Benjamin Senauer, University of Minnesota

1983 Agricultural Outlook Conference, Session # 30
Washington, D.C.

For Release: Wednesday, December 1, 1982

Rising food prices are currently not a major concern of consumers. Low agricultural commodity prices, however, are a major problem for farmers. The Consumer Price Index for all urban consumers - U.S. city average (CPI-U) rose only 5.1 percent between October 1981 and October 1982. The CPI-U for food rose an even lower 3.4 percent during the same period, with the CPI-U for food at home increasing 2.7 percent and for food away from home 4.9 percent. Food prices have had a dampening effect on the overall inflation rate over the last twelve months. Consumers have had very little to complain about regarding food prices recently and this pattern should continue for the next year. With grain stocks at record levels, food price increases should be small in 1983 and probably less than the general inflation rate, unless there are some major surprises.

As we all remember though, this country has been through a period of sustained price increases, both in general and for food. During the period of high inflation, the CPI for wage earners and clerical workers for food rose from 126.0 in December 1972 to 276.6 in July 1981. An increase of 120 percent in eight and one-half years, an annual average price rise of over 9 percent. In this period the annual increase in food prices was less than 6 percent only during 1976, based on a comparison of the average annual CPI indices.

Consumers are particularly sensitive to rising food prices, because of the large proportion of the average household's budget involved and the frequency of purchases. The cost of food at home, as estimated by USDA, for a moderate-cost meal plan for a family of four (with two elementary school age children) was $43.00 per week in December 1972. This figure had risen to $90.00 by June 1981, an increase of 109 percent. During the entire thirteen year period from 1960 until the end of 1972, the increase in the cost of this meal plan had only been 35 percent, rising from $31.90 in January 1960.

From another perspective, food has remained a remarkable bargain in the U.S. By 1970, the proportion of disposable income spent on food had declined to 17 percent. This figure held at roughly this level during the 1970's and has fallen below 17 percent in the last few years. In the second quarter of 1982, 16.1 percent of disposable personal income was spent on food, only 11.7 percent went to food consumed at home. In comparison, food expenditures accounted for 25 percent of disposable income in 1929. The average American household spends a smaller portion of its budget on food than in almost any other nation. Food accounts for over 30 percent of total per capita consumption expenditure in Japan and over 25 percent in the United Kingdom. However, in the U.S., food can still represent a large drain on low income families' budgets. In 1979 the bottom fifth of families, in terms of income, spent 35 percent of their pre-tax income on food.

Retail food price changes are generated by two quite different sets of factors. One set of forces affects the farm-level value of basic agricultural commodities. The other set affects overall marketing costs. About 2/3's of the cost of food to the consumers is added after the product leaves the farm. The CPI-U for food stood at 287.0 in October 1982. The CPI-U for all items was 294.1 The closeness of these two indices indicates a remarkable long-run correspondence between the general inflation rate and increases in food prices. The major force pushing up consumer food prices is the general inflationary pressure on costs after the products leave the farm.

Food prices are affected by the costs of processing, transporting, and retailing. Labor costs are responsible for the largest share in increased food marketing costs. As in many areas of the economy, labor productivity in the food marketing system has improved only erratically in the last decade. The long-run key to controlling food prices is to contain the general inflation rate and improve productivity in the marketing system.

However, since the basis of the food system is agricultural production, food prices retain a unique volatility. Fluctuations in basic commodity prices due to weather and foreign demand can have a sharp short-run impact, especially on certain food prices. This was clearly demonstrated following the Russian Grain Deal of 1973, with exports to other countries also booming. The general inflation rate was only 6.2 percent in 1973 measured by the CPI, whereas the food index increased 13.2 percent. And in 1974, the increases were 11 percent and 13.8 percent, respectively. Beef and veal prices rose 29 percent during the first nine months of 1973.

In fact, given the vagaries of the weather, the recent food supply and price situation could have evolved quite differently over the last two years. In the summer of 1980 there was a drought throughout much of the Midwest. Consequently, feed-grain stocks were at near-record lows in the spring of 1981. Adverse weather conditions or some other crop disaster in the 1981 growing season could have sent prices through the roof. Instead, with highly favorable weather, there have been two years of bumper harvests.

Behind the aggregate price indices, there are significant changes in the relative prices of many food products, which deserve attention. Some of the most dramatic changes have occurred for meat and poultry. The July 1980 CPI-U with 1967 = 100 was 267.9 for beef and veal, 200.3 for pork, and 187.9 for poultry. The food at home CPI-U stood at 251.5. The price of pork, therefore, became more attractive relative to beef and also to other food items in general. Poultry became a markedly more attractive buy in relation to red meats, especially beef, and other grocery cart items in general. These relative price shifts represent a long-run trend and are not just the result of short-term fluctuations.

The evidence clearly suggests that consumers responded to these relative price changes by adjusting their consumption pattern. The per capita consumption of beef and veal fell from 82 pounds (retail weight) in 1967 to 78 lbs. in 1980. At the same time, pork consumption increased from 60 to 68.3 lbs. Poultry consumption (chicken and turkey) rose from 44.9 lbs. to 60.5 lbs. between 1967 and 1980, a 35 percent increase. Meat and poultry consumption have been affected by other factors also, but price shifts have unquestionably had a major impact.

I had a chance to review a preliminary version of Paul Westcott's paper and found very little with which to disagree. Perhaps some explanation is needed with regard to our seemingly contradictory figures on 1982 retail food price increases, which Westcott said averaged about 4.5 percent higher than in 1981. My figure of 3.4 percent is based on a comparison of the CPI-U in October 1982 with the level in October 1981. Westcott's food price changes, reported in his Table 1, are based on a comparison of annual average CPI levels for the various years. Westcott's price increase for 1982 is a preliminary estimate. For this reason, I prefer the accuracy of my figure. With food price increases decelerating, my figure is lower. Between June and October 1982 the CPI-U for food actually fell slightly from 287.8 to 287.0.

My guess is that when the December 1982 CPI-U for food is available, a comparison with the December 1981 figure will yield an annual increase of 3.5 percent, or quite possibly slightly less. For next year, Westcott's estimate of 4 percent as the most likely percentage increase in food prices seems a good one. My estimate might be a little higher, say 4.5 percent, but since the future can be full of surprises, these very low projections might look quite foolish in retrospect.