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FOOD MARKETING MARGINS WIDEN AS COSTS ACCELERATE

Even though farm prices dropped considerably in the first half of this year, food prices increased sharply during the same period. But while there may be a general notion that these variables are directly related, divergence in their movements is not unusual. This is because prices consumers pay for food reflect the added costs of moving food products from the farm gate to retail outlets—a complex marketing network that includes assembling, processing, transporting, and distributing food commodities.

In most years, these costs of marketing food account for about three-fifths of the food dollar, with the farm value providing the remaining portion. Simply put, this means that farm prices have less impact on consumer food prices than does the bill for the entire marketing process. Consequently, the impact of changes in farm prices can be negated by concurrent shifts in marketing costs. Such has been the case in 1974, with food prices rising even as farm prices fall.

The magnitude of marketing costs can be illustrated by spending in 1973. Consumers spent an estimated $134 billion for foods originating on U.S. farms—$18 billion more than a year before. Of that, marketing costs were responsible for $83 billion, a gain of $6 billion over 1972. Meanwhile, higher farm prices boosted the farm share of the bill to $51 billion from $39 billion a year before. Even though slowed somewhat by economic controls, marketing costs continued to climb upward.

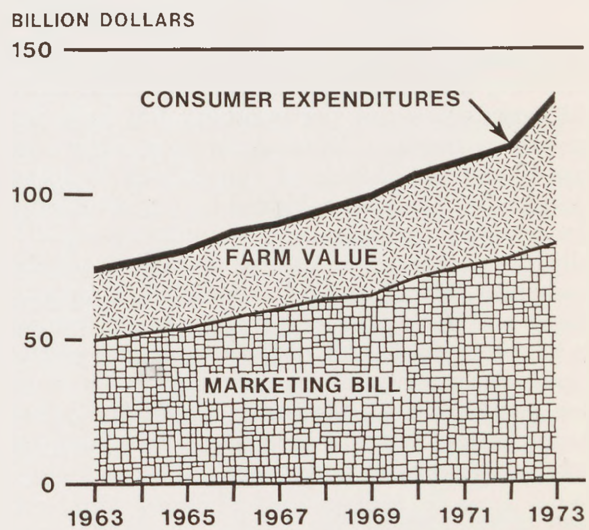
Labor costs mount

Close inspection of the marketing bill indicates that the rapid escalation of marketing costs can be linked primarily to increased labor costs. Direct labor costs for the marketing of U.S. farm foods totaled slightly more than $40 billion in 1973, or 30 percent of all expenditures for food.

Much of the increase has come in recent years. Since 1962, earnings of employees in food marketing establishments have increased about 5 percent annually, or about in line with across-the-board gains of individuals. But in the last three years, rising labor costs have impacted even more severely, as hourly earnings have risen more than 7 percent a year.

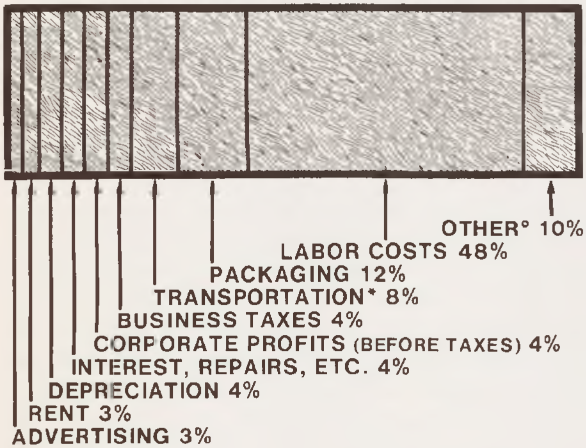
Many marketing firms have been able to somewhat offset the surge in labor costs by increasing

CONSUMER EXPENDITURES FOR FARM FOODS



SOURCE: U.S. Department of Agriculture

FARM-FOOD MARKETING BILL, 1973



°Includes such costs as utilities, fuel, promotion, local for-hire transportation, insurance
*Intercity rail and truck

SOURCE: U.S. Department of Agriculture

productivity. Although hourly labor costs of food marketing firms have advanced 70 percent since 1962, greater output per manhour has held the increase in per-unit labor costs to a little less than 50 percent. Much of the growth in labor productivity has been achieved by improvements in marketing facilities and equipment—specifically, by large expenditures for new plants, warehouses, stores, and other facilities. However, a sharp rise in costs of new plant and equipment has begun to limit some of the cost-saving effects of substituting capital for labor. So with wage rates continuing to climb and productivity beginning to lag, per-unit labor costs this year are likely to increase substantially.

