Factors Behind Rising Food Costs

Last year the retail cost of a market basket of farm-produced foods bought by an urban household averaged $1,537—$226 or 17 percent more than in 1972. Not since the 21 percent jump from 1946 to 1947 had food prices risen so sharply. Moreover, food prices have continued to push higher well into 1974. Consumers in the first quarter, for example, paid an average of $1,720 (annual rate) for a market basket of farm foods, up 5 percent from the fourth quarter of 1973 and 22 percent above a year earlier. Overall, food-at-home prices have soared at a far more rapid pace than have prices of food away from home.

Effects of this food-price spiral have been felt by almost every American household. Harried homemakers—especially those with large families and those living on fixed incomes—have found it increasingly difficult to stretch the family food budget. Plotting their shopping strategy in efforts to make their food dollars go further, these cost-conscious shoppers have boycotted meat counters, planned and served more casseroles, and substituted eggs and poultry, cheese, and navy beans for beef and pork. But this shift to less costly foods has helped, in turn, to drive up the prices of these foods.

Homemakers across the nation are asking plaintively: Why this upsurge in food prices? Who is to blame? Is it the farmer? Is it the marketing system? Or, does part of the responsibility lie elsewhere?

To get at the facts, some useful basic background information— and perhaps some of the answers—can be found by examining recent data of two major statistical series maintained by the U. S. Department of Agriculture. One is known as the market basket, and the other is called the marketing bill.

FARM FOOD MARKET BASKET

The farm food market basket is a guage set up by the USDA to measure average changes in retail food prices. It also measures changes in returns to farmers and in the costs of marketing farm foods. This so-called market basket contains the average quantities of domestic farm-produced foods bought annually per household in 1960 and 1961 by families of urban wage earners and clerical workers and by single persons living alone.

The retail cost of market-basket foods does not represent all the money a typical urban family spends for food during the year, however. It does not include the cost of meals in away-from-home eating places. Nor does it include the cost of seafoods and imported foods such as bananas and coffee. Actually, the retail cost of the market basket for a specific year is an estimate of what the foods in the 1960-61 food basket would cost in that year.

Retail Cost Retail food prices in 1973 rose at the fastest rate in over a quarter century. The sharp rise last year reflected strong domestic and foreign demand and reduced food supplies. Domestically, rising employment, higher wages, and longer work-weeks boosted personal incomes and the demand for food. Moreover, foreign demand for United States farm products was stimulated by continued economic growth abroad, the devaluation of the dollar, and the Russian wheat deal. The latter situation in itself accounted for a large portion of the upsurge in exports.

On the supply side, both food and feed supplies were reduced significantly. Because of bad weather during the fall of 1972, harvests of a number of important fruit and vegetable crops were reduced and grain and soybean harvests were seriously hampered. This development reduced food supplies in the first half of 1973. Then, with rapidly rising feed grain and protein meal prices reducing the profitability of livestock and poultry feeding during much of the year, farmers cut back production of livestock commodities. Meanwhile, price ceilings imposed on red meats in March of 1973 added a further setback to the supply situation by disrupting normal marketing patterns. They also created more uncertainty among farmers about expanding production in view of the sharply rising feed costs.

The abnormal supply-demand conditions of 1973 spilled over into 1974 and were reflected in the rapid rise in food prices this past winter. Food supplies at the beginning of the first quarter of 1974 were even smaller than a year earlier. And on the demand side, even though disposable personal income rose at a slower pace, consumers spent a larger share of their incomes on food purchases. Also, the large increase in bonus food stamp allotments undoubtedly added a further stimulus to demand.

The strong demand and tight supply situation in

1973 boosted retail prices for all foods in the market basket, especially poultry, eggs, meats, and fresh vegetables. More than two-thirds of last year's increase in the cost of the market basket came from animal-related food products. The retail cost of meat products averaged nearly one-fourth higher than in 1972. Beef prices were up about one-fifth and pork prices almost one-third. Prices of poultry and eggs averaged nearly half again as high.

