

**Market of Financial-Credit Services**

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**DIRECT METHODS  
OF FOOD PRICE ADJUSTMENT:  
METHODS OF IMPLEMENTATION  
AND PERFORMANCE MEASUREMENT****Abstract**

The analysis of the application of the direct methods of the food price adjustment in Ukraine is conducted. The consequences of their influence on the food market entities are studied. The evaluation of the adjustment performance is realized. The implementation aspects of the direct methods of the price adjustment are defined in order to stabilize the position of Ukraine's food market in the postcrisis period.

**Key words:**

The direct methods of adjustment, foodstuffs, fixed price, price change declaring, limitation of the level of profitability, limitation of the trade margin.

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**Problem definition.** The economic theory and practice always pays much attention to the performance and nature of the price adjustment. This may be caused by the government intervention into the process of market pricing that leads to the limitation of the business entities' economic freedom. The studying of the regulatory forms in the crisis and postcrisis conditions (when the economic entities together with the state feel the problem of the limitedness of financial resources) are very actual.

The high social significance of the food market raises the actuality of the investigated processes. In particular, it concerns the processes of the food price adjustment. The events, concerning the implementation of the direct methods of the price adjustment should be investigated first of all, inasmuch as the expediency of their implementation for the regulation of the market processes is controversial. Nevertheless, the direct methods of adjustment considerably influence on the food prices and the consequences of their usage have the biggest form of appearance.

Nowadays, the price adjustment becomes rather common in the world practice. For example, in EU countries, the state price adjustment spreads to the 90 % of the farm prices [7]. Ukraine is not the exception in the list of countries which practise the direct methods of the price adjustment at the food market. In the scientific literature, the expediency of using the direct methods of the price adjustment is mainly considered from the perspective of transference of other countries experience into the national economic area and improving the necessity of practising of the specific price adjustment methods. The problems of price adjustment were studied by P. Sabluk, B. Paskhaver, O. Shpychak, Yu. Bilyk, P. Haidutskyi, V. Oniehina, H. Mostovyi, D. Hladkych and others. At that, the analysis of the essence of the price adjustment procedure and the performance measurement of the appropriate events is not studied completely.

**The aim of the scientific paper** is to study the peculiarities of application of the direct methods of food price adjustment in Ukraine and performance measurement of their usage in the formation of the paradigm of the government management of the Ukrainian economy.

The economic system with the applied direct methods of price management is defined by the availability of the fixed prices. Fixed price is a price, which is determined on the fixed level, during the well-defined space of time up to the next its review by the government body, addressed the issue of the price setting and is obligatory for the all economic entities irrespective of their patterns of ownership and subordination. The determination of the fixed food prices does not provide the government body price determination, due to which the one or another product will be encashed at the market. The usage of the fixed prices deals with production links, wholesaling and retailing. The most effective social consequences of this method depict on the retail trade, inasmuch as the price of

the specified foodstuff is directly defined by the state. At the same time, such adjustment can cause the biggest skewnesses at the market.

Today, the practice of using such a method of price adjustment as fixation is one in a thousand. During the last eight years the government bodies didn't determine the fixed price on food. Those trends are natural because as the scientists notice, according to the development of market relations, the sphere of the fixed prices application is gradually narrowed, they are used only in the extremal situations [1].

The direct methods of the price adjustment also include the standardization of the separate relations within the price structure. It is realized through:

- limitation of the level of profitability of the output;
- standardization of the trade margin;
- standardization of the cost-based component of price.

In Ukraine, the using of this method can be carried out both at the national and local levels. At the national level, the limitation of the level of profitability of foodstuffs was used over November 10<sup>th</sup> 2003 to July 1<sup>st</sup> 2004 in reference to the flour of first and second grades, bread and flour products, rye-wheat flour blend, bread and flour products for diabetics, when the threshold level of profitability was adjusted by the Order of the Cabinet of Ministers of Ukraine «About the urgent actions concerning stabilization of the bread and flour products market situation» № 1747 of November 10<sup>th</sup> 2003 in an amount of 5 % to the full expenditures. The aim of such method was the further stabilization of the bread and flour products and food grain market. According to the Cabinet of Ministers' conclusions, the assumed measures stabilized the prices on bread and flour products [2].