Other costs increase

After labor, the second largest category of costs is packaging materials, which account for 12 percent of the marketing bill. Prices of packaging materials were fairly stable in the last decade, but in recent years, limited supplies have driven prices sharply higher. As a result, the index of prices for containers and packaging materials in the first quarter was 9 percent above the same period a year earlier. And with paper boxes and grocery bags expected to remain in tight supply for the rest of the year—even though mills should be operating much closer to full capacity than usual—prices are apt to increase even more.

Transportation costs are a further input to the nation's food bill. Because most foods are produced a considerable distance from the centers of final distribution, the cost of shipping food by rail and truck alone amounts to about 8 percent of the marketing bill. Other methods, including intracity truck transportation and water and air transportation, add further costs. And with higher fuel prices and some reduction in transportation services due to lowered speed limits and other fuel-saving measures, shipping costs are almost certain to continue to climb. Skyrocketing fuel costs are also driving up the cost of energy used directly in the processing and handling of food.

The profit side, too, contributes to marketing costs as corporate profits before taxes add 4 percent to the bill. Although profits account for only a small part of food costs, after-tax profits of food manufacturing firms climbed to more than 15 percent of stockholder equity in the last quarter of 1973. For the year, profits averaged nearly 13 percent of the equity, or fractionally more than for all manufacturing industries.

Increased costs, however, are not limited to the major components of the bill. Other costs involved in the marketing of food—including business taxes, interest, repairs, depreciation, rent, and advertising—are also rising.

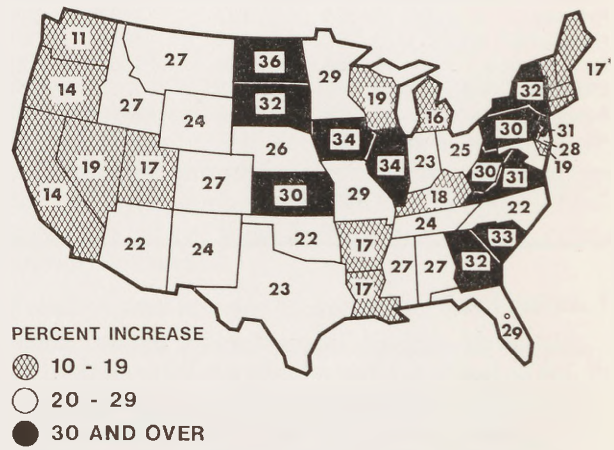
Marketing margins to increase

Food prices are apt to trend upward in the near future irrespective of any changes in farm prices. This is because marketing costs—unlike farm prices, which have moved up and down—have trended upward for many years. In fact, marketing margins have risen nearly every year in the past two decades. And with wage rates, energy and material costs, and transportation charges all expected to continue to increase, marketing margins will be forced upward in the foreseeable future.

Historically, the trend in the farm-to-retail spread for food has tended to parallel changes in the general price level. This close association is understandable, since the operation of the food marketing industry is similar to other sectors of the economy. Given this relationship and the climb expected in the general price level, marketing costs are expected to increase substantially this year.

INCREASE IN AVERAGE VALUE OF FARMLAND PER ACRE

MARCH 1973 – MARCH 1974



*Average increase for Maine, New Hampshire, Vermont, Massachusetts, Rhode Island and Connecticut
°Average of the percentage change in Georgia and Alabama index values

NOTE: Based on index numbers of average value per acre
SOURCE: U.S. Department of Agriculture

RISE IN FARMLAND VALUES EXPECTED TO WEAKEN

Substantial growth in farm income and an optimistic outlook with regard to future income levels combined to push U.S. farmland values up sharply in the 12-month period ended March 1. But the momentum that spurred the rise in farmland prices appears to be abating, and a slowdown in the rate of increase during the next year seems likely.