That the food-price spiral has continued into 1974 is illustrated all too well by this rundown of retail prices in the first quarter and their comparison with the first quarter of 1973:

Navy beans, 66 cents per pound—
up 40 cents or 155%

Rice, 52 cents per pound—
up 26 cents or 104%

Potatoes, $1.64 for 10 pounds—
up 53 cents or 47%

Vegetable shortening, $1.42 for 3 pounds—
up 45 cents or 47%

Turkey, 82 cents per pound—
up 24 cents or 42%

Eggs, 91 cents per dozen—
up 21 cents or 31%

Sugar, 93 cents for 5 pounds—
up 21 cents or 30%

American cheese, 73 cents for ½ pound—
up 16 cents or 29%

Pork, $1.15 per pound—
up 17 cents or 17%

Farm Value of Foods Higher farm values for food accounted for 78 percent of the upturn in the retail cost of the market basket last year. The farm value—gross returns or payments that farmers receive from the retail price of food—averaged around one-third higher than in 1972. But between the first quarter of 1973 and the same quarter in 1974 when the gain in farm values was somewhat slower and the increase in marketing spreads was much faster, only half of the gain in market basket retail costs was attributable to the rise in the farm value of food.

Review of the long-term trend in market-basket data reveals quite a different story. Retail prices of farm foods rose 27 percent between 1952 and 1971, for example, and reflected a 4 percent gain in farm value and a 48 percent jump in the marketing spread. Thus, only 6 percent of the rise in retail prices of farm foods during this period was due to the increase in farm value. The remaining 94 percent was due to the advance in the marketing spread.

As the year 1974 progressed and farm prices dropped further while the marketing spread widened, the situation again became quite similar to that in the long-term period. By May, farm values of food products were just 4 percent above a year earlier, with the increase accounting for only 12 percent of the sharply higher retail food prices.

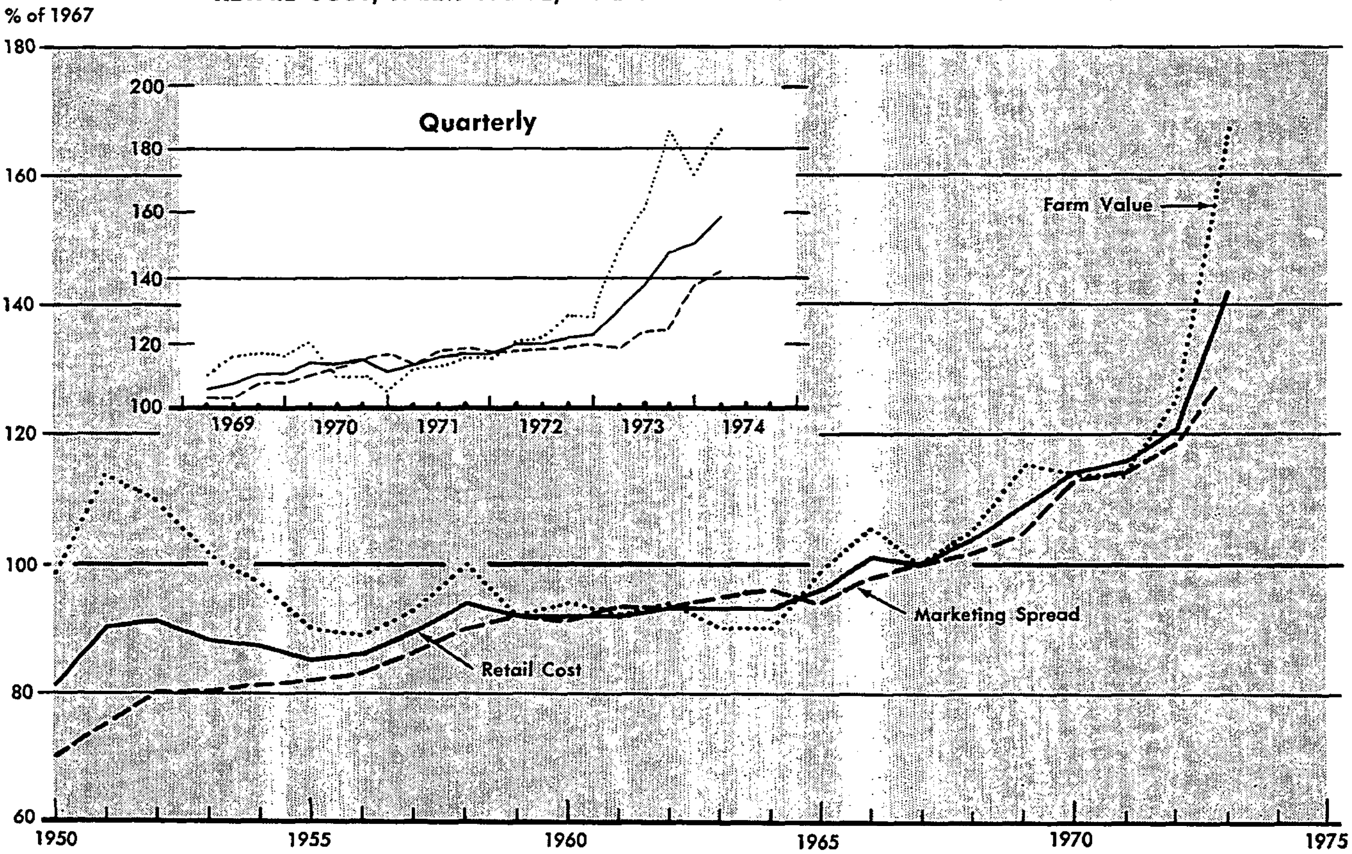
The farmer's share of the consumer's food dollar is the proportion of the retail price attributed to farm value. Or, put another way, it is the sum the farmer receives from each dollar the consumer spends for farm-produced foods in retail food stores. Over a long period of time, the farmer's share reflects relative changes in farm and retail food prices.

