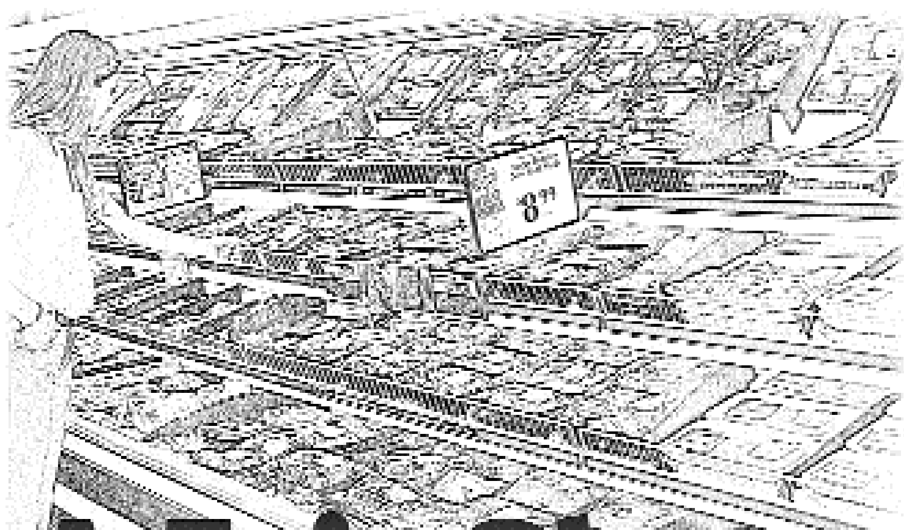

A Fair Share

Controversy over price spreads and how they reflect cattlemen's share of beef industry profits has created the need to restructure price series reporting.

by ***Corinne Blender***

Usually, at any given time, at least one sector of the beef industry — whether it is cow-calf, stocker, feedyard, meat processing or retail sales — is making a profit. Yet it is not always clear *who* is making a profit and *who* is finding it tough to make ends meet. Profit within the industry is driven by many uncontrollable factors, including weather, feed-grain exports, feed prices, consumer income and expenditures, inflation, changing consumer preferences, and the structure of cattle feeding.

Farmers compare the price they receive for their live product to the price consumers pay at the store. As wholesale and retail prices have outpaced the prices farmers receive — creating greater farm-to-retail price spreads — producers question whether they are getting their fair share of the consumer dollar.

Price spreads for beef have been published on a regular basis since 1942 by the U.S. Department of Agriculture (USDA) Economic Research Service (ERS). ERS calculates farm-to-wholesale, wholesale-to-retail and farm-to-retail price spreads. Often viewed as profitability indicators, economists warn they aren't necessarily a good representation.

Price spreads are better at measuring performance of the meat-marketing sector. Meat price spreads show how the value of an animal and its resulting meat products change as the animal (carcass) moves from the farm, to the packer and, finally, to the grocery store.

The *Angus Journal* interviewed Ted Schroeder, an ag economist at Kansas State University (K-State), about some of the issues surrounding beef price spreads.

Problems arise

The Livestock Mandatory Reporting Act of 1999 was enacted to improve the way livestock prices were reported. Mandated reporting of fed cattle and boxed beef prices was enacted in April 2001 and was launched for retail beef prices in late 2002. The Bureau of Labor Statistics (BLS) has long collected retail beef prices prior to this act for use in constructing the consumer price index, says Schroeder, who was a member of a team of 40 economists who reviewed the BLS price series and the problems that the industry was facing with its interpretation.

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>
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"Price and price-spread data must be interpreted with care," according to a report[2] published by the ERS. "Misinterpretation of these data and indicators can lead to unwarranted conclusions about prices and price spreads."

The report points out three issues that were the leading force in the reevaluation of price-spread reporting:

(1) Interpreting price-spread data is not an indication that observed price changes are cost-justified;
(2) The calculation of Choice beef retail price only reflects that product, not other grades of beef that are sold; and
(3) The price spread does not take into account the pounds of product moved at the price reported.

"The problem with the BLS price the USDA has used in the past is that the price series was not volume-weighted. The BLS collected that data by simply going to designated retail outlets and recording the price of the product on a per pound basis across those retail outlets," Schroeder says. "So, let's say for a Kansas City strip loin steak package, they took the prices across however many different locations, averaged them together and called that the retail strip loin price. They did the same thing for all of the other cuts involved and aggregated those individual cuts into a carcass equivalent."

