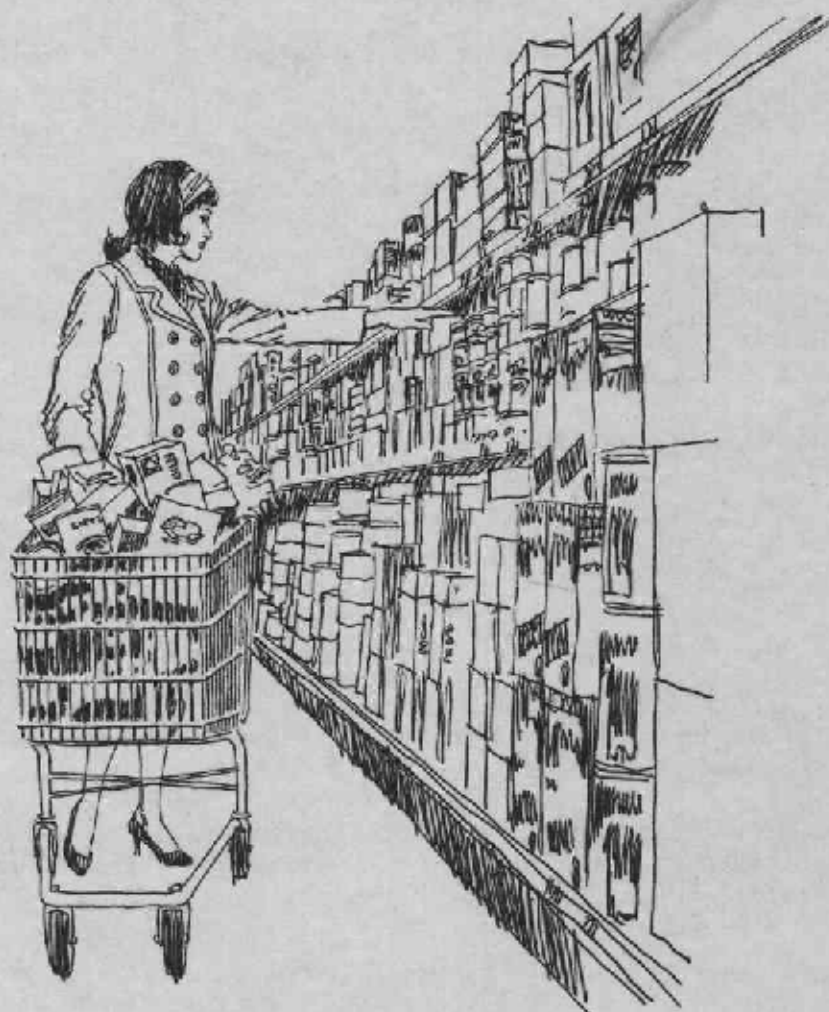


Here Is Why-- Food Prices Are Composing



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This information is presented to help improve understanding of the basic economic factors that are influencing prices of meat and other foods.

Statistical data from which the charts were developed may be obtained from the author or by writing for the references identified on the last page of this report.