In the main, the weakening in the rise of farmland prices can be linked with deteriorating income prospects. Factors such as rapidly mounting farming costs, tight financial conditions, a projected decline in farm exports, and only moderate domestic demand for expanding supplies are squeezing off farm profits. Too, the usually strong demand for rural land from urban residents is being dampened by a slowing in the growth of purchasing power.

Record advance

In the year ended March 1, U.S. farmland values shot up 25 percent. That was the largest 12-month advance ever, surpassing the previous record of 22 percent for the year ended March 1, 1920. According to the U.S. Department of Agriculture, the average per-acre value of farmland reached $310, compared with $247 a year earlier.

The rise in farmland values in states of the Eleventh District slightly lagged the national average. In Arizona, Oklahoma, New Mexico, and Texas, advances in farm real estate values ranged from 22 percent to 24 percent. In Louisiana, meanwhile, the gain was only 17 percent. In the rest of the nation, the biggest year-to-year gains were 36 percent in North Dakota and 34 percent in Illinois and Iowa. For the most part, the large gains in land values were in states where farming and ranching activities are the most highly concentrated due to the agricultural productivity of land.

FARM REAL ESTATE VALUES, MARCH 1

(1967 = 100)

Area	1968	1970	1972	1974
Arizona	106	127	159	208
Louisiana	105	116	139	174
New Mexico	106	120	136	186
Oklahoma	108	115	131	183
Texas	109	119	138	191
48 contiguous states	107	117	132	187

SOURCE: U.S. Department of Agriculture

Lending brisk

Although current interest rates exceed those of 1973, funds for farm loans are expected to be available for the rest of 1974. In the early part of the year, farmers' use of credit has remained brisk. Farm mortgage lending by federal land banks, which reached a record level in 1973, continued to be exceptionally strong.

With rates of interest currently around 9 percent, lending by insurance companies has also been prominent. Repayments to insurance companies have almost offset new loans, however, keeping total loans outstanding for the early part of the year generally steady. The loan volume of the Farmers Home Administration, despite its small share of the market, was substantially higher in the first quarter than in the same period last year.

The constriction of credit has been felt mainly in the mortgage money market, affecting both rural homesite construction and recreational land purchases. Funds for farming and ranching operations have remained readily available.

On balance, with a cost-price squeeze pressuring farming operations, demand for rural land lessening, and a somewhat constrained financial market, the rate of increase in farmland values is apt to moderate substantially in the year ahead.

FARM LENDING SEEN UP BY AGRICULTURAL BANKERS

An increase in farm lending—especially in general operating and equipment loans—and little dampening of farmers' use of credit by high interest rates are some of the expectations of agricultural bankers for 1974.

Those were among the results of the 1974 Agricultural Credit Situations Survey, conducted by the Agricultural Bankers Division of the American Bankers Association. The sample included banks selected randomly from all banks that extend farm loans. The survey was completed early this year, with a total of 1,124 banks responding.

To some extent, bankers' responses reflected the excellent farm year in 1973—when agriculture realized a record net farm income that was recently revised upward to $32.2 billion. But many bankers expressed concern over the mounting cost-price squeeze and indicated caution must be used in determining credit extensions in 1974. For one thing, prices have generally been weakening, as sizable production has outpaced moderate demand. And such problems as the cost and availability of fuel and fertilizer, soaring land prices, and the availability of farm mortgage credit are sources of continuing frustration to farmers and bankers.

More than half the banks reported legal lending limits of $150,000 or above, but roughly a fifth needed additional funds to accommodate their loan commitments. Of those, nearly half used a city correspondent to secure the needed funds. Others needing funds mainly purchased Federal funds or borrowed from Federal Reserve banks. Finally, despite high rates of interest, the bankers overwhelmingly opined that farmers are receiving adequate credit from all potential sources.

Prepared by Carl G. Anderson, Jr.