With food products in the typical market basket costing $1,537 at retail in 1973, the farmer received $700, or 46 cents out of each dollar. This share was 6 cents more than in 1972 and the largest in over 20 years. The farmer's share of the consumer's dollar is not the same for all foods. How much of each food dollar goes to the farmer depends on how many marketing services are needed to get the finished product to the consumer. When, for instance, the homemaker bought a dollar's worth of large Grade A eggs during the first quarter of 1974, the farmer got 71 cents. He received 69 cents of each dollar she spent for butter and 64 cents for Choice grade beef. By contrast, the farmer received only 25 cents of each dollar spent for white bread and just 21 cents of the average processed fruit and vegetable dollar.

Marketing Spreads The farm-to-retail spread, or marketing margin, is the difference between the retail cost and the farm value of market-basket foods. It is the total charge made by the food industry for assembling, processing, transporting, and distributing a market basket of farm-produced foods. The spread is actually an accumulation of all charges made by the firms moving food products from the farmer to the consumer, plus their profits. Because of the difference in the handling and processing methods required for each product, marketing margins, as well as the farmer's share, vary widely from commodity to commodity.

With the growing importance of marketing services and the cost of performing these services, it is important to recall some of the basic facts concerning the behavior and influence of marketing charges. These costs—for such items as wages, rents, taxes, freight rates, electricity, and other utilities—tend to be much more stable than farm prices. They rise more slowly than farm prices on the upswing and decline even more slowly on the downswing. Sometimes, as in the first half of 1974, they continue to climb while farm prices fall. Thus, when marketing charges make up the largest proportion of the retail price of farm food products—75 percent in the case of white bread, for example—the price at retail is

RETAIL COST, FARM VALUE, AND MARKETING SPREAD OF FARM FOODS*



*For a market basket of foods produced on U. S. farms.

Source: U. S. Department of Agriculture.

influenced much more by changes in marketing costs than by changes in prices at the farm level.

The marketing spread has followed a long-term upward trend, paralleling the movements of the general price level rather closely. Last year was no exception. The spread between the retail cost and farm value of market-basket foods in 1973 averaged \$837—up \$50 or 6.5 percent over 1972. The rise was only slightly below the record 7.5 percent increase that took place both in 1951 and in 1970. But since the farm value of foods in the market basket advanced at a much faster rate, the widening marketing spread accounted for only 22 percent of the jump in the retail cost of the market basket in 1973.

Historically, however, the uptrend in retail food costs has stemmed primarily from the persistent rise in the farm-to-retail spread. The marketing spread has increased nearly every year since 1950. Farm value, on the other hand, has declined in about half of these years. During the fifties, the marketing spread advanced at an annual average rate of 2.7 percent; in the sixties, the annual rate of increase averaged 1.4 percent. With these annual rates of gain, it is no wonder that the marketing spread jumped 48 percent between 1952 and 1971 and accounted for 94 percent of the 27 percent advance in retail food costs.