By lifting these prices in such a way, the USDA didn't take into account whether or how much of the product was moved off the shelf. As such, the reported prices were not weighted by sales volume. Consumers will generally buy when the price is right; the BLS price data didn't take into account that specials or sales offered on different products, such as ground chuck or sirloin, led to a greater volume of sales of those products at the stores having the sales.

"Take an extreme: If you had an example of one store offering a half-price meat cut and another store offering normal price, you end up getting a price average that is the middle of the two prices. If we volume-weighted the price report and the store offering the sale price sold all the product that week, the actual trade price would be considerably lower than the reported market price," Schroeder explains.

From this, Schroeder says, it was evident that the BLS price series USDA was using was inaccurate, and the price listed was biased upward because of the collection process.

A new series evolves

USDA recently came up with a retail scanner meat price database that promises to provide a better measure of what some grocery stores sell. The first retail price information from this system was reported Oct. 21, 2002, for August data. There is a two-month lag on prices reported.

"This new series is running parallel to the old series and is now collected in this more comprehensive volume-weighted fashion. About 20% of total supermarket sales are represented in this sample, which is quite substantial," Schroeder says.

Early comparisons of the two series would suggest that this new feature-weighted price series is lower than the BLS series for most items, but not all, for most months, Schroeder says.

"For November of 2002 the USDA round steak Choice price as collected via feature sales weighting was $2.77 per pound. The BLS series price was $3.70 per pound," Schroeder points out (see Table 1). "As another example, let's go to a product that has a huge amount of movement, ground chuck. The feature volume-weighted price was $1.83, and the BLS price was $2.09 per pound in November 2002."

Not every meat product has shown that much difference, and the volume-weighted price has not always been lower than the BLS price, he adds. "There are a few that the two series were very similar on."

Schroeder says the new volume-weighted series is a step in the right direction to more closely link the relationship of retail price and fed-cattle price. "Watching retail prices under this volume-weighted series should give us a little better indication of what market conditions are likely going to feed back to the fed-cattle complex," he adds.

"That said, there are a lot of reasons that a dollar-per-hundredweight or a dollar-per-pound change in retail price does not end up in the same dollar-per-hundred or dollar-per-pound change at the fed-cattle level. Those will not operate one-for-one for a whole lot of reasons, but at least this should give us a better relationship between the two," he points out.

Schroeder says many people say that if this price reporting problem has been going on forever, there shouldn't have been any reason that would suddenly make prices over the last two years less reflective of farm level than they were 20 years ago. Schroeder can explain some of the problems.

Table 1: Comparison of average retail prices for selected meat cuts from BLS and supermarket scanner data, most recent month (November 2002)

Item[1]	Feature-weighted price ($/lb.)[2]	BLS price ($/lb.)[3]
Ground chuck	$1.83	$2.09
Ground beef, 100% beef	$1.85	$1.72
Lean and extra lean ground beef	$2.58	$2.62
All uncooked ground beef	$2.12	$2.30
Chuck roast, USDA Choice, boneless	$2.17	$2.71
Chuck roast, graded and ungraded, but not Choice or Prime	$2.28	$2.49
Round roast, USDA Choice, boneless	$2.57	$3.17
Round roast, graded and ungraded, but not Choice or Prime	$3.12	$2.97
All uncooked beef roasts	$2.64	$3.08
Steak, T-bone, USDA Choice, bone-in	$6.65	N/A
Steak, rib eye, USDA Choice, boneless	$8.00	N/A
Steak, round, USDA Choice	$2.77	$3.70
Steak, round, graded and ungraded, but not Choice or Prime	$3.38	$3.29
Steak, sirloin, USDA Choice, boneless	$4.05	$5.23
Steak, sirloin, graded and ungraded, but not Choice or Prime	$3.40	$4.55
All uncooked beef steaks	$4.53	$4.41
Beef for stew, boneless	$2.93	N/A
All uncooked other beef, not veal	$2.94	$2.45

Source: U.S. Department of Agriculture Economic Research Service (USDA-ERS).
For more information, contact William F. Hahn at (202) 694-5175.
N/A = Not available. Occasionally, Bureau of Labor Statistics (BLS) is unable to find an adequate number of observations of a particular item's price to ensure statistical reliability.
[1]Random-weight items only.
[2]Average monthly price, weighted by sales volume, and accounting for featuring (discounts given to customers from regular shelf price). Compiled for USDA-ERS from retail supermarket scanner data.
[3]Prices reported by the BLS.

