Fighting Depressed Prices

Growers in many markets are currently fighting depressed prices. Some who may now be doing better, have experience of fighting depressed prices in previous years. Is it the inevitable lot of a fruit grower to be constantly in danger of unprofitable prices? Or, is there anything that can be done about it? To answer these questions, it is necessary to look at the major forces that drive agricultural markets.

Why Prices Fluctuate

In general, demand for food products at the consumer/ retail level tends to be relatively stable. There may be some seasonal patterns, although these have tended to become less pronounced as many products are available twelve months a year. However, in general, consumers will eat about the same amount of a familiar product like apples from month to month or from year to year.

It makes sense then to conclude that most of the swings in retail price of a food such as fresh apples are the result of changes in supply, primarily in the supply of apples themselves, but also in the supply of other fruits that might compete for retail shelf space or for the consumer's stomach. Indeed, observations of apple markets over many countries and many years suggest that while average prices are responsive to changes in total supplies, the submarkets for different varieties, sizes or grades of apples are also highly responsive to changes in relative supplies of these categories.

Role of Income Levels

One other factor also affects retail prices, the general level of income among the consuming public. Studies that examine the behavior of different income groups show that the volume of apples bought, and the average price paid, tends to rise through successively higher income groups. This does not usually apply to the highest income groups. The very rich do not consume more apples than the moderately rich. Perhaps they spend their money on caviar and champagne or on ski trips to Switzerland.

However, over time, gradual changes in average incomes have a very modest influence on average consumption of a product like fresh apples. When workers get a salary increase, they are more likely to splurge on a new wide screen TV set than on buying more apples.

There is one situation where changes in income levels appear to have a modest effect on purchases of fresh apples, when incomes decline suddenly, as they have in the last two years. When people lost their jobs, or were cut back to part-time work, or suffered salary cuts or job furloughs, they often responded by reducing their purchases of fruits and vegetables. That happened in the 1980-82 recession, and appears to have happened to some extent in the current recession.

Thus, some of the changes in retail prices for fresh apples can result from income declines during a recession. But, in normal times, average income changes have little effect.

Role of Marketing Margins

High marketing margins do not cause depressed prices in the way most growers assume. Marketing margins between FOB shipping point and final consumer have been high for many years. In most countries they consistently account for at least two-thirds of the retail price. However, because marketing margins tend to be relatively fixed, a small percentage change at the retail level converts to a bigger percentage change at the FOB level and an even bigger percentage change at the farm level.

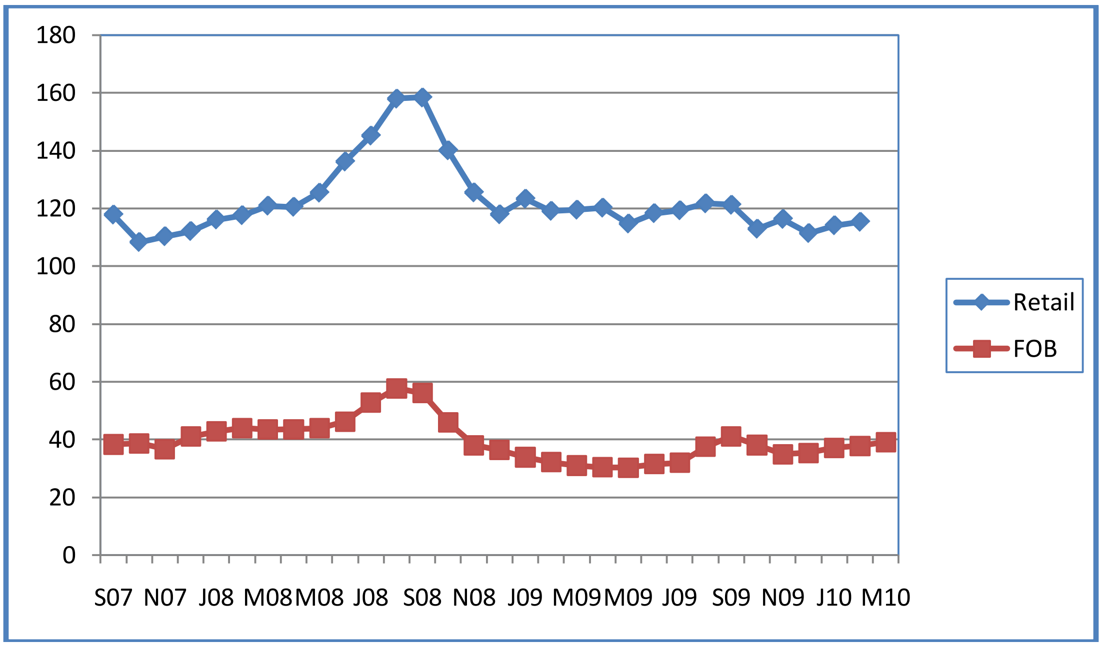
To illustrate, if the retail price per lb drops from 100 cents to 98 cents, the FOB price drops from 34 cents to 32 cents, and the grower price drops from 17 cents to 15 cents, the percentage decline is only 2% at the retail level, but almost 6% at the FOB level and almost 12% at the grower level. Under the same scenario, just a five cent decline at the retail level would translate into a 29 percent decline at the grower level. It is those sorts of price swings that trouble growers because of their devastating effects on profitability.

