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FOOD PRICES AND POLICY

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Economics, Statistics, and Cooperatives Service

ESCS-59

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ABSTRACT

Food prices in 1979 will likely increase about 10 percent, the same rate as last year. Higher prices for farm commodities, particularly meat, and higher marketing costs are the primary causes. This paper puts the food price situation into historical perspective and reviews the 1979 USDA food price forecast.

Keywords: Food prices, food policy, food marketing

FOOD PRICE ANALYSIS AVAILABLE

A report analyzing food price behavior, component costs, consumer demand, and food availability will be available from ESCS this summer. If you wish a copy of the report, "Food Prices in Perspective," fill in the request form on the back cover of this publication and send it to: ESCS Information, Room 1664-S, (B-K), U.S. Department of Agriculture, Washington, D.C. 20250.

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Washington, D.C., 20250 July 1979

SUMMARY

Retail food prices are expected to increase about 10 percent in 1979. There was a dramatic increase in the first part of the year, but a slower rate of gain is in prospect for the next part of the year. The 10-percent forecast reflects an expected 10- to 14-percent increase in farm prices, a 9- to 11-percent climb in marketing costs, and a 7-percent cost increase for such nonfarm foods as fish and coffee and other imports.

Controlling avoidable food price inflation is an important component of a national food policy. A review of the data indicates that:

- Food prices have only recently exerted significant upward pressure on general inflation.
- The beef herd in 1975 began a cyclic reduction which now is pressuring meat prices upward.
- The food system is becoming more dependent on production factors outside its control, such as labor, energy, and capital. These factors are increasing in cost at relatively fast rates.
- The food system is becoming more concentrated. There are fewer farmers, fewer processors, fewer retailers, and fewer input suppliers. This increase in firm concentration increases the potential for higher prices.

All these factors combine to make food prices more vulnerable to a wage/price inflationary spiral. Without significant changes in the nature of the economy and the food system, annual increases in food prices at about the general rate of inflation can be expected in the years ahead.

Food Prices and Policy

William T. Boehm and Rodney C. Kite
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INTRODUCTION

Food prices have increased more rapidly since 1970 than the general inflation rate. Since food is purchased frequently and by almost everyone, sustained price increases are visible and controversial. The food price policy setting and the role played by food in the overall rate of inflation are discussed in this paper. Factors affecting food prices and USDA's 1979 food price forecast are reviewed.

THE POLICY SETTING

The American public is becoming more personally involved in issues dealing with the environment, work conditions, health and safety, and the extent of competition in industry. Food issues, too, have become part of this changed public policy setting where wide public participation is expected and, now, even encouraged by Government. For example, USDA has an institutional structure for obtaining decisionmaking input from the public--a public which spans many interest groups including consumers as well as the more traditional agriculture groups such as farm and agribusiness organizations.

Food policy discussions these days recognize that there must be balanced programs to assure an adequate, safe, wholesome, nutritionally balanced, and reasonably priced food supply. But, a policy to encourage reasonable food prices is not necessarily consistent with cheap food. Lower food prices in the short run cannot come at the expense of the farm sector or the food system. Adequate supplies over the long run depend on whether the food system remains economically viable.

FOOD PRICE MONITORING PROGRAM

Public involvement in food policy has been coincidental with the increases in prices. Retail food prices have increased at an increasing rate over the last 10 years. Food prices have increased 84 percent since 1970, slightly more than the increase in all prices.

Controlling avoidable price inflation in the food system will be important to the overall success of the Administration's anti-inflation program, and to the implementation of a balanced food policy. The word "avoidable" must be emphasized because some of the most basic sources of food price increases within a year are the ones we can do least about (such as weather and other natural and biological factors).

To identify and distinguish between controllable and uncontrollable sources of inflation, the U.S. Department of Agriculture is cooperating with the Council on Wage and Price Stability to monitor food prices. An Office of Food Price Monitoring has been established in USDA to provide current information on food price changes and analyses of the factors responsible for the changes. Food prices are monitored monthly and, where possible, weekly at the retail, wholesale, and farm levels.

Prices, farm-to-retail price spreads, costs of major inputs to farmers and marketing firms, and profit margins of food processors and retailers are monitored. When unusual or unexplained changes in prices or margins are identified, special studies are conducted to determine the underlying causes, and to identify policy options available for easing the inflationary pressure.

FOOD PRICES IN HISTORICAL PERSPECTIVE

Until recently, food prices have not exerted a sustained upward pressure on the general price level (fig. 1). Food price increases from 1950 to 1969 averaged about 2 percent per year and contributed less than 1 percentage point to the overall rate of inflation in 15 of those 20 years. Since 1969, however, the rate of increase has accelerated, increasing an average of 7.5 percent per year. Food prices increased 14 percent in 1973 and in 1974 and 10 percent in 1978.