With wide movements in farm and retail prices and several phases of price controls in 1973, marketing spreads varied considerably throughout the year. During the summer price freeze, margins were squeezed between ceiling prices and rapidly rising farm prices. But with the plunge in farm prices in September, margins turned up sharply. They continued to widen substantially through the remainder of the year as farm prices declined and food marketing firms attempted to recover from the price freeze. Marketing spreads rose 17 percent from August to December. Price spreads for beef and pork, in fact, were at record levels throughout the fall.

Marketing margins continued to push higher well into 1974. By May, they were more than one-fourth above a year earlier and accounted for 88 percent of the 16 percent increase in retail food costs since May of 1973. The bulk of the sharp advance has taken place since last fall.

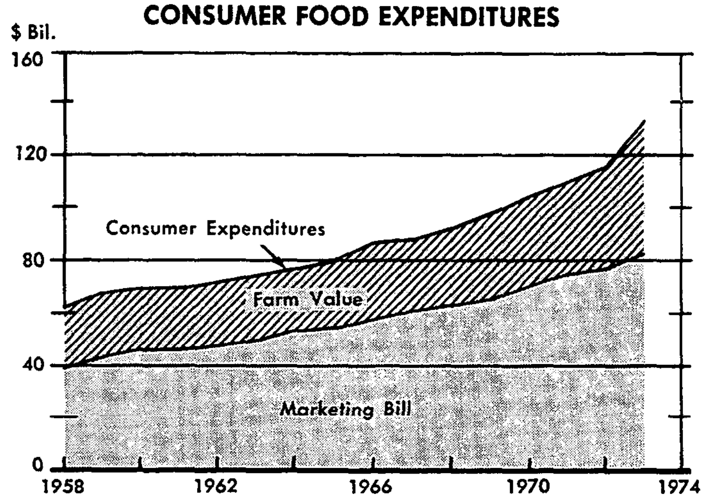
THE MARKETING BILL

The makeup of marketing charges is understood more fully, perhaps, by examining the farm food marketing bill statistics. These data measure the total charges made by marketing firms for processing, transporting, wholesaling, and retailing foods originating on the nation's farms and bought by or for civilian consumers. Foods sold in restaurants and other away-from-home eating places are included. Simply put, the marketing bill is the difference between total civilian expenditures for farm foods and the farm value of food products. Generally, the marketing bill accounts for around two-thirds of consumer food expenditures and is nearly double the amount farmers receive for food products.

American consumers spent an estimated $134 billion in 1973 for foods produced on the nation's farms, some $18 billion or 15 percent more than in 1972. The marketing bill totaled $83 billion, up $6 billion or 8 percent from a year earlier, while the farm value amounted to $51 billion for a gain of $12 billion or 31 percent. Last year marked only the second time since 1950 that returns to farmers for food products increased more than the marketing bill.

Last year's 8 percent upturn in the food marketing bill compares with its annual average increase of slightly more than 5 percent over the past ten years. Most of the rise was due to higher prices of inputs—containers, packaging materials, and other intermediate goods and services—purchased by marketing firms. Wages of employees in food marketing firms also continued to climb, even though at a somewhat slower rate than in recent years.

FARM-FOOD MARKETING BILL AND CONSUMER FOOD EXPENDITURES



Note: For domestic farm foods purchased by U. S. civilian consumers for consumption both at home and away from home.

Source: U. S. Department of Agriculture.

Agency Components When farm food products take the trip from the farmer's gate to the supermarket's shelf or a restaurant, they are involved in a number of handling and processing steps. Each step has a price tag, and the price tags seemingly get more expensive each year. The marketing bill for some agencies has grown much more rapidly than it has for others, however.

Last year's bill for marketing farm food products was distributed among the various agencies in this fashion: processors, 35 percent; retail food stores, 29 percent; restaurants and other away-from-home eating places, 23 percent; and wholesalers, 13 percent. The share of the marketing bill attributable to food processors has declined over the past decade, while the proportion attributable to the distribution agencies has risen.