prepared by

Stephen C. Marks
Extension Agricultural Economist

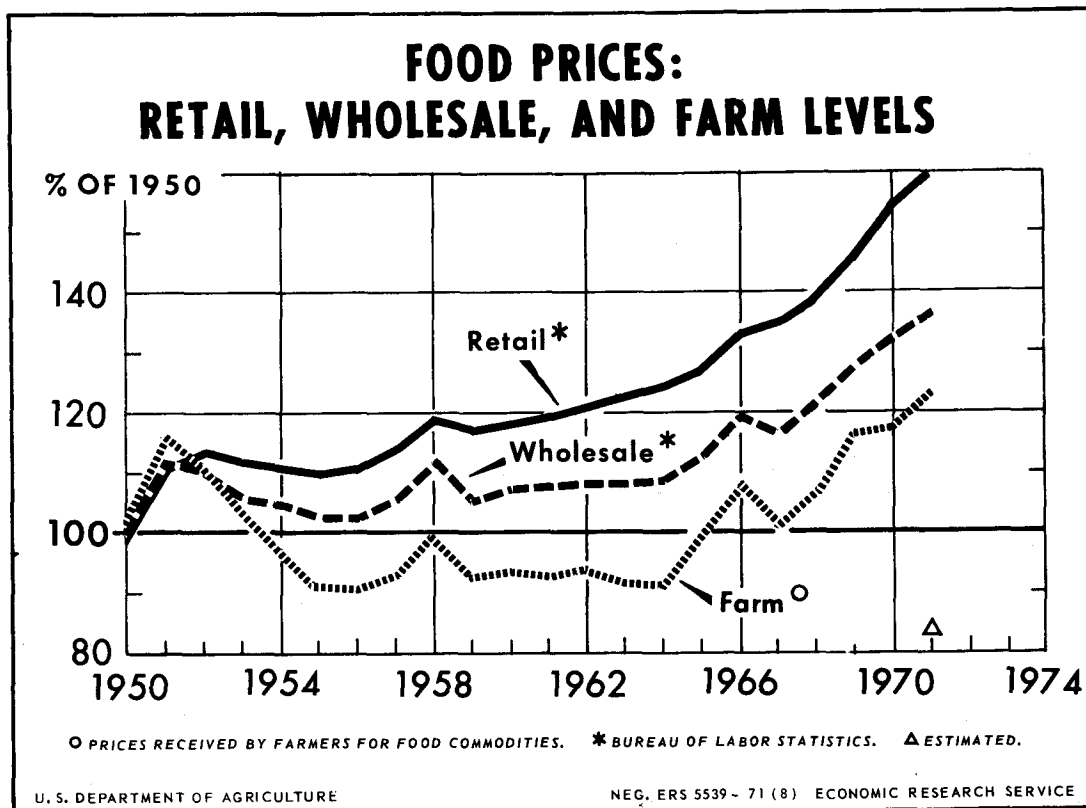
Acknowledgements

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Confusion about the basic economics of food marketing has spawned an imaginary sword of Damocles over the meat industry as consumers complain about higher prices.

The following information is presented in an attempt to defog the hazy atmosphere about why food prices went up this winter and over the years.

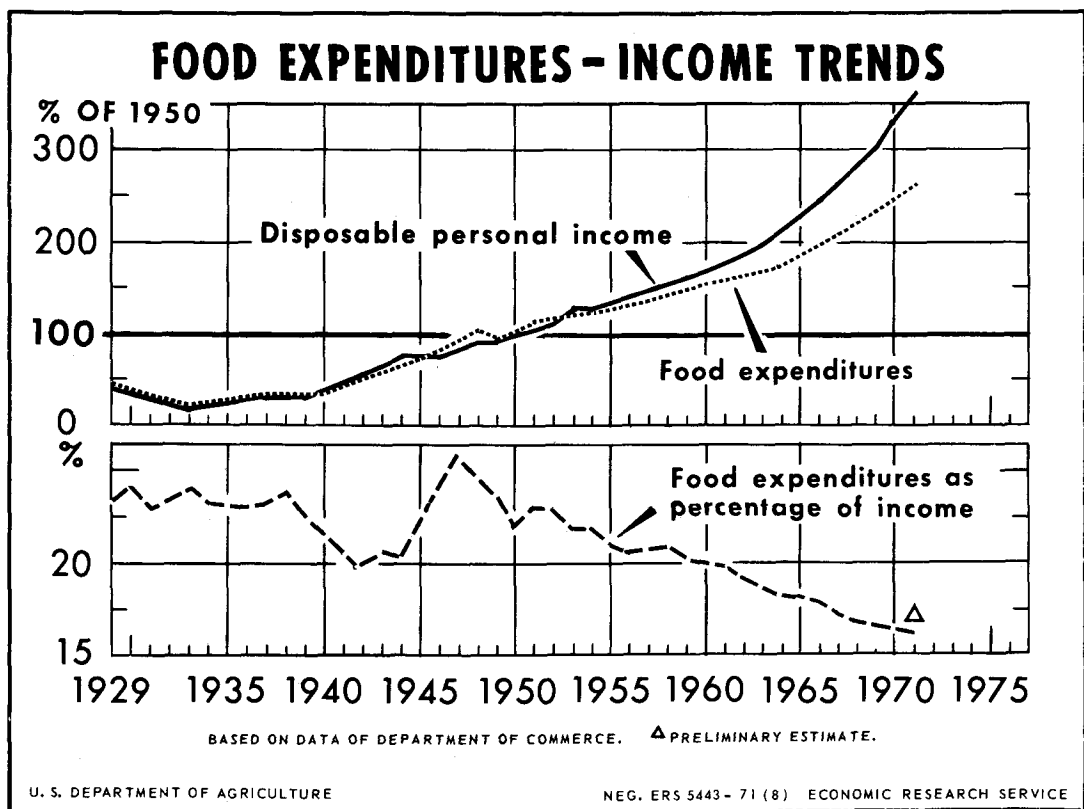
It is true that prices of food and all consumer goods and services have increased and are now at record levels.