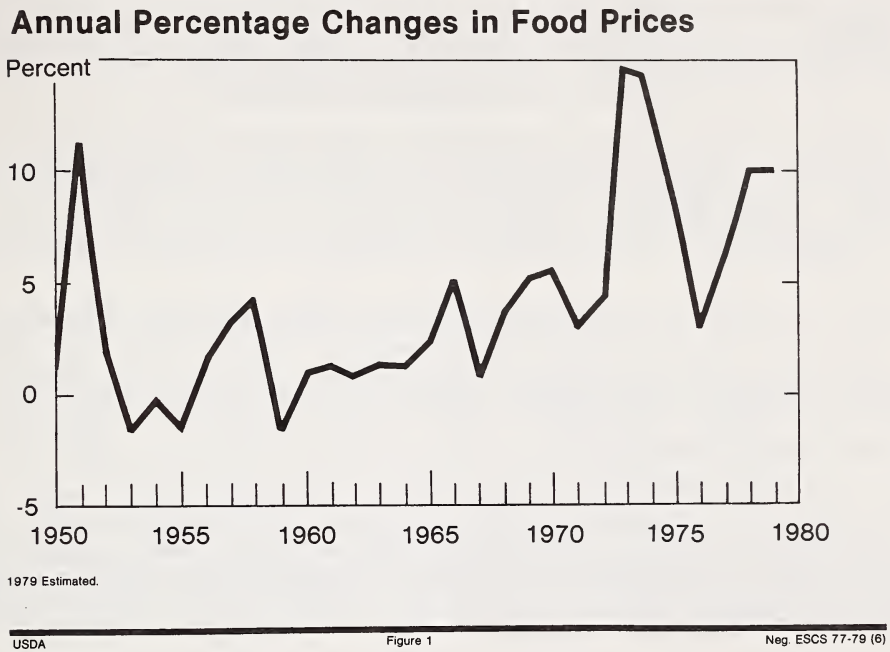
An increasing proportion of the food bill does not pay for food; rather, it pays for the services involved in moving food from the farm to the consumer. The underlying rate of increase in food prices, therefore, will increasingly reflect the rate of inflation in the general economy. This dramatizes the need to slow the general rate of inflation.

OVERVIEW OF THE FOOD SYSTEM

The food industry is large by any standard. Expenditures for food in 1978 accounted for about 18 percent of all consumer expenditures. Personal consumption expenditures for food were about $240 billion. 1/ About 87 percent ($208 billion) was spent on foods produced on U.S. farms. The rest was spent on foods such as fish, nonalcoholic beverages, and imported foods. Marketing costs accounted for $141 billion of the $208 billion and the farm value was $67 billion.

Personal consumption expenditures for food consumed at home represented about 75 percent of all food expenditures in 1978. The remaining 25 percent was spent on food consumed away from home, up from 22 percent in 1967. The increase in expenditures for food away from home is even more dramatic if purchases by airlines, business expense accounts, and some institutions are considered. This increased proportion of food expenditures allocated to the away-from-home market can be traced to increased mobility, changing lifestyles, more multiple-wage-earner households, and higher incomes.

1/ The Department of Commerce routinely monitors personal consumption expenditures for food. These data exclude food paid for by institutions.



FACTORS AFFECTING FOOD PRICES

Food prices, like prices for other goods and services, largely reflect consumer demand and the underlying costs of production. But, food prices also reflect the influence of uncontrollable forces such as weather and the biological life process, which heavily influence farm output.

Farm Production Costs

The farmer receives an average of 32 cents per dollar spent for domestically produced foods. Within a year, each 3-percent increase in farm food prices, therefore, generally increases retail prices for these foods by 1 percent. Higher prices for farm foods last year accounted for about one-half of the total increase in food prices.

Production is influenced by natural forces such as weather, plant and animal diseases, and insect infestations, which are almost impossible to predict. Such factors greatly influence output and commodity prices.

Farm-level prices are also influenced by biological forces, the effect of which we can predict but can do little about. Farmers cannot respond quickly to higher prices because the biology and genetics of plants and animals dictate just how fast or slow the production process will be, no matter how quickly an economic decision is made. The present meat situation is an excellent example. Even after beef farmers decide to increase production, it still takes about 43 months to bring significantly more meat to market. The beef cow herd contained 37 million cows as of January 1, 1979--21 percent less than the 46.9 million head available when the herd size peaked in July 1975. Per capita beef production in 1976 was 129 pounds; this year, it will be less

than 116 pounds, or down nearly 11 percent. This change in quantity was reflected in a 22-percent increase in retail prices from July 1975 to January 1979.

