price spreads for beef and pork are adjusted for the value of byproducts generated from processing and for the weight loss as animals are transformed into retail cuts of



Providing services, such as improved packaging and closer trimming, accounts for some of the widening in the price spread between the packer and the consumer.

meat. For instance, farm prices for Choice steers and hogs are converted from dollars per pound of animal to dollars per pound of retail cuts.

Theoretically, the farm-to-retail price spread consists of the costs and profits of marketing firms. An economically efficient marketing and processing system will move products from the farm to the consumer at low costs and will not earn "excessive" profits (those arising from abuse of market power).

Two factors limit the use of pork and beef spreads as a tool for monitoring industry performance. First, ERS price spreads are not divided into costs and profits. Second, the retail prices for Choice beef and pork are based on a mix of cuts that an animal can produce, not on the mix that grocery stores actually sell. For instance, lower priced pork cuts are often processed into hot dogs or luncheon meats. Restaurants are a more important outlet for beef steaks than for beef chucks. Because grocery stores sell a different mix of cuts than ERS uses to calculate the retail price, the wholesale-to-retail spread cannot measure retail gross margins (the difference between the price of the product bought and the price of the product sold). Price spreads cannot widen (or narrow) unless the gross margin on at least one meat cut widens (or narrows).

Longrun Price Spreads Are Stable

The beef- and hogpacking industries have undergone major consolidation in the past 20 years. The largest slaughtering firms have gained increasing shares of the Nation's meat production. Despite the fears of some industry observers that this consolidation would make it easier for meatpackers to exploit market power, the farm-to-wholesale spreads for beef and pork have

not kept pace with inflation. Improved productivity by packers has kept down farm-to-wholesale spreads. ("Beefpacking Costs Are Lower for Larger Plants," elsewhere in this issue, explains how the trend to fewer and larger slaughter plants lowers processing costs.)

The slow growth in farm-to-wholesale price spreads (relative to inflation) is good for both retailers and farmers. It allows farmers to receive more for their animals and retailers to pay less for beef and pork. This improvement in packing industry performance does not imply that packers cannot or are not earning excess profits. Productivity increases may have been great enough to allow the largest packers to cut spreads and still increase profits.

Wholesale-to-retail meat spreads have grown a little faster than inflation. While this could be the result of retail stores earning greater profits on meat sales, there are two reasons to believe that store costs have increased faster than inflation. First, labor produc-

tivity in grocery stores probably has not increased, and may have dropped. Second, some stores are providing more services related to beef and pork sales, such as improved packaging and closer trimming. The costs of providing these extra services account for at least some of the widening in the price spread between the packer and the consumer. However, wide retail meat spreads concern livestock producers and processors because higher retail meat prices cause lower consumer purchases of beef and pork.

Month-to-Month Price Spreads Are Erratic

Longrun price spreads seem to reflect changes in inflation and productivity. Shortrun price spreads, on the other hand, vary greatly from month to month, especially the wholesale-to-retail spreads. (Farm-to-wholesale price spreads, while variable, are more stable than wholesale-to-retail spreads.) This variability leads to sharp cycles in price spreads.

Beef Price Spreads Set New Records

Since spring 1991, ERS price spreads for Choice beef set several record highs. Through November 1991, the record farm-to-retail price spread was set in August at \$1.40 per pound, up 26 cents from August 1990. Such high price spreads have prompted much concern and numerous calls by farmers and politicians for investigation into market abuse or price gouging, especially by supermarkets.

While the beef price spreads in 1991 have been high, the

spread for Choice beef is consistent with past farm-to-retail price relationships. Our economic model for predicting retail beef prices did so with accuracy to plus or minus 1 cent. Given the model's ability to predict current retail prices based on marketing relationships of the early 1980's, it is likely that retail beef markets have changed very little. While some may not like the current shortrun performance, it did not worsen in 1991.

The instability in wholesale-to-retail price spreads is primarily caused by two factors. First, farm and wholesale prices vary more than retail prices. Fluctuations in wholesale prices, coupled with relatively stable retail prices, cause spreads to vary.