FOOD SPENDING INCREASES WITH INCOME GAINS

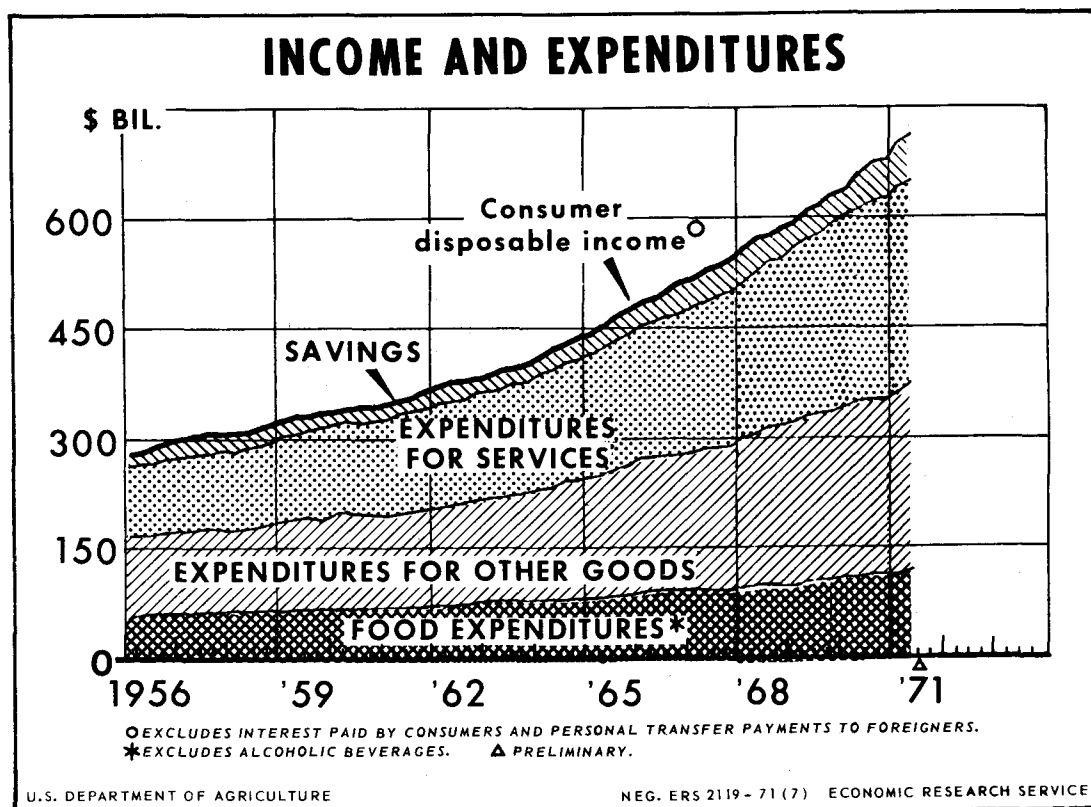
But there seems to be a widespread unawareness that food takes a smaller percentage of the consumers highest ever, after-tax income than ever before. This year buying food will take less than 16% of spendable income. That's down from 23% just twenty years ago.

Spending for food is associated with gains in consumers' spendable income. The effect of rapid income growth since the mid-1960's is boldly apparent.



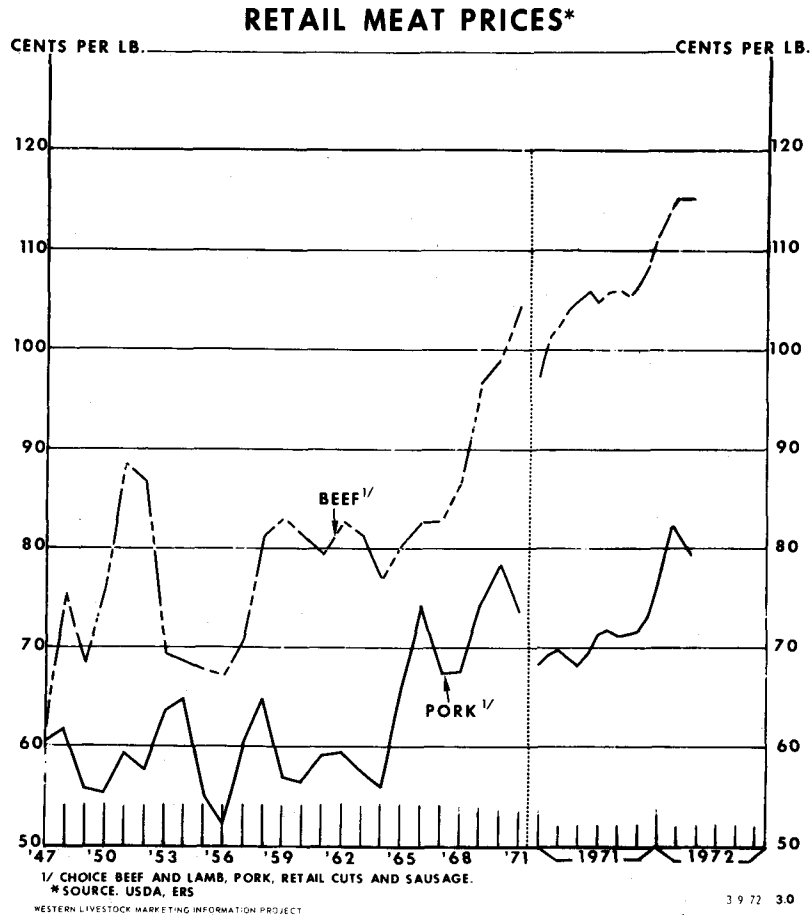
NON-FOOD GOODS AND SERVICES COMPETE FOR CONSUMERS DOLLAR