In accordance with the active legislation, the local bodies can also use such form of direct adjustment. In particular, The Order of the Cabinet of Ministers of Ukraine of July 24<sup>th</sup> 2003 № 1150 «About disadvantages in the work of the certain executive authorities concerning preservation of the food supply security and events, concerning stabilization of the food market» entitled the Autonomous Republic of Crimea Ministry Board, Kyiv and Sevastopol City State Administrations to adjust prices on corn, flour, bread and flour products, paste goods, grits, sugar, beef, cooked sausage, milk, cheese, butter and oil. Some regional state administrations also used such right. For example, by the Order of the Zhytomyr Regional Administration the standard of profitability, concerning some kinds of food production was determined:

- production of beef, cooked sausages, milk, cheese, butter and oil is carried out with the 10 % threshold level;
- the production of sugar, high-grade flour, pasta goods, grits with the 5 % threshold level.

In Volyn region the Order «About measures, concerning stabilization of the price situation at the regional food market» of February 2, 2004 was adopted. Accordingly, the threshold level of the trade margins for the business entities of all forms of ownership in the time of realization (for the period to July 1, 2004):

- bread crops – in the amount of 6 % to the wholesale and producers' cost price;
- flour, pasta goods, grits, oil and sugar in the amount of 12 % to the wholesale and producers' cost price;
- cooked sausages, sausage rolls and frankfurters in the amount of 10 % to the wholesale and producers' cost price;
- kefir – in the amount of 15 % to the wholesale and producers' cost price.

The consequences of usage of such method showed up urgently: the increase of the retail food prices stopped, and even the prices reduced. The limitation of the trade margin and bread production level of profitability was introduced in November on the base of the data about retail price index on the bread and flour products, which at the beginning of the year was 163, 7 %. The usage of the standard of profitability and trade margin enabled to reduce the amount of the annual retail price index on bread in 2003 to the level of 136 % [6].

The limitation of the level of profitability of the bread and flour products production and trade margin acted within the I half of 2004 – to the period of new harvest gathering. The application of such method of price adjustment caused the reduction of the index of retail prices on bread in 2004 to 98, 0 % – the prices within this period reduced in comparison with the previous year. But we can't say that the reduction of prices on such type of product was only the result of the standardization of the level of profitability and trade margin. Such result was reached by means of the usage of the whole complex of measures concerning price stabilization at the food market. Particularly, to stabilize the situation at the bread and flour products market at the end of 2003 – at the beginning of 2004 it considerable volumes of grain were imported on the duty-free base and in 2004 the quota allocation for grain export was introduced. Such measures balanced the market and enabled to overcome the reason, which caused the increasing of price on bread and flour products.

In such a way, it is hard to answer the question what method of price adjustment (direct – standardization of the price components or indirect – balanced export-import oriented policy) influenced on the stabilization of the food price market situation. But, we may say that the direct method of adjustment enables to smooth the consequences of price increase and indirect – to overcome the reasons of such increase.

Today, the adjustment of the retail food prices is carried out with the usage of the threshold levels of trade margins. In particular, the introduction of this

method in October 2007 envisaged the limitation at the level not higher than 10 % of the threshold volume of the trade margins on food. At that, the defined volume of the trade margins concerning end-consumer does not depend on the number of mediators.

The Order of the Cabinet of Ministers of 26.03.2008 № 276 introduced changes in the powers of the executive bodies and City Council executive bodies, concerning price adjustment. According to it, the mentioned government authorities can adjust the threshold levels of trade margins on flour, bread and flour products, pasta goods, grits, sugar, beef, cheese, pork and poultry, cooked sausages, milk, cream, butter, oil, hen's eggs not higher than 15 % without consideration of the expenditures for the transportation of the mentioned products in trunk connection. That is to say, the adjustment regime of the trade margins volume of March 2008 became less hard.

Besides using of such form of price adjustment in the mentioned context, the mechanism of determination of the threshold trade margins is used to adjust the prices on baby food products of the domestic production as well as number of products for diabetics.

According to the Order of the Cabinet of Ministers of Ukraine of December 25, 1996 № 1548 «About identification of capacities of the executive bodies concerning price adjustment» revised and expanded, the declaring of changes in the wholesale and cost prices belongs to the mentioned above methods of food price adjustment.

The declaring of changes in the wholesale and cost food prices envisages the coordination of the changes in the wholesale and cost prices by the economic entities, which realize the food products with the organs of the price control authority. The aim of this declaring was preventing of the price increase on the certain types of product without economically proved reasons. Such method of food price adjustment was introduced by the Order of the Cabinet of Ministers of Ukraine in October 2007 (The Order of the President of Ukraine stopped the effect of the Order of the Cabinet of Ministers from March till June 2009) [5].

