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Food Costs Beyond the Farm Gate

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Higher marketing costs were the primary cause of rising consumer expenditures on food over the past decade. Marketing costs are measured by the marketing bill, which is the difference between the farm value of domestically produced foods and the final cost to consumers. Between 1980 and 1990, the marketing bill rose 83 percent and accounted for most of the 67-percent rise in consumer domestic food spending (figure 1). The farm value, or farmer's share, of food purchases climbed only 30 percent (see box).

Labor: The Largest Cost

Labor costs overshadow all other cost components in the marketing bill (figure 2). Rising labor costs have accounted for almost half of the total increase in the marketing bill over the last decade. And, higher labor costs were primarily responsible for the 5.9-percent increase in the marketing bill between 1989 and 1990. Labor costs rose 6 percent to $154 billion, largely because of greater employment in the food industry and higher employee compensation (table 1). Employment in eating and drinking places—which account for 53 percent of total food industry employment—rose 2.3 percent in 1990. About 27 percent of the industry was employed in foodstores and 20 percent in food manufacturing and wholesaling.

During 1990, employment in the retail food industry grew 3.3 percent, which was the average rate of increase for this sector over the last decade. Foodstore employment increases were generated by higher consumer purchases of microwaveable foods; take-out foods from salad bars, bakeries, instore delicatessens; and other prepared foods. Grocery stores are making greater use of part-time workers to stem increased labor costs arising from these labor-intensive services. Part-time workers hold down labor cost increases because they are paid less, qualify for fewer benefits, and reduce overtime pay to full-time workers.

Employment in food manufacturing grew just 0.3 percent in 1989-90, the fifth consecutive year in which employment rose after 6 consecutive years (1979-85) of decreases. Employment has grown over the past few years largely because more workers were hired in poultry processing plants as consumers increased consumption of poultry products. Nearly 4 percent more employees worked in the poultry industry in 1990 than in 1989.

While health concerns may be increasing the demand for poultry products, Americans' palates continue to crave candy. As a result of strong demand, more candy was produced, requiring 8.6 percent more workers at candy manufacturers. However, the overall effect on food processing employment was not as great because candy manufacturers employ less than a third as many people as poultry processing establishments.

The biggest factor affecting labor costs in the past year was the rapid escalation of health care costs, resulting from rising health insurance premiums. Employers have attempted to contain health costs by requiring second opinions prior to surgery, approval from insurance carriers prior to hospital stays, and participation in health maintenance organiza-

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Figure 1

Marketing Bill's Share of Consumer Food Spending Has Risen

Source: *Food Cost Review, 1990*, AER-651, USDA, ERS, July 1991.
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tions (HMO's). Employers have shifted some health costs to employees by means of higher deductibles and copayments. Some plans have reduced benefits, while others have required employees to pay a larger share of the premium.

Higher Social Security taxes and pensions were also behind the higher cost of employee benefits. Social Security payroll taxes for employers escalated because the maximum amount of taxable wages increased as did the tax rate on wages.

Low inflation rates and concessions on wages and benefits by unions held down labor costs during the 1980's. Cost-of-living adjustments (COLA's), for example, were once a major feature of union wage contracts. In 1990, COLA's were in effect for only 7 percent of food manufacturing employees, while no major contract provided COLA's for retail food employees. With low inflation rates, COLA's were phased out and replaced by lump sum payments.

Lump sum payments were granted in lieu of wage increases or to offset wage decreases. They restrain labor costs by holding down the wage rate base, which is used to calculate benefits such as overtime, pensions, and life insurance. These payments were largely eliminated in 1990 bargaining settlements. Two-tiered wage contracts—in which workers hired after a specified date receive lower wages or fewer benefits—continue to be phased out. Both management and labor have noted the reduced productivity from employees on lower wage tiers.

Back-loaded contracts also continue to be phased out. These contracts provide lower wage rate increases in the first year of a contract, relative to subsequent years. Prior to 1983, more contracts were front-loaded, meaning the largest wage increases occurred in the first year. Back-loaded contracts were used to dampen rising wage rate bases, which effectively delayed wage increases. Nearly half of all workers were covered by back-loaded contracts in 1986. That figure had dropped to 20 percent of all workers by 1990.