The food basket is the first place we usually look when we find ourselves a little short of money for a new car, TV, vacation trip or medical bill. That's because we buy food so frequently. Still we spend 4 to 5 times as much of our income for other goods and services.



STRONG DEMAND PUSHES MEAT PRICES UP

Meat prices went up rather sharply last winter due to short term changes in the supply-demand balance in the meat market, together with a continually increasing demand for beef.



But note that meat prices have been trending irregularly upward over the years. The irregular pattern was caused by fluctuating meat supplies. Since the mid-1960's retail meat prices have gone up markedly. The steep climb in beef prices reflects consumers preference for beef and their ability to buy beef with the rapid increase in personal income during the last seven years.

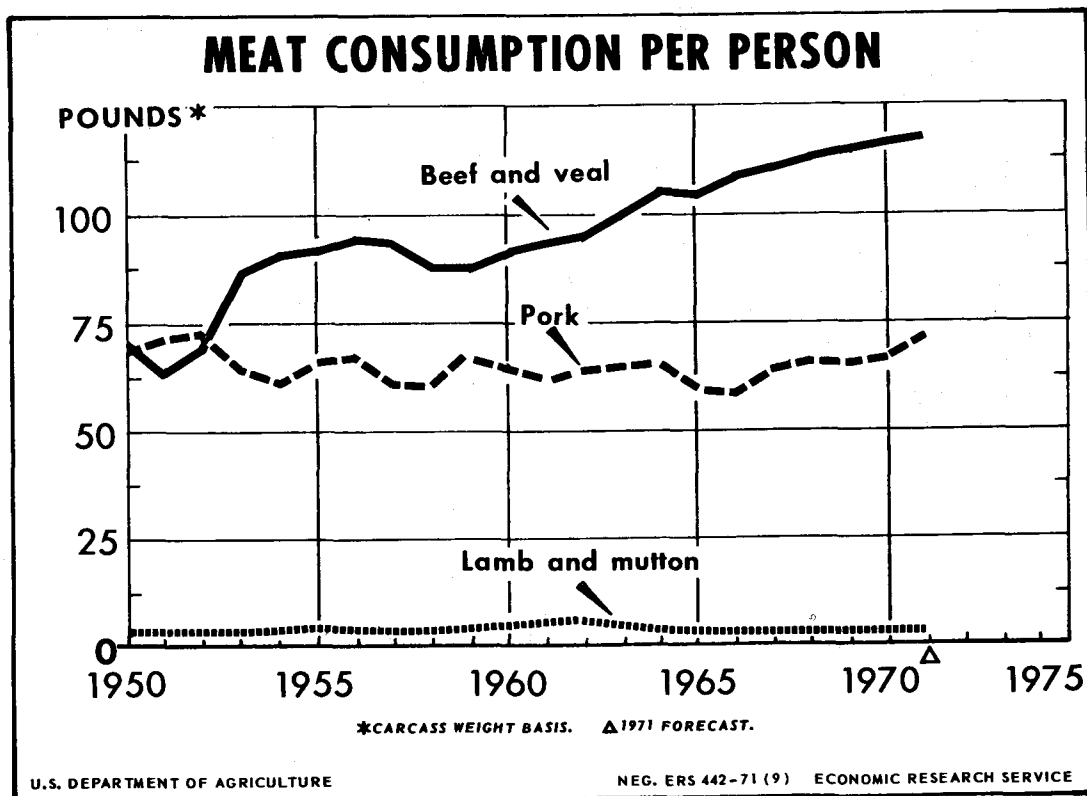
CONSUMERS PREFER BEEF

Beef consumption is closely associated with personal income.

However, pork and lamb are not.

From 1950 to 1971 beef consumption increased 80% or 51 pounds per person. Pork consumption was practically unchanged. Lamb and mutton consumption dropped to 3 pounds per capita.