Cost and Profit Components When the farm food marketing bill is broken down into cost and profit components, the following picture emerges:

Labor: Labor costs are by far the largest costs of food marketing firms and in recent years have made up almost half of the total marketing bill. These costs amounted to over $40 billion in 1973 and were 8 percent larger than in 1972. The rise in the cost of labor last year, in fact, accounted for half of the $6 billion increase in the total food marketing bill.

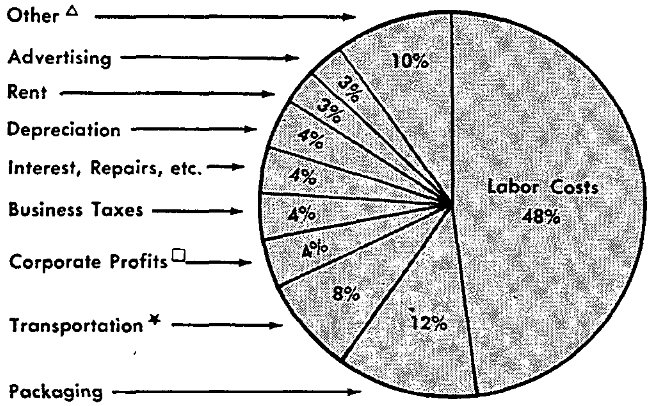
Labor costs of all food marketing agencies have been increasing for a number of years. Over the past decade, however, the increase in the costs of labor involved in distribution—retailing, wholesaling, and away-from-home eating — has been substantially greater than in processing.

Food marketing firms for many years have been offsetting rising wages and salaries to some extent by boosting productivity. Hourly labor costs, for example, have risen almost one-half since 1967. But productivity gains have limited the increase in unit labor costs to about one-third.

Packaging: Containers and packaging materials represent the second largest cost component of the food marketing bill, accounting for 12 percent of the total. Food marketing firms spent an estimated $10.5 billion for these materials last year, up 8 percent from 1972. Most of the advance in food packaging costs was caused by higher prices. Glass container prices rose 5 percent, while prices of paper products increased 9 percent. Grocery bags were in short supply, and their prices jumped 14 percent.

Transportation: Truck and rail transportation costs, which vary widely for different food items, are the third largest component and account for 8

COMPONENTS OF BILL FOR MARKETING FARM FOODS, 1973✱



✱ Preliminary.

△ Residual includes such costs as utilities, fuel, promotion, local for-hire transportation, insurance.

□ Before taxes.

✶ Intercity rail and truck.

Source: U. S. Department of Agriculture.

percent of the bill for marketing farm foods. Shipping farm food products by truck and rail cost nearly $6.4 billion in 1973, about 4 percent more than in 1972. These costs, however, do not include the costs of intracity truck transportation nor water and air transportation.

Other Costs: Lumped together, other major cost components comprised 18 percent of last year's marketing bill. These totaled about $15 billion and included charges for business taxes, such as property and social security taxes; interest, repairs, etc.; depreciation; rent; and advertising. Other charges, which made up 10 percent of the 1973 bill, were for such items as utilities, fuel, and insurance.

Corporate Profits: Consumers sometimes blame higher food prices on profits. Total corporate profits of food manufacturing firms have risen over the past decade as sales volume has grown, but as a proportion of the marketing bill they have fallen. Corporate profits before taxes amounted to around 4 percent of the marketing bill in 1973, about the same as in 1972 but down slightly from the 4.8 percent a decade earlier. Although profits are a fairly small proportion of the marketing bill, they are larger than some individual cost components such as depreciation, rent, advertising, and repairs.

Last year, food manufacturers' profits after taxes averaged 2.5 percent of sales, up only slightly from the 2.4 percent in recent years. Meat packers' after-tax profits rose to 1.1 percent of sales from 1.0 percent a year earlier and advanced further to 1.4 percent in the first quarter of 1974. Dairy food manufacturers' profit margins were unchanged from 1972 at 2.0 percent of sales, while bakery manufacturers' profits dropped from 2.2 percent of sales in 1972 to 1.1 percent.

Profit margins of food retailers also rose last year after having declined the two previous years. After-tax profits of 15 leading retail food chains averaged 0.7 percent of sales in 1973, up from 0.5 percent in 1972, but below the 1.2 percent average a decade earlier. Profit margins of food retailers climbed to 0.9 percent of sales in the first quarter of 1974.

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