

## FOOD PRICE INFLATION

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Consumers are well aware of rising food costs. Their greater awareness of food price increases than for other goods is largely due to the frequency of food purchases. We use the question and answer format to examine some of the reasons why food prices have increased.

## 1. HOW MUCH HAVE FOOD PRICES INCREASED IN THE PAST THREE YEARS?

In 1977, food prices increased a little over 6% (See Figure 1). In 1978 food prices increased 10.5%, and in 1979 food prices increased approximately 10%. The farm value of the marketbasket of domestically produced farm foods accounts for about 40% of the yearly increase in grocery store prices. The farm to retail price spread, a measure of processing and marketing costs, accounted for about 50% of the rising food prices in 1979. Prices for fish and imported foods accounted for the remaining 10% of the increase in 1979. Food purchased away from home on the average increased 11% relative to 1978.

## 2. HOW MUCH HAVE PRICES OF SPECIFIC FOOD ITEMS INCREASED IN 1979?

Figure 2 shows specific food item cost increases as well as the great variability in food price increases between food categories in 1979. All food items increased 10%. But, cereal and bakery products increased 9.8% whereas beef and veal increased 27.9%. Pork and poultry products increased only 3%, and dairy products 11.1%. Fresh fruits and vegetables increased

14.1%. Most food prices increased less than the general rate of inflation more than 13% as measured by the Consumer Price Index.

3. WHY WAS THERE SUCH A LARGE INCREASE IN THE PRICE OF BEEF AND VEAL IN 1979?

The reason for the relatively large price increases for beef and veal in 1979 can be attributed to the beef cycle (Figure 3). Prices to producers were very low from 1975 to 1978 and many producers decided to liquidate their cow herds. Today there are 110 million cattle in the U.S.; in 1975 there were over 130 million head.

Beef cycles are caused by two basic factors. First, producers tend to base their expected future profits on current and past profitability. When prices fall to cattlemen (like in 1975-78), producers become pessimistic and cut back on the number of cattle. Beef supplies increase as more cattle are slaughtered and cattle prices are pushed still lower. The result is that consumers have plentiful supplies of beef at reasonable prices at the supermarket. But eventually beef supplies are reduced sufficiently that prices rise to both producers and consumers making beef production profitable (like 1979) and farmers decide to expand. Secondly, beef production is a biological process that requires about four years to appreciably expand the level of beef output. But as producers in general decide to expand beef output, prices are destined to fall many years later.

4. WHAT PART OF THE DOLLAR SPENT AT THE GROCERY STORE IS ACTUALLY SPENT FOR FOOD?

In 1978, as shown in Figure 4, 69% of the grocery store dollar goes for food. Another 9% goes for beer, wine, liquor, soft drinks, candy and chewing gum. Non-food items account for the remaining 22%. Nearly 13% is

for "other groceries" such as detergents, paper goods, cleaners, etc. and 9% goes for general merchandise like health and beauty aids. Individual shoppers can separate their food expenditures from grocery store spending by deducting the taxable items from the total bill.

#### 5. WHO GETS THE CONSUMER'S FOOD DOLLAR?

This chart (Figure 5) represents total food expenditures of \$239 billion in 1978, including food eaten at home and away from home. Of the total, only \$66 billion, or 27 percent of the nation's annual food bill was received by farmers. About 16 percent of the total food expenditures are for seafood and imported foods, including the marketing charges for these items. Marketing costs for U.S. farm produced foods amounted to about \$135 billion in 1978 or about twice the amount received by U.S. farmers. Combined, the food marketing costs totaled \$160 billion or 67 percent of the nation's food bill in 1978.

Retail food prices are affected by manufacturing and processing, transportation, and selling costs. The marketing bill has increased 110 percent in the 12 years since 1967, due both to the cost of marketing a larger quantity of food and increases in the per unit costs of marketing.

Direct labor costs have increased by more than 150 percent since 1967 and account for the largest share (about one half) of the total increase in food marketing costs. Average hourly wage rates have doubled since 1967 in food processing, manufacturing, food stores, and eating establishments. Fringe benefits increased about 25 percent in just the last 5 years and now account for 30 percent of total labor costs. Labor productivity in the food marketing system has improved, but erratically. For example, productivity at the food retailing level has declined 6 percent in the last 5 years due to changing work rules, longer store hours, an increase in products requiring services (such as delicatessen items), and a slowdown of investment in labor saving

technology.

Packaging and costs of transporting food products have more than doubled since 1967. Taxes, profits, advertising, fuel, interest, insurance and other business costs have increased by substantial amounts, thus placing additional upward pressure on food prices.

6. ARE GOVERNMENT PRICE SUPPORT PROGRAMS FOR FARMERS THE REASON FOR AT LEAST PART OF HIGHER GROCERY PRICES?

Many consumers feel farmers should not be paid for not growing grain. Today there is no program in affect that pays farmers for not producing. In recent years, market prices to producers have consistently exceeded price supports for farm products. (Overhead 6) There is a farmer-held grain reserve program to store grain in years of large output and relatively low farm prices. The intent is to meet consumers desires for stability and security in the supplies of food. Reserves do reduce price risks to farmers. The price that consumers pay for food products today reflect world market prices.

7. OVER A LONG PERIOD OF TIME, WHAT DIFFERENCE EXISTS IN FOOD PRICE INCREASES BETWEEN FOOD CATEGORIES?

The all food index of the Consumer Price Index has increased 134 percent in the 12 year period from 1967 to mid-1979 (See Table 1). Food prices have risen at an average annual rate in excess of 11% in this period. The general rate of inflation, as measured by the Consumer Price Index, has risen at about 9% per year.