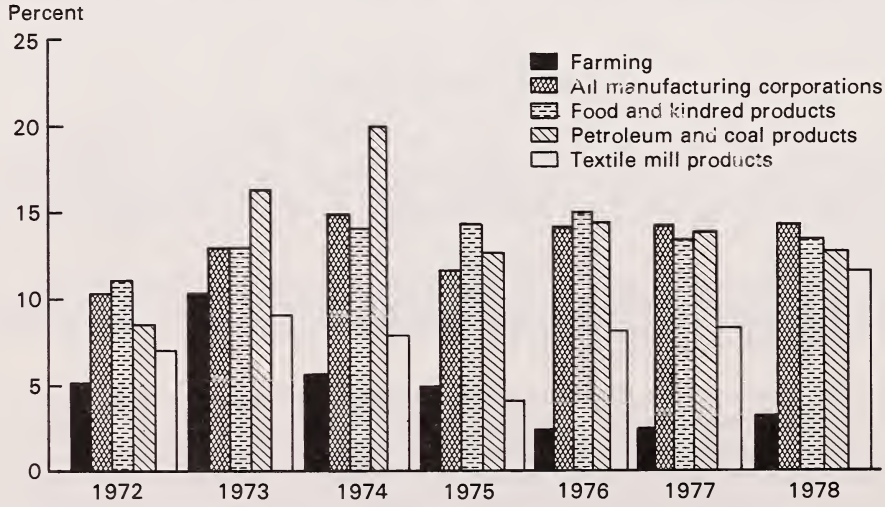
Reduced supply is not solely responsible for the price increase. In the same period, more people were employed (the unemployment rate dropped from 8.6 percent to 5.8 percent) and disposable per capita income increased 37.4 percent. While output declined, demand increased and prices responded accordingly.

Reduced supply of beef, however, was the major reason for the price increase. The nature of the farmer and the farm business help explain why. Agriculture has high fixed costs. Farmers continue to produce even though their rate of return on investment is relatively low. In 1978, for example, the return to farm equity was 3.6 percent, compared with a 14.6-percent rate of profit on stockholder equity in all manufacturing (fig. 2).

But, farmers do respond to economic signals; they invest more when conditions are right. Total farm debt increased 14 percent between January 1, 1978, and January 1, 1979. Farmers also choose not to invest when economic signals are not favorable. That is what happened to the beef herd between July 1975 and January 1979. Feeding margins, which represent a measure of profit, turned negative in the last half of 1973 and remained negative through 1977.

It takes 2 years from the birth of a calf until it can produce a calf. Thus, the increase in the herd in July 1975 was the result of a decision made in early 1973 when feeding margins were positive. Between July 1975 and January 1976, the herd was reduced by 3 million head, following 2 years of negative feeding margins. Margins remained negative, except for one period in 1976, and the herd was further reduced to the current 37 million head.

Return to Farm Equities and Annual Rates of Profits on Stockholders Equities, for Manufacturing Industries



USDA Figure 2 Neg. 21-79 (6)

Herd reduction occurs two ways: cows from the herd are sent to market and heifers normally destined for replacement are marketed. About 16 percent of the herd must be replaced each year under normal conditions: 1.5 percent because of deaths and 13 to 15 percent because of culling. From a herd of 47 million head, this would be a 7.5-million-head reduction in the herd in 1 year if no replacement animals are added. The actual herd reduction was, of course, not that fast. It took from July 1975 to January 1978 before that number of animals had left the herd.

Feeding margins were positive in 1978, pointing to increases in herd size. However, since it takes 2 years to produce a "new" cow and another 18 months to produce an animal for slaughter, we cannot expect much growth in meat supplies before 1981. Much depends on what producers did in late 1978 in response to better profit conditions. Current indications are that they held some calves for addition to the herd:

(1) The number of heifers entering the herd during the second half of 1978 was 20 percent higher than in the last half of 1977.

(2) However, the number of heifers added to the herd in the last half of 1978 still did not offset the number of cows slaughtered. So, herd size declined.

(3) The number of heifers on feed January 1 was down 7 percent from January last year, indicating that some were withheld for addition to the herd.

The reduction in beef production has been dramatic and a major contributor to the increase in meat prices. This has seriously affected food prices. About 70 percent of the increase in food prices in the first part of 1979 was due to higher farm-level prices. The remaining portions were added by marketing costs (20 percent) and nonfarm foods (10 percent).