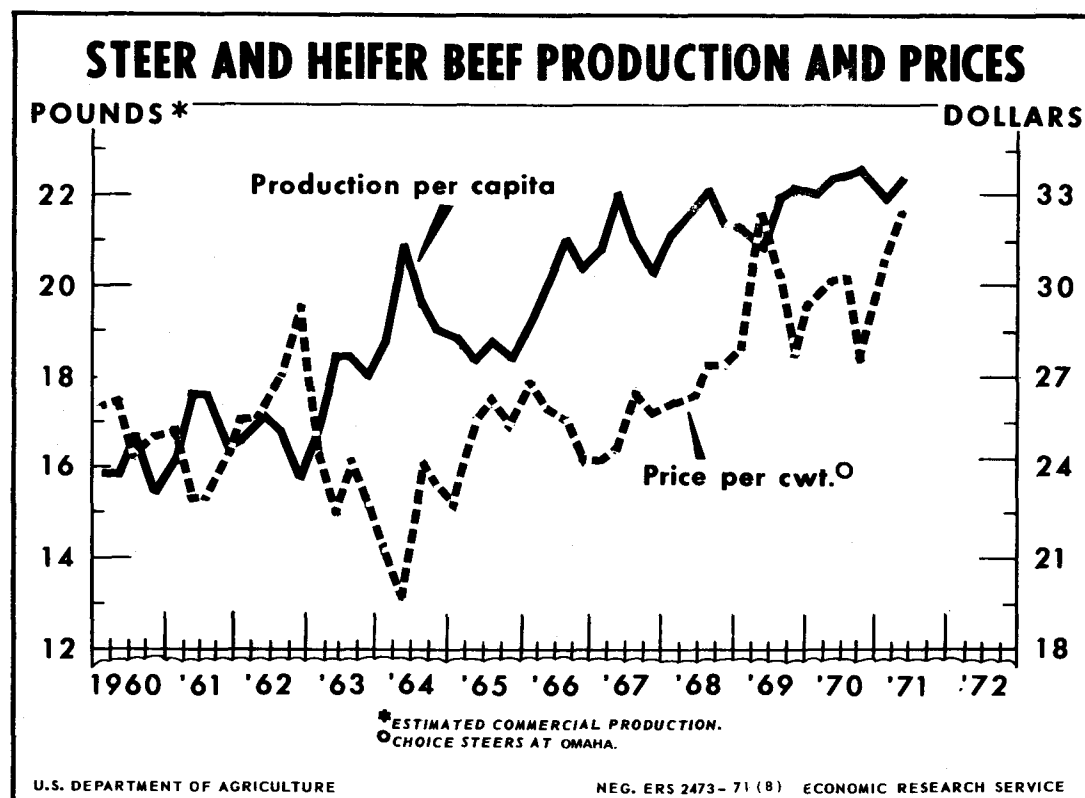
This year beef consumption is continuing the upward trend but we will eat less pork because farmers are raising fewer hogs. Lamb consumption probably will decrease also.



HIGHER PRICES NEEDED TO OFFSET RISING COSTS

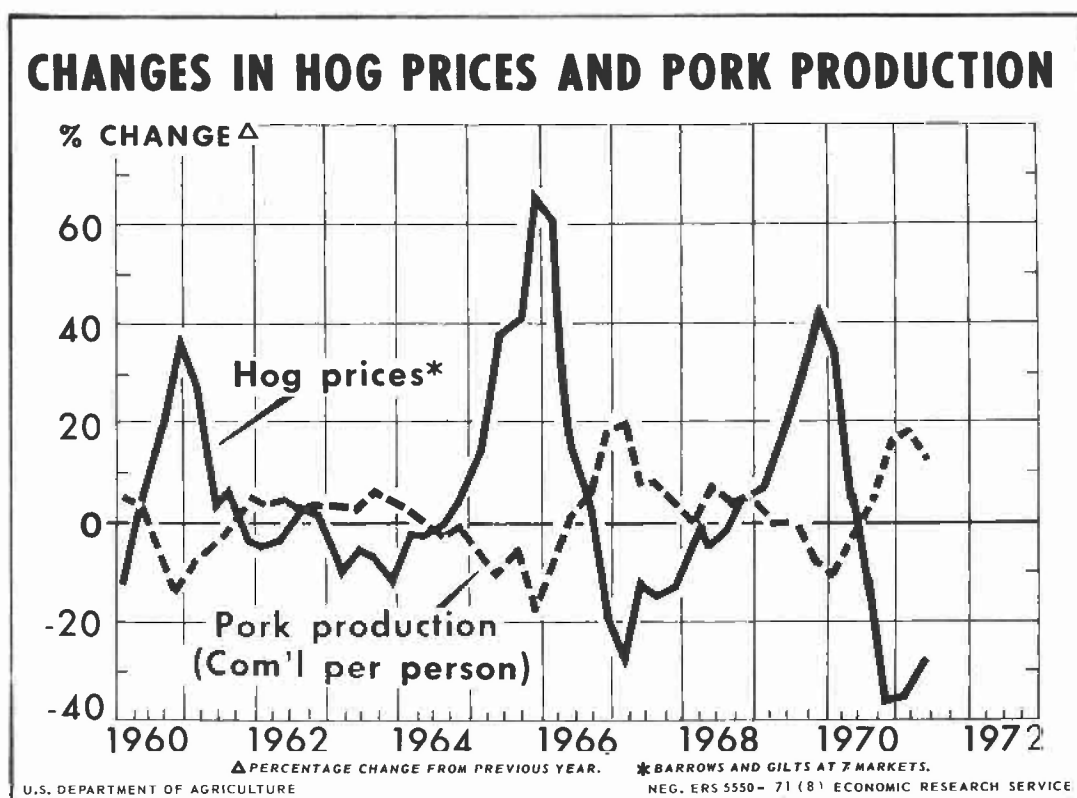
What segment of the meat industry benefitted most from the rise in retail meat prices? Was it the producer? The packer? The retailer?