Sharing profits

Let's go back to the farmer's share of the retail dollar. As producers of the raw product, cattlemen are generally interested in their share of the finished product value, which Schroeder says is rightfully so. The farmer's share has been shrinking, which is a cause for concern for many.

If you go back to the 1980s, the farmer's share of the consumer's dollar was around 60¢-65¢. Today, that number is down around 40¢-45¢. Why is it that the farmer, who produces the commodity, is realizing a shrinking proportion of the total consumer expenditure, Schroeder asks.

Part of what's happening, he explains, is the fact that the BLS retail price has been wrong. But he won't hang his hat on that being the only factor.

Wage rates for processing and wages at the retail level have an effect. "Over time there has been a sizeable increase in the amount of labor being used to get the beef to the retail shelf. For example, wages for the entire meat counter are going to be greater today because of the higher levels of processing," he says. "For example, delis have very intensive labor needs. They have high spoilage rates relative to a vacuum-sealed product. So those higher costs get absorbed by much of the entire meat counter."

Structural changes in the industry, like packer concentration, could be part of the reason for the farmer's shrinking share of the consumer dollar. But there is no strong, good proof or quantification of how much can be attributed to this concern.

"Most of this decline in the farmer's share of the retail dollar has been associated with the wholesale-to-retail wedge. It has not been farm-to-wholesale; packers haven't driven the farmer's share down," Schroeder says. "If you look at packer margins over time, they would have probably increased the producer's share because packers were getting more and more efficient at processing beef. The wedge that has been widening, for the most part, has been between the packer and the retailer."

Even with the new scanner price data, the retail price spread could still be biased upward. Schroeder says Wal-Mart, probably the second-largest retailer, won't participate in the scanner data system. Research indicates it has a tendency to have the lowest price.

In an article published in the Aug. 31, 2002, edition of *The Topeka Capital-Journal,* Dave Weaber, a marketing analyst and economist with Cattle-Fax, was quoted on trends in the beef industry. Wal-Mart, he says, wants to buy beef only twice a year, which is consistent with how it buys poultry. The company wants a steady, weekly flow of product at a set price, and it doesn't want to pay for the product for up to three months after delivery — well after the product is sold. Not financing its own inventory made the company $6 billion last year, according to Weaber.

Wal-Mart moves vast quantities of retail beef, but at what cost?

Future trends

What, for certain, will continue to drive beef prices?

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"In the long run, consumer demand is absolutely critical. But as we look at year-to-year fluctuations in cattle prices, especially month to month within the year, those are supply-driven," Schroeder says. "That's the volume of beef that we are trying to push through the market, and the only way we are going to push it through is to adjust the price."

When there are huge volumes of beef and competing products (pork, poultry, lamb, etc.) to push through a market, we are going to see prices decline regardless of how strong consumer demand may be, he says.

The industry's major challenge, and the main reason producers across all segments of the beef industry have been struggling to be profitable, has been the declining demand that has taken place over the last 20 years.

The beef industry has huge amounts of fixed assets. A breeding herd's useful life is anywhere from 8 to 10 years. The land that is used for grazing probably isn't useful for any other practice.

"It is extremely difficult for an industry with such huge investment in fixed assets that can only be used for beef production and processing to be profitable when demand is declining," Schroeder says.

"That's what we call asset fixity," he adds. "A beef producer has fixed assets that are uniquely suited for this industry. To try to liquidate them when demand is declining is economically devastating."

"That is why we spend a lot of time digging into the details, because it turns out that the surface typically doesn't reveal much."

—Ted Schroeder

In the long run, the most important factor that has affected profits, Shroeder says, is the entire beef industry's struggle to vertically coordinate the production and marketing system. Improving vertical coordination, he says, will add value back to the industry. If cattlemen can produce for the market — precisely what and when the consumer demands — through branded beef programs like Certified Angus Beef LLC (CAB) or by developing alliances, he says the industry can take back some of its competitive edge.

"It is extremely complex. We have a lot of different factors that ultimately go into what the transaction price for that animal is. We can't just isolate one factor," Schroeder says. "A lot of times there is a tendency to do that, and it leads to bad decision making. It leads to poor policy. It leads to inefficiencies that wouldn't be there otherwise. I guess that is why we spend a lot of time digging into the details, because it turns out that the surface typically doesn't reveal much."

Editor's Note: *The following articles were used for background in writing this artcle.*
[1]*"Price Spreads and Marketing System Performance." December 2002.* Agricultural Outlook *magazine.*
[2]U.S. Beef Industry: Cattle Cycles, Price Spreads and Packer Concentration. *Report published by the Economic Research Service (ERS).*