In 1990, front-loaded contracts predominated in bargaining agreements covering food manufacturing and retailing. They provided higher wage adjustments than back-loaded contracts. The Bureau of Labor Statistics reports that the average front-loaded adjustment for food manufacturing workers was 4.6 percent in the first year and 3.4 percent annually

Where Our Food Dollars Go

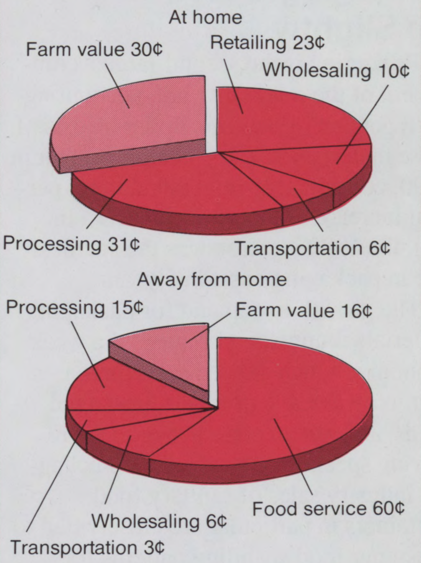
Consumer food expenditures cover items bought at foodstores and eating places. They can be broken into two components based on where the dollars go—the farm value and the marketing bill. The farm value, which accounted for 24 percent of the 1990 food dollar, is an estimate of the farmer's share of food purchased for at-home and away-from-home consumption. The marketing bill is the difference between the farm value of domestically produced foods and the cost to the consumer. Imported foods and seafood are excluded from these estimates.

In 1990, marketing costs accounted for $334.2 billion of the $440.8 billion Americans spent for U.S. farm foods. The marketing bill rose 5.9 percent and the farm value increased 2.7 percent over 1989.

The marketing bill is the cost of processing, wholesaling, transporting, and retailing food. These costs are higher for away-from-home meals than for food for at-home use. Correspondingly, the farm value share for away-from-home food is smaller, primarily because the cost of additional labor needed to prepare meals and snacks reduces the farmer's share of the final product's value. For the same reasons, away-from-home foodservice costs are much greater than their retailing counterpart in the at-home market—60 cents of the food dollar, versus 23 cents.

Processing is a larger share of at-home food expenditures than of away-from-home, 31 cents versus 15 cents. However, when an allowance is made for the larger share of food service in the away-from-home market relative to the share of retailing in the at-home market, processing costs are about the same. This suggests that retail stores and away-from-home outlets purchase about the same proportions of raw and processed foods.

Marketing Costs Take a Larger Share of the Away-From-Home Food Dollar[1]



[1]1990 data. Farm value is an estimate of the farmer's share of food purchased for at-home and away-from-home consumption.
Source: *Food Cost Review, 1990*, AER-651, USDA, ERS, July 1991.
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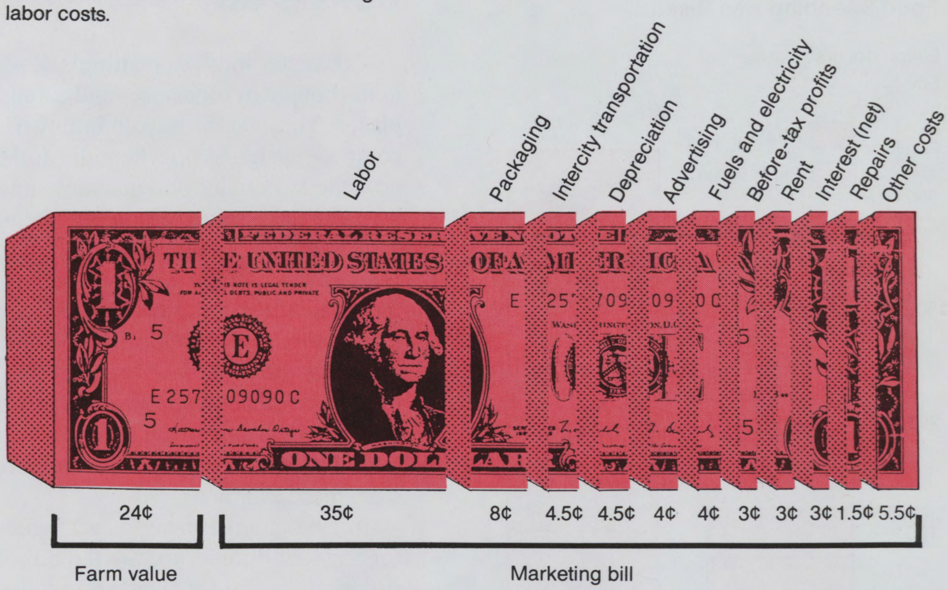
over the life of the contract. For foodstore workers, wage increases averaged 4.6 percent during the first year and 3.8 percent annually over the life of the contract.

Recent collective bargaining settlements in food manufacturing and retailing provided larger wage adjustments than the contracts they replaced. These wage increases reflect renewed efforts by unions to regain wage concessions and givebacks that were granted during the 1980's. Since labor agreements are valid for a period of 2-3 years, labor costs are expected to accelerate upward over the next few years.