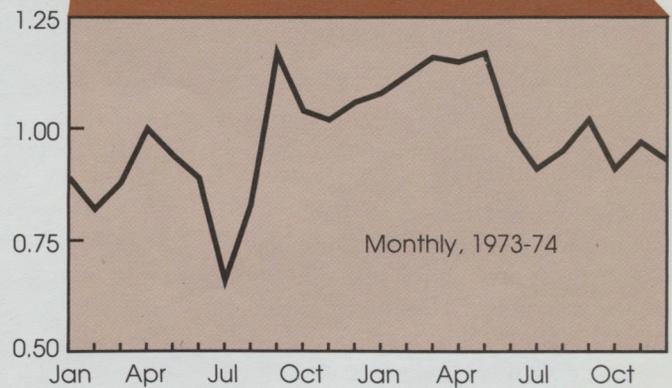
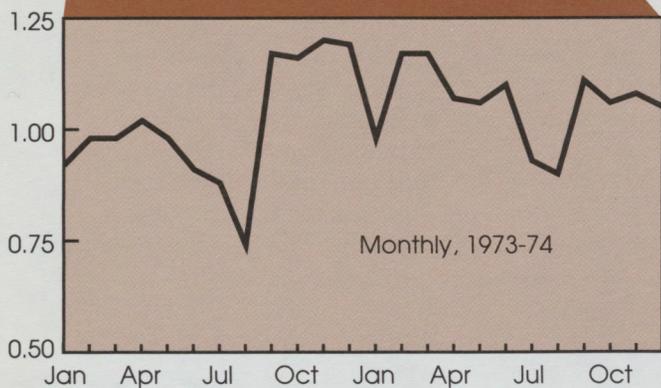
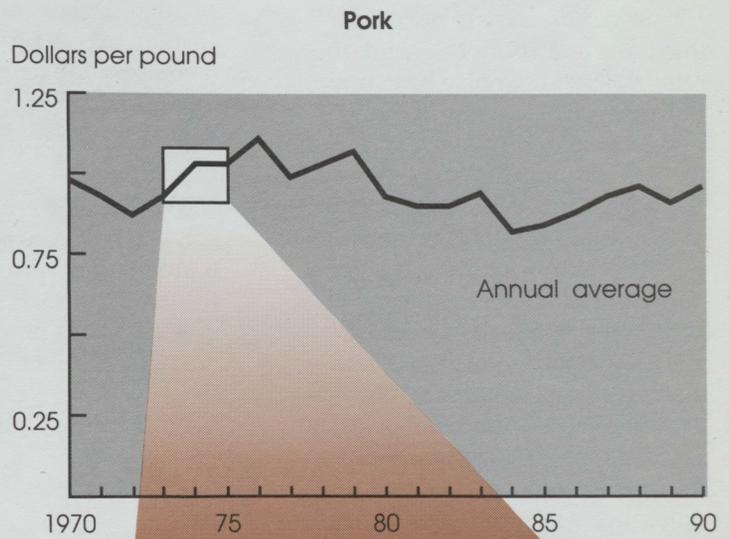
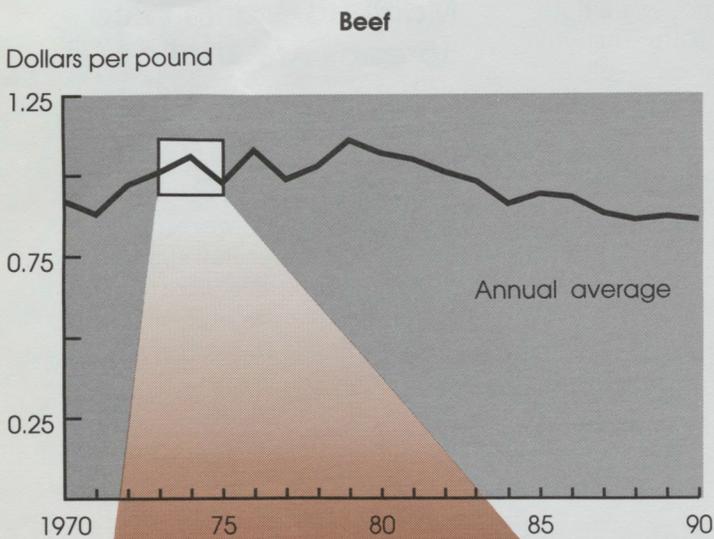
Meat is not the only food product for which retail prices are more stable than farm prices. In fact, retail prices of most foods are more stable than their farm prices. Retailers sometimes claim that they stabilize prices partly as a service to their customers, because consumers do not like price fluctuations. Consumers naturally dislike price