Upsides and Downsides

Of course, the magnification of changes in retail prices on grower prices works on the upside as well as the downside. For example, chart 1 below shows the monthly movement of retail prices and of FOB prices of Red Delicious apples in the United States for the last three seasons. Between October 2007 and September 2008, when retail prices rose, FOB prices also rose. After September 2008, both retail prices and FOB prices fell sharply for a few months, and have remained relatively flat since.

Chart 1. United States: Monthly Retail and FOB Prices of Fresh Red Delicious Apples, September 2007 to March 2010

(cents per lb)



The periods when retail prices move sharply above the norms tend to be relatively short because the periods when apple supplies are below normal tend to be relatively short. Once, again, the inference is that changes in supplies are the biggest drivers of price changes.

What Can be Done to Fight Depressed Prices?

A few popular remedies can be dismissed fairly quickly. One frequent target is reducing marketing margins. However, the track record of getting retailers, wholesalers or transportation companies to lower their typical charges, either voluntarily, or by government mandate, has been dismal in the past. These companies themselves face rising costs for labor, fringe benefits, utilities, etc., and severe price competition.

A second common tactic is to restrict imports. However, existing trade agreements make it very difficult to restrict imports. Anti-dumping actions are possible under some circumstances, but they are costly to mount, are limited in their application, and tend to give very little relief to growers.

A third technique, that was once more widely used, is to shift the emphasis of promotional programs behind the varieties or sizes that are in worst over-supply. However, with the dismantling of may large generic promotion programs, that approach is not possible for most countries.

Last Resort. Reducing Supply
Often, the last resort is an effort to reduce supplies. This is ironic, since we have argued above that the main cause of depressed prices is excess supplies, both for the total apple market and for individual categories of apples within the total.

There are two broad alternatives for reducing supplies. One is for growers to agree on voluntary reductions of supplies. However, in the past, such agreements have been difficult to negotiate, and even more difficult to police. There will always be some growers who do not meet their commitments.

The other alternative is control through mandatory government programs, where the power of the state can be used to provide incentives for controlling supplies and to enforce compliance by tree removals, withdrawals of products from the market, or other diversions. However, many growers are reluctant to give government such power over their operations. In some countries, such controls may be illegal. In other cases, where such supply controls have given a temporary boost to prices, growers have responded by increasing supplies anew, and beginning the downward spiral of prices again.

Budgeting for Price Volatility
In general, fruit producers can expect to lose money in at least two out of every five years. That reality needs to be built into their plans. Until a generic, industry-wide solution can be found, individual operators have to rely on their own resources to ride out the price roller coaster. Knowing that it will inevitably happen, they need to make planting decisions based on both the best and the worst case scenarios that may lie ahead. They need to have plans to build up reserves in the good years that will tide them over the bad years. They need a friendly banker who understands the realities of the fruit business.

In particular, producers need to guard against the tendency to make long-term plans using price projections based on the most recent favorable price levels. The "hotter" the market, the more caution is recommended.

First published in the World Apple Report, June 2010, page 1.