According to the Order, the economic entities are obliged to declare the changes in the wholesale and cost prices on the main types of the food products [4]. The list of the declaring has five groups of products: milk, flour and meat products, hen eggs, sugar, oil, sausages, except sausages of high grade, milk up to 2,5 % of fat, lactic cheese (up to 9 % of fat), cream (up to 20 % of fat) butter (up to 72,5 % of fat). Although the document defined the declaring of prices in case of change, but in fact, it concerned only the increasing of prices. Particularly, it is predicted the necessity of declaring the wholesale and cost prices in case of their increase for more than 1 % during the month.

The permission for the price change is given by the State Inspectorate of the price control after the careful examination of the documents with the proper cause of the price change. For the entities of the food market the proper cause of the price increase can be the increase of the cost price of food products

through the changes of the volumes of economic and labor costs. At that, the indicators of actual and declared profitability are taken into consideration.

In response to the enterprises-producers price increase, the food market entities which realize the food products can prove the feasibility of their whole-sale price increase. The reason is in the increase of the cost price of the food products realization through the increase of the sale price, carried out according to the declaring requirements.

The need of the application of this method was proved by means of the significant growth rates of the retail prices on the main types of food products.

In Particular, in September 2007 p. the retail food price index was 103,3 %, and at the beginning of the year 113,1 %, the index of the food producers' prices in September was 103,7 % and 114,6 % – at the beginning of the year. We can make a conclusion and compare the dynamics of food market price indicators before and after the introduction of the declaring of the price changes. The comparison is conducted with the usage of the graphical method of analysis inasmuch as the peculiarity of its implementation is the possibility to introduce vividly the results of the analysis without the computation of the additional indicators.

The flow chart of the indexes of changes of the retail food price and food producers' price changes are depicted in the figure 1 and 2. In October 2007 the highest growth rates of retail and wholesale prices of the food producers were observed (the corresponding indexes were 104,5 %).

The presented charts enable to imagine the peculiarities of the consequences of the introduction of declaring of wholesale and cost food prices:

1) the next period after introduction of declaring (November 2007), the growth rates of prices on the mentioned products reduced: index of the retail prices – 102,4 %, index of the producers' prices – 102,0 %;

2) although the declaring concerned only wholesale and cost prices, but such method of adjustment positively influence on the volume of the retail prices;

3) after introducing the declaring, the indexes of the food producers' prices didn't reach the criticality.

The conducted analysis provides the opinion that the declaring of the changes of the wholesale and cost prices is the effective method of adjustment. At the same time, such method gives successful results only in the short-term period. Eventually, the economic entities adapt to the given kind of administrative adjustment and its consequences become less perceptible.

The implementation of the price declaring in practice requires standardization of the approaches of the food pricing. For this purpose, in April 2008 the Order of the Cabinet of Ministers confirmed the Order of the food pricing, adjusted by the state [3]. The Order defines the peculiarities of calculation and determination of food prices by the producers.

Figure 1.

