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FOOD PRICES IN 1980: DISCUSSION

(By Doyle A. Eiler, Director of Research, Food Marketing Institute)

I would like to commend Dr. Farrell on his careful analysis of our current food situation. While we all might wish he could provide a definitive single estimate for next year's food inflation, the uncertainties of the economic, agricultural and political situations are just too great.

It takes courage to resist the political and media pressure for a single definitive number and we congratulate Dr. Farrell for his fortitude.

Although I must admit I am intrigued by the number the USDA has selected. Seven and eleven sounds Las Vegas to me but with the international situation today, maybe we really are rolling the dice for next year.

Perhaps the roll of the political dice has something to say about our domestic economic policy as well. Food prices cannot be considered in isolation from the political pressures they generate and I would like to turn to that topic for a moment.

With the prospect of continuing high inflation, I am concerned that short term political considerations have become the overriding focus of our economic policy. There is no disagreement that inflation is our primary economic problems but its solution requires long-term adjustments.

Last fall, in an effort to interrupt the self-perpetuating cycle of inflationary expectations, a voluntary wage-price guideline program was established to provide a moderating climate which would nurture the price decelerating effect of appropriate long-term adjustments in monetary and fiscal policy.

No matter how noble its intent, a guideline program can only be effective for a short period of time. By its very nature, a guideline program attempts to maintain the status quo. While the status quo may be politically desirable, we have seen with the recent increases in international oil prices that it is economically impossible.

Just because there is no simple economic solution to inflation does not eliminate the need for political solution. As an example of a politically motivated solution to inflation, pressure is now developing at the White House and within the Council on Wage and Price Stability to require food retailers to selectively post historic prices in their stores. The intent of this cosmetic program would be to demonstrate that the government is doing something about inflation but what is its real impact.

Just as cattlemen can't buy feed at last year's prices, neither can consumers buy hamburger at last year's prices. With farm prices outside the guideline program, as they should and must be, prices of individual agricultural products at retail are not the proper focus for public attention. The control program for food distributors is extremely complex—complex beyond the reach for a single price posting number. Historic price data does not even make a significant contribution to helping consumers make informed choices among their current shopping alternatives.

The selective posting of historic prices has the potential for seriously distorting the pricing signals so important to encouraging the supply response of producers. We only need look at the reaction of beef producers during the price freeze of the early 1970's to see the important role price plays in their decision process. If a shortage causes an upward pressure on price, artificially dampening price movement doesn't encourage the natural price moderating force of increased production to occur.

In our current inflationary environment, food retailers are in the unfortunate situation of being bearers of bad tidings. No matter what its source, inflation is noticed by the consumer when they pay their hard earned dollars for fewer and fewer bags of groceries. Grocery store inflation is more noticeable to consumers because of the frequency of cash purchases. While food inflation may be more easily noticed by consumers, Dr. Farrell appropriately points out that in the long run food closely parallels inflation in the general economy. Thus any effort to heal the diseases of inflation must move beyond temporary measures to reduce the patient's fever as reflected in food store prices.

With the high visibility of food inflation, we all are frequently asked to comment on food prices and their impact on the cost of living. As economists, when you and I are asked "what has happened to the cost of living" we usually refer to the Consumer Price Index (CPI) which is published monthly by the Bureau of Labor Statistics (BLS). In doing so, we frequently slide over a subtle, yet, important technical point which is particularly significant in examining food price inflation. The CPI is not a cost of living index but rather a fixed weight index. In many areas this distinction may not be important but it is for food.

Of all major consumer expenditure categories, food provides the greatest opportunity for product substitution in response to changing relative prices. It is recognized that if the price of chicken drops relative to hamburger, consumers will shift their purchase from hamburger to chicken. In fact, this is the most important way for individual consumers to cope with inflation. Yet this constantly changing mix of actual food purchases is not picked up by the CPI.

This does not mean that the CPI is not a good fixed weight price index; rather, it illustrates the inappropriateness of using the food component of CPI, as a cost of eating indicator. By its very nature, the CPI overstates the actual increase in the consumers cost of eating.

To illustrate the effect product substitution can have on the cost of eating, I would like to cite some actual retail food store data. As part of their retail accounting program some retailers collect information on the average per case retail value of merchandising moving through their store. This per case value can be used as an index of the price consumers are paying for the goods actually purchased. As consumers substitute one product for another, it is reflected in average per case value.

In the market where this company operates, the CPI food at home index increased 9.2 percent between September 1978 and September 1979, but the average value per case for all food commodities increased only 8.5 percent. This 0.7 percentage point difference is indicative of the tendency of CPI to overstate actual increases in eating costs. During a period of stable relative prices this distinction is unimportant but in periods of rapid price increases in one or two commodities we should avoid overlooking the impact rational consumer behavior has on the cost of eating.

It is very easy to slip from technically correct interpretation of CPI as a price index into using it as a cost of living index which it is not. Dr. Farrell, in his paper, was most careful to avoid this trap and I am encouraged that the USDA acknowledges the problems associated with misinterpretations of fixed weight indexes. Negotiators of cost of living accelerator clauses in various contracts have not been as careful.