Farm prices of beef cattle on the hoof have moved irregularly upward since 1960, varying with the supply of beef processed by packers and offered to consumers. Livestock producers need to get higher prices to offset the continually rising production costs.



Hog producers have enjoyed good times and poor times. Pork prices vary with changes in production and consumption. Cheap meat at retail means farmers are not faring well.

The demand for farm products is quite inelastic; so a large increase in supply in a short period of time moves into consumption only at a reduction in prices throughout the entire marketing pipeline.



MEAT ANIMALS NOT ALL MEAT

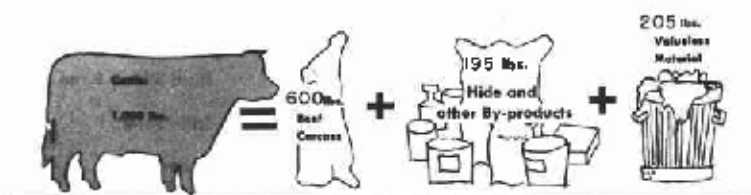
Following beef cattle from the ranch to the packing plant we find that a 1,000 pound steer produces a 600 pound carcass. So the wholesale price has to be higher than the farm price so the packer can recover his costs.

Farmers' returns vary with the market price received for the steer.

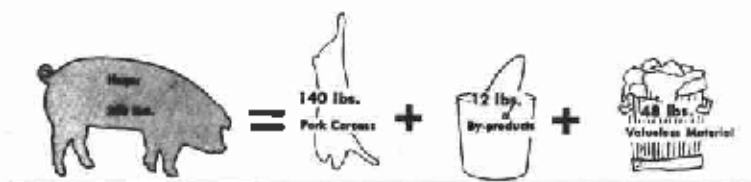
The packers' return over cost is the difference between (1) the farm price he paid for the live steer and the wholesale price he received for the steer carcass and (2) the value of the hide and by-products.

How much eatin' meat?

Steers are not all steaks . . . Pigs are not all pork chops, and neither are Lambs all lamb chops.



Little more than half of the live weight of cattle is carcass beef . . . and only about 17 per cent of the carcass is loin, which produces Club, T-bone, Porterhouse, and Sirloin steaks which are so popular.



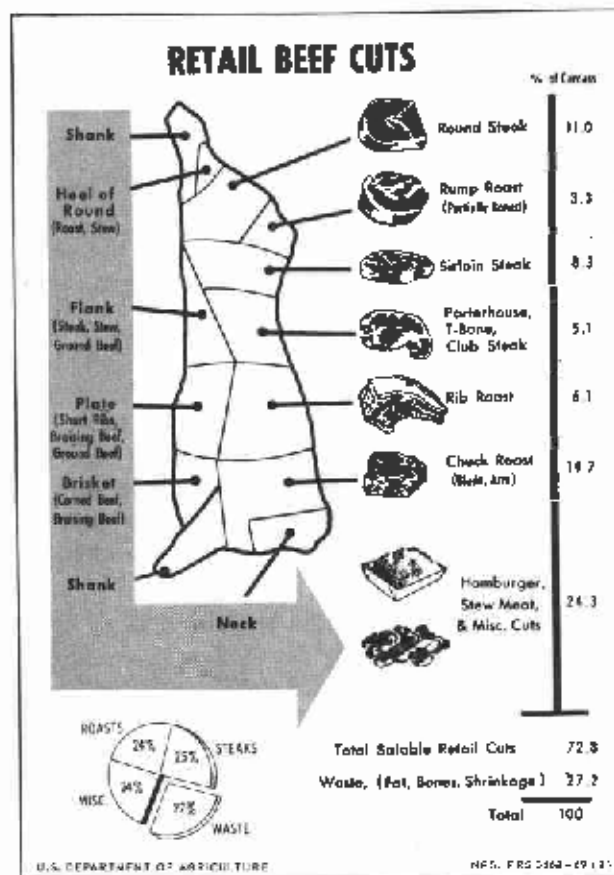
About 8 lbs. of a live 200-lb. "porker" are center-cut pork chops . . . about 24 lbs. are ham. When dressed, the carcass weighs about 140 lbs. During processing and curing, additional weight is lost. That leaves about 96 lbs. of pork and 29 lbs. of lard for the consumer.