Marketing Costs

Costs for processing, transporting, packaging, and selling food account for about 68 cents of each dollar spent for domestically produced farm foods, about $141 billion in 1978 (table 1).

Table 1--Marketing bill for U.S. farm food, 1978 1/

Item	Value	Proportion
	Billion dollars	Percent
Total food expenditures	208	100
Marketing costs	141	68
Direct labor	66	47
Packaging	18	12
Transportation	11	8
Other components	46	33
Farm value	67	32

1/ Preliminary.

Direct labor is the single most important component in food marketing costs. Packaging and transportation now account for about 20 percent of food marketing costs. Energy-related inputs are also quite important in food marketing. Reducing the rate of increase in food costs will depend, in part, on energy costs. Other components of marketing costs, noted in table 1, include profits, interest expense, advertising, and insurance. These account for a significant portion of food marketing costs. Each of these "minor" costs depend on conditions outside the food system. Interest rates, the strength of the dollar, and rates of return in other industries all impact importantly, if indirectly, on food marketing costs.

Increased costs for food marketing also reflect the increased concentration of economic power at all levels in the food system. There are fewer farms and all factors of production are more interdependent. Labor is less of a variable expense; contracts help ensure against layoffs in periods of lower production or decreasing demand. Investors expect returns to the money invested in the food industry to exceed the general rate of inflation. Management salary levels too are not likely to decline regardless of relative performance.

The gradual shift over time toward the increased concentration of economic power in food industry, coupled with declines in labor productivity, means that increases in costs get passed through to consumer prices more quickly. Simply put, cost increases and thus higher prices get built in.

Consumer Demand

Production and marketing factors affect food costs on the supply side of the food price equation. The evolving nature of consumption and consumer buying habits affect the demand side.

There are significantly more multiple wage-earner families these days. Family sizes are smaller and the social mores regarding the role of women (and men) are changing. Add to these changes the fact that incomes have increased steadily over the past decade, and that the population has continued to grow. It is then easy to see how consumers have influenced the generally higher food prices. Although prices continue to rise, consumers continue to demand more in food quality and services. For example, despite the higher prices, Americans could still purchase more steak from the income earned in 1 hour in 1978 than was possible in 1969.

Some of the changes in demand are already being reflected in the relative weights for the various components in the food Consumer Price Index (CPI); foods with high "service" components are increasing in importance. Away-from-home foods now account for 31 percent of total food weight in the CPI--9 percent higher than in 1977. The "other processed food" category--including packaged prepared foods, snacks, and condiments--has also increased in importance from 5.6 percent in 1977 to 8.5 percent, a 52-percent increase. The nonalcoholic beverage category is now 12.4 percent of the total at-home food purchases index, about 30 percent more than previously.

The fact that processors continue to add and sell more services with food products reflects our changing life styles. Higher food prices reflect our willingness to pay for added services such as pre-preparation and slicing.

OUTLOOK FOR 1979

Marketing costs, consumer demand, and the relative availability of farm commodities will combine again this year to produce higher food prices. The most likely weather,

economic conditions, marketing costs, and input prices indicate a retail food price increase in 1979 of about 10 percent. This forecast reflects current estimates of a 10- to 14-percent increase in farm value; a 9- to 11-percent increase in marketing costs; and a 7-percent increase in the cost of nonfarm foods.

Beef and veal prices will increase this year, because of reduced supplies and strong demand. We expect beef production to decline 10 percent this year, partly reflecting the rebuilding of the cattle herd. This reduced production, combined with an expected 10-percent increase in disposable income and increase in population leads to an approximate 30-percent increase in retail beef and veal prices in 1979. Despite significant increases in production of both pork and poultry, retail prices for these products will again be pulled higher by the reduced availability of beef, particularly beef used for hamburger.

Table 2--U.S. per capita meat consumption, 1976-79

Item	1976	1977	1978	1979 forecast
	Pounds			
Beef	129.3	125.9	120.1	110.0
Veal	4.0	3.9	3.0	1.8
Pork	59.5	61.5	61.4	69.0
Lamb and mutton	1.9	1.7	1.6	1.6
Red meat	194.7	193.0	186.1	182.4
Broilers	40.4	41.7	44.7	48.5
Other chickens	2.9	3.1	3.0	2.9
Turkeys	9.2	9.3	9.4	10.1
All meat	247.2	247.1	243.2	243.9

Source: Economics, Statistics, and Cooperatives Service, U.S. Dept. Agr. Forecast is current for May 1979.

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