Just four of the 10 major food categories have had price increases above the average for all food items during the past 12 years (Table 1). Fish and sugar prices have increased 28 and 18 percent respectively more than the all food index. Increases slightly above average have occurred for meat, (about

6.5 percent) and fresh fruits and vegetables (about 4 percent).

Price increases in the 12 year period for poultry meat, eggs, dairy products, fats and oils, processed fruits and vegetables and cereal and bakery products have been smaller than the increase in the all food price index.

Long run variations in the increase in retail food prices reflect mainly: 1) changes in consumer preferences and consumers' ability to pay for the products they desire; and 2) long run supply conditions that are influenced largely by improving technology and physical production limitations. Short run variations stem directly and indirectly from weather conditions in the U.S. and around the world and the biological nature of food production.

**8. WHY IS THERE SO MUCH DIFFERENCE BETWEEN PRICE CHANGES FOR SEAFOOD AND POULTRY MEAT?**

A dramatic contrast in food price variations over the longer term is provided by fish (seafood prices) and poultry meat. Fish paced the increase in all food prices during the period since 1967. (Table 1) The 1977 U.S. fish harvest, at 5.2 billion pounds, was 28 percent above 1967 (Table 2). Rising prices provided an incentive to increase the fish harvest. As a result of a policy change, our fishing boundaries were extended to 200 miles offshore, thus reducing foreign fishing competition in U.S. waters. During this 11 year period the net value, after deducting for expanding exports of domestically harvested and processed fish rose 142 percent.

A growing consumer preference for seafood was accompanied by improving incomes and is reflected in a 25 percent increase in per capita consumption during the 11 year period. To provide the additional fish required a threefold increase in the value of fish imports. The increase in our domestic fish harvest and more imports at higher prices indicates a strong shift in demand. Limitations in the physical capacity of our fishing fleet and the limitations of the seas to supply seafood contributed to the price

increases.

Near the other extreme, price increases for poultry meat products have trailed the all food price index by 20 percent even though the use of poultry meat per person has increased 36 percent in the 12 year period since 1967. Poultry production and marketing enterprises have experienced technological developments that have reduced costs and helped minimize retail poultry meat price increases.

9. WHAT KIND OF PRICE INCREASES FOR FOOD CAN CONSUMERS EXPECT IN 1980?

Figure 6 contains the U.S.D.A. projections for 1980 food prices. The Department of Agriculture is projecting prices for all foods will increase about 8% in 1980. Cereal and bakery products may increase about 9% and beef and veal prices may go up over 8%. Large quantities of pork, poultry meat and egg production mean prices to consumers may decline. Dairy product prices are expected to increase by 9%. Fresh fruits and vegetables may increase a little over 7%.

These estimates are, at best, minimum price increases for food in 1980. Higher inflation rates could alter the size of food price increases just as unexpected poor weather in 1980 could alter food output. Current levels of beef production indicate that the retail price could go up as much as 15%. With significantly higher transportation and labor costs, the all food price index could be up 11 or 12%.

Consumers can help contain their personal food spending by practicing careful comparative shopping. Look for advertised specials and purchase foods in plentiful supplies. Boycotts and government imposed price controls will not help; instead they encourage larger increases at a later time.

10. WILL THE EMBARGO ON U.S. GRAIN SHIPPED TO THE USSR MEAN LOWER FOOD PRICES IN 1980?

No! The amount of livestock-poultry products that will come to market in 1980 will not change (Overhead No. 10). Past profits and the biological process of animals has "locked in" the quantity of meat that will be available to consumers in 1980. Furthermore, some government actions to place additional amounts of corn in the reserve program and the government purchase of wheat for distribution to poor people around the world under the Food for Peace program will keep prices near the pre-embargo level. Thus lower livestock feed costs will not influence livestock expansion in 1981 or 1982.

11. IN SUMMARY, WHY HAVE FOOD PRICES INCREASED?

There are generally five causes for food price increases. (Overhead No. 11) All factors, except weather, are directly related to inflation. Inflation is the underlying factor in food price increases.

1) Increases in farm production costs. These are reflected in higher commodity prices. Increased farm prices are passed through the processor, manufacturer, wholesaler and retailer to the consumer in the form of higher food prices.

2) Increased marketing costs. Marketing costs have increased 160 percent from 1967 to 1978. Food marketing costs includes labor, transportation, processing and all other costs and are reflected in higher food prices.

3) Structural changes in the food industry. The possibility for concentration of market power in certain localities is greatly increased as the number of retailers declines. The government has a responsibility to monitor prices and generally will not allow market power to be too great in the food industry. This is not a serious problem with the food industry in most communities.

4) Food price increases as incomes of consumers grow. Away from home eating now accounts for 31% of the food component of the Consumer Price Index. Also the type of foods purchased are affected. In 1977, 5.6% of the Consumer Food Price Index was in the form of snacks and condiments; in 1979 it had increased to 8.5%. As income increases, consumers buy more prepackaged and luxury food items. Despite much higher 1979 retail beef prices, Americans can purchase as much steak with one hour of work today as was purchased with one hour of work in 1969.

5) Weather conditions and the biological nature of food production. These factors, too, affect food prices. Bad weather can cause crop failures which will result in higher prices in the food marketing system. The nature of the cattle cycle is such that when the cow herd is low, as in the early 1980's, consumers will pay higher prices for beef. The current hog cycle is in the plentiful stage for consumers with reasonable pork prices. However, hog producers are in a financial bind and will be reducing the breeding herd in 1980 and 1981. Pork prices will escalate in 1982 and 1983.