Figure 2

What a Dollar Spent on Food Paid for in 1991[1]

About one-third went for food marketing labor costs.



[1]Includes food eaten at home and away from home. Other costs include property taxes and insurance, accounting and professional services, promotion, bad debts, and many miscellaneous items.
Source: *Food Cost Review, 1990,* AER-651, USDA, ERS, July 1991.
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Packaging Costs Up Slightly

Packaging is the second-largest component of the marketing bill, accounting for 8 percent of the food dollar. Costs of these materials rose less than 3 percent in 1990, considerably lower than the 8-percent increase of the previous year. In fact, the 1990 increase was the smallest rise in packaging costs in 5 years.

The growth in demand for packaging materials diminished because of a weak economy, which slowed sales increases of microwaveable products, packaged foods, and other convenience foods requiring specialized packaging. Packaging industry sales of sanitary food containers in particular are closely tied to consumer food spending patterns for these items. Also stemming the rise in packaging costs was a decline in the price of plastic packaging, while prices of paperboard boxes and sanitary food containers held steady.

The choice of packaging products is largely driven by modern cooking technology and demographic forces, such as population changes and shifts in workforce composition. Fast-paced, two-income lifestyles have reduced the amount of time available for preparing food at home and increased the demand for quick, easy-to-prepare meals. The growing pool of older adults also tends to use more convenience foods. The desire for convenience implies increased sales of sanitary food containers that are lightweight and microwaveable.

The demand for convenient, microwaveable food products was strong enough that, despite a sluggish economy, the amount spent on food packaging rose in 1990.

Table 1.

Higher Labor Costs Fueled the Marketing Bill's Rise in 1990

Component	1975	1980	1985	1988	1989	1990
			Billion dollars			
Labor [1]	48.3	81.5	115.6	137.9	145.1	153.8
Packaging materials	13.3	21.0	26.9	32.6	35.2	36.2
Rail and truck transportation [2]	8.4	13.0	16.5	17.8	18.6	19.6
Fuels and electricity	4.6	9.0	13.1	14.1	15.3	16.3
Pre-tax corporate profits	7.1	9.9	10.4	11.6	11.8	14.1
Other [3]	29.7	48.3	76.5	87.9	89.6	94.2
Total marketing bill	111.4	182.7	259.0	301.9	315.6	334.2

[1]Includes employees' wages or salaries and health and welfare benefits. Also includes imputed earnings of proprietors, partners, and family workers not receiving stated remuneration. [2]Excludes local hauling charges. [3]Includes such items as depreciation, rent, advertising and promotion, interest, taxes, licenses, insurance, and professional services.

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Transportation Costs Have Soared

Intercity truck and rail transportation costs for farm foods amounted to $19.6 billion in 1990, or 4.4 percent of retail food expenditures. Larger food marketings and higher transportation rates boosted costs more than 5 percent in 1990, the largest increase since 1981.

The entire transportation sector was hit hard by higher oil prices that occurred with the Persian Gulf crisis. Trucks and trains that transport food products use diesel fuel. The oil price rise had a large impact on diesel fuel prices, which rose 26 percent in 1990. Fuel costs account for approximately 20 percent of total truck transportation costs.

Energy Bill Is Higher

The 1990 energy bill came to about $16 billion, up 6.5 percent from 1989, and represents almost 4 percent of retail food expenditures. The energy bill included only the costs of electricity, natural gas, and other fuels used in food processing, wholesaling, retailing, and foodservice establishments. (Transportation fuel costs, except for those incurred for food wholesaling, were excluded.) Higher energy costs resulted largely from the expanded size of the food industry.

Higher oil prices arising from the Persian Gulf crisis had a limited effect on food marketing costs. Food manufacturers and distributors use natural gas and electricity to power their facilities. Natural gas prices remained at 1989 levels as a result of abundant domestic supplies. Electric rates increased less than 2 percent, since coal — not oil — is the principal source of energy for generating electric power.

Corporate Profits Rose

Before-tax profits that firms earned from marketing foods of U.S. origin were estimated at $14.1 billion for 1990, a 19-percent increase over 1989. Higher food industry sales and larger profit margins in food retailing were the primary causes of the dramatic jump in industry profits.

The large profit margin can be explained by several factors. First, a number of companies cut costs and sold assets to reduce debt and interest payments resulting from merger and acquisition activity. (see " The Food Marketing System" elsewhere in this issue.) Second, greater efficiencies have been achieved through the use of technology for inventory management and merchandising, labor savings at checkouts, and energy conservation. Third, retailers have built larger stores to give more space to the highest margin products, including perishables, service departments, and nonfood items. ■