increases more than they like price decreases, and price increases also appear to be more memorable. Store managers clearly have an incentive to stabilize prices.

The delay between farm and retail price changes also makes price spreads more volatile. Farm prices and wholesale prices tend to move parallel to each other. Retail prices

Despite Monthly Fluctuations, Meat Price Spreads Are Stable Over Time

Farm-to-retail price spreads



Note: Data are adjusted for inflation.

tend to hit their highs and lows a month after farm and wholesale prices hit theirs. When farm and wholesale prices rise, the lag in response by retail prices causes the wholesale-to-retail price spread to narrow. When farm and wholesale prices drop, a lag causes the wholesale-to-retail price spread to widen.

The lag between wholesale and retail price changes is often attributed to the amount of time it takes to move products from the farm to the consumer. The retail industry claims that since products currently in the store were bought from the farmer at some earlier time, the prices reflect earlier farm prices.

A 1-month delay between farm sales of livestock and consumer purchases of meat seems too long for most fresh meat items. Retail stores typically take delivery of fresh meat at least once a week. Many meatpackers can process live animals into wholesale cuts in 1-2 days. USDA's regulations require beef carcasses to be refrigerated for 24 hours prior to grading carcasses.

Most of the lag between farm and retail price changes for meats is due to factors other than the time it takes to move products from the farm to the consumer. One possible factor is that many retailers try to maintain fairly stable prices. Wholesale and farm prices change daily, and often a price rise one day is followed by a price drop the next day. It makes little sense for retailers to react to day-to-day changes in wholesale meat costs, especially if a price change may not persist.

Asymmetric Price Changes

ERS research shows that the lag between farm and retail prices depends upon whether the farm price is increasing or decreasing. In both beef and pork markets, retail prices rise faster than they fall, as do farm and wholesale prices. Prices exhibit what economists call asymmetric adjustment. That is, if delays in product movement are responsible for lags in price changes, then the faster adjustment to price increases implies that meat reaches consumers sooner when prices are rising. The quicker movement of meat from farms to consumers during price increases is reasonable. In a market economy, price increases are signals that demand has grown more rapidly than supply. To meet the increase in demand, inventories can be drawn down and the meat spends less time moving from farms to consumers.

The faster reaction of retail prices to wholesale price increases could also be the result of psychological factors. Retailers, like consumers, may react more strongly to price increases. Because increases are more memorable than decreases, store managers could be quicker to call a price increase a permanent change.

Overall Performance Is Competitive

The longrun trend of inflation-stable meat price spreads suggests that the competitive performance of meat and livestock markets has changed little in past years. How-

ever, because price spreads are not divided into profits and costs, they cannot be used to tell how well the markets worked at the start. Shortrun fluctuations in price spreads suggest that the performance of meat markets is erratic—that at times retail stores earn high margins on meat and at other times margins are low. The asymmetry in the transmission of farm price changes to retail prices has resulted in some critics claiming that there are shortrun inefficiencies, perhaps caused by abuse of market power.

The fact that retail prices react more quickly to cost increases than to cost decreases is consistent with many critics' views of food retailing: that retailers are quicker to pass on cost increases than decreases.

But while asymmetric retail price change is consistent with the idea that profits may sometimes be excessive, it is not sufficient proof that this is occurring. As noted, competitive business practices may account for asymmetric price changes. Also, farm prices usually react more quickly upward than downward to changes in market conditions, and this keeps farm-to-wholesale price spreads for both beef and pork relatively stable. This may suggest that livestock markets may function about as well in the short run as they do in the long run. ■