**Index of the retail food prices changes**

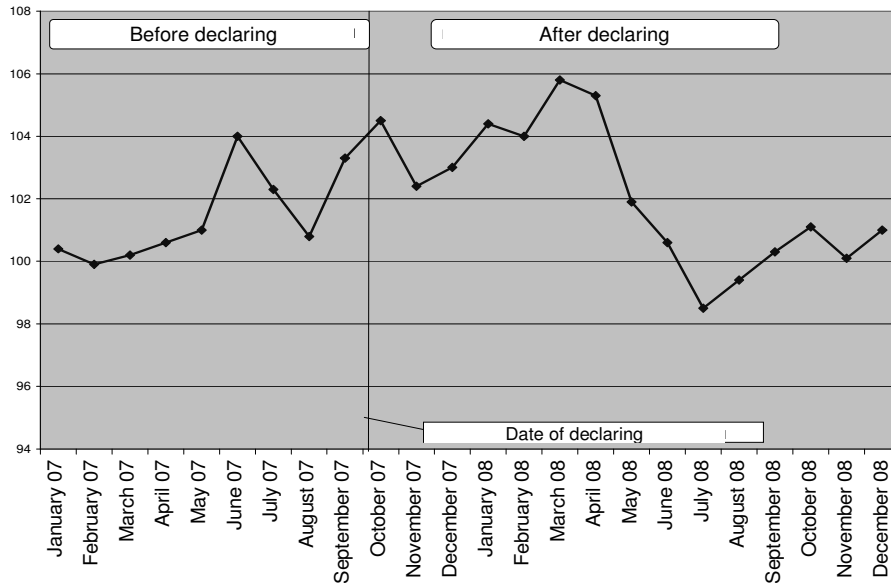
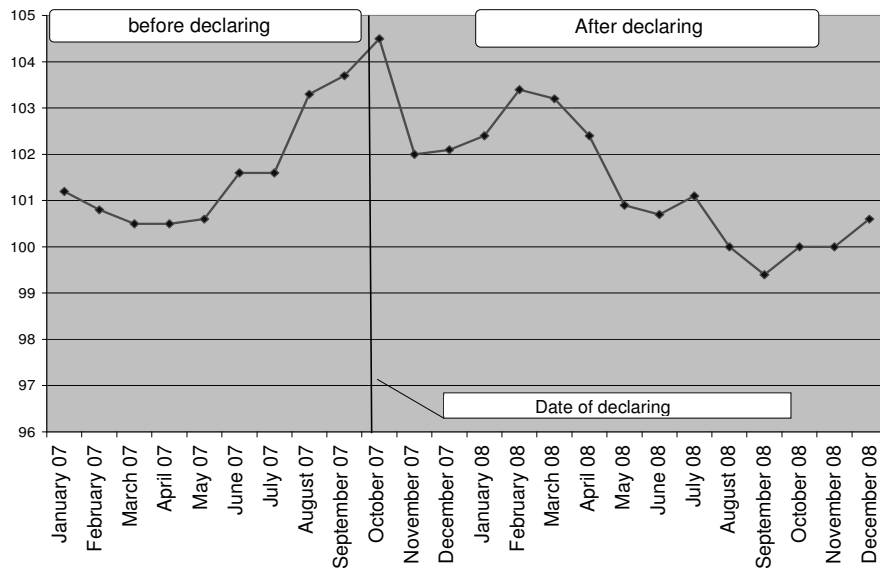


Figure 2.

**Index of change of the food producers' price**



The principle of the economically sound values underlies the price computation, according to the Order: economically sound food price is a price, which is formed on the base of the economically sound value of the planned expenditures for the production, merchandising of the given products and profit within the standard of profitability which is defined by the organ of price adjustment. At that, the economically sound expenditures are expenditures, which are planned by means of all requirements, standards, and technological norms as well as requirements concerning production turnout of the special quality.

The amount of profit is defined as product of sums of the target figure of product, administrative costs, sales and financial expenses on the standard of profitability, defined by the authorized body for price adjustment.

In fact, the methodics of price computation, showed in the Order, corresponds to the general approaches of the price setting. The peculiarity of the computation is only the profitable part of price, which is defined through the adjusted standard. It is considered that in the given context the declaring of the price change is combined with the other method of price adjustment – standardization of the separate correlations within the price structure.

From the other hand, the confirmation of the Order gives the methodological assistance to the food market entities in the pricing – this is the positive side of adjustment method application. The confirmed Order can be considered as an alternative of the methodological recommendations, concerning computation and determination of food prices. The introduction of such rules (recommendations) into the modern practice of price setting constricts the disagreements between the data of financial and fiscal accounting of the enterprise performance. By this, the information actuality about the financial situation of the economic entity increases. Correspondingly, the image of the enterprise increase in the eyes of the available and potential customers, creditors, providers and competitors. From the other hand, the availability of recommendations, concerning the order of price computation reduce the number of transgressions of the price state discipline and tax legislation requirements.

**Conclusions.** The conducted analysis showed that over the last decades in Ukraine the direct methods of adjustment were used towards food prices quite often. As a whole, we may say about the high effectiveness of the each adjustment method. But such effectiveness is observed only in the short-term period. The reason is that the direct methods of price adjustment can in a certain manner stop the process of price increase and can't overcome the reasons of such increase.

It is impossible to settle the problem of price increase completely using only the direct methods of adjustment; after all, the reason of the price increase is the disbalance at the market of the corresponding products. The direct methods of price adjustment are able to soften the negative action of the food price increase, but more deepen the disequilibrium of the market. The indirect (economic) methods can settle the problem of disequilibrium of the market. That is why; the application of the direct methods of price adjustment will be effective



only in case of effective measures concerning using of indirect (economic) methods of food price adjustment.

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