Lamb dressing percentage varies by seasons. On the average, slightly less than half the live weight of a lamb is carcass meat. About 17% of the carcass is loin- when trimmed, there's even less. That's why there's only about 5 to 6 lbs. of trimmed loin chops per lamb.

BEEF CUTS PRICED ON VALUE

After the retailer trims excess fat and bone from the beef steaks and roasts, and measures shrinkage, he has only about 437 pounds of saleable retail beef product left. The retail cuts are priced by the retailer in accord with the value of each cut. This value is determined by the relative supply of the various cuts and the demand for them.



*Based on a typical yield grade 3 U.S. Choice carcass.
Figures may vary with yield grade, cutting, and trimming.*

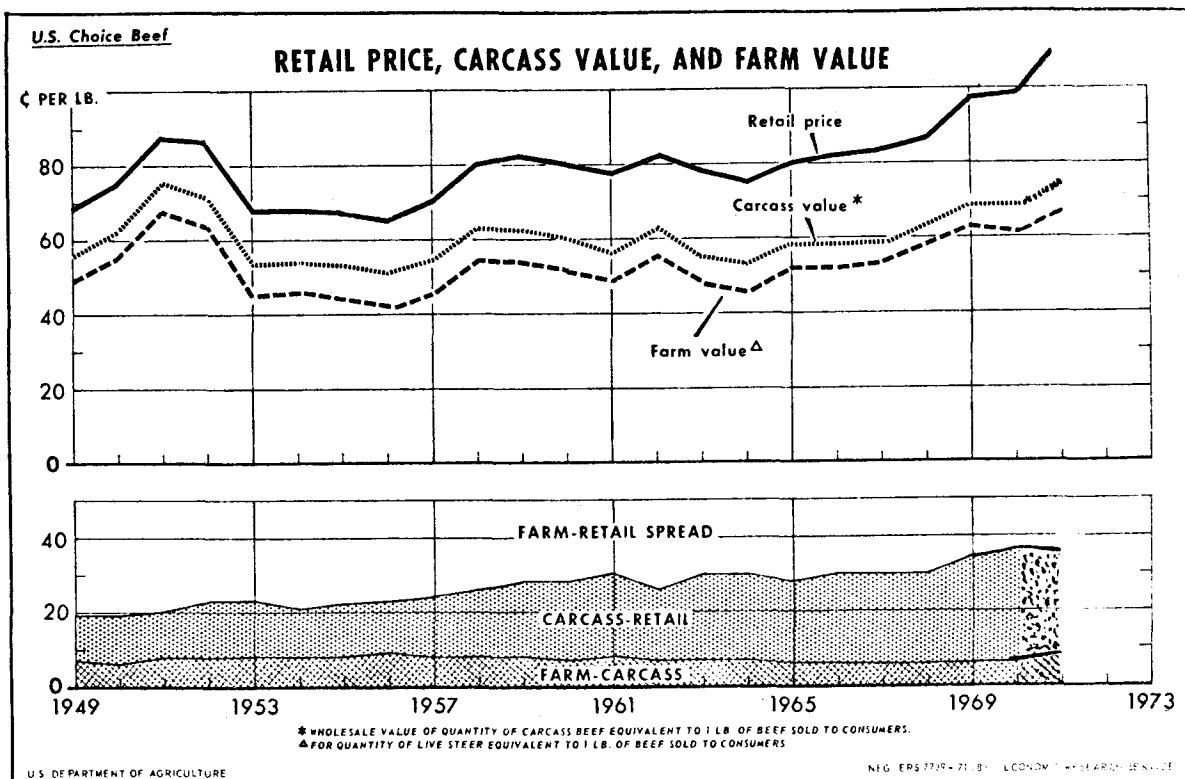
Finally, consumers select the cuts they want, paying the retailers more for T-bone and sirloin steaks than for the other cuts. So when consumers talk about the price of meat they may only be thinking of the prices of steaks and chops. Their concerns will be more realistic if they realize that their meat purchases over the course of a year include various cuts, not just steaks, chops and ham.

In March this year the Economic Research Service found retail prices in 27 U.S. cities averaged \$1.80 per pound of porterhouse steak , \$1.24 for center cut pork chops and \$1.95 for lamb loin chops. The average retail price of all beef of choice quality was a bit less than \$1.16 a pound. All pork averaged a little over 79 cents a pound and lamb \$1.15.

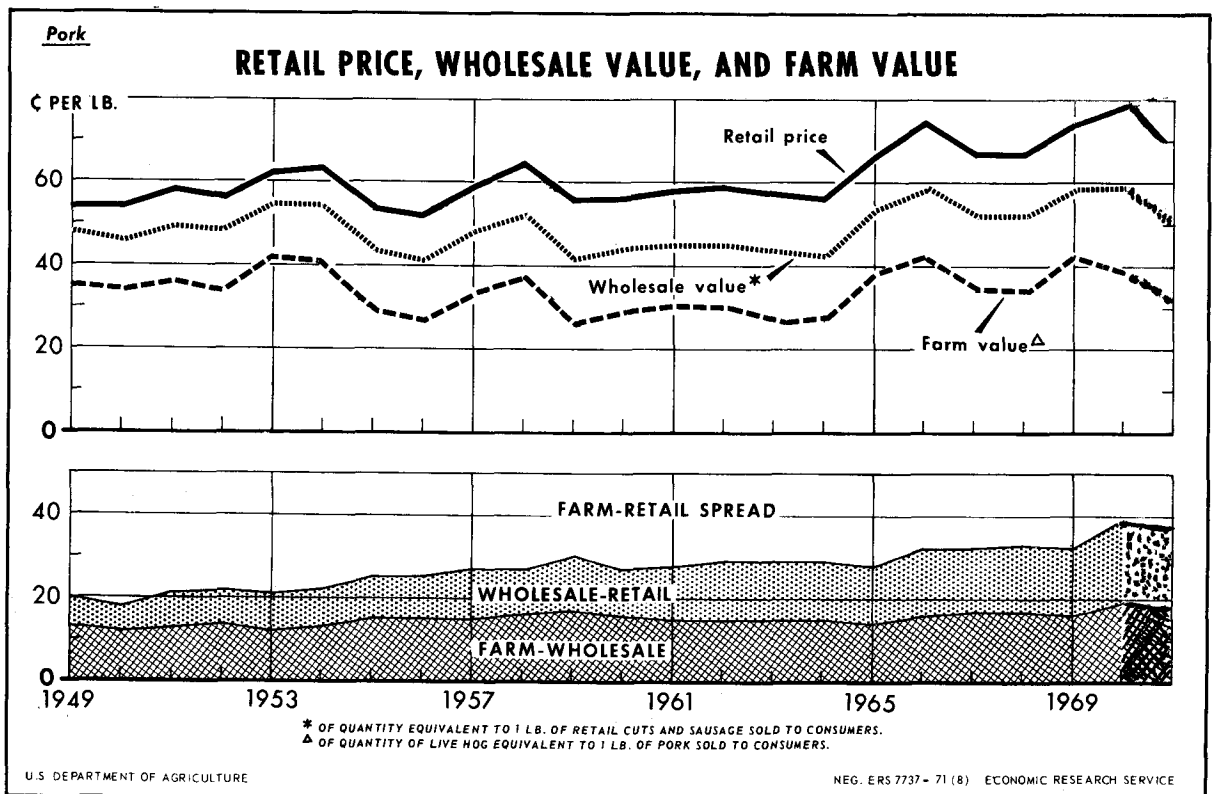
WHERE THE RETAIL MEAT DOLLAR GOES

Now let's see what has been happening to the retail meat dollar. The chart below shows how the retail dollar of the 437 pounds of beef cuts obtained from a 1,000 pound steer has been divided between producers, packer-wholesalers and retailers. Note that the spread between farm value and wholesale (carcass value) has narrowed since the mid-1950's. This reflects greater packing plant efficiency. Retailers are more efficient too, but their costs have increased steadily due to the rising cost of labor, packaging and all other inputs required to run a retail market outlet. Of course, these cost increases wouldn't stick if consumers' income did not increase and they were unable and unwilling to pay for the meat marketing services.

In 1971, the wholesale to retail beef price spread narrowed slightly as the farm to wholesale price spread increased. This year, the wholesale to retail price spread is widening. This reflects higher meat cutters wages and other retailer costs as well as higher farm and wholesale prices of beef.



The wholesale to retail spread in pork prices is less than it is in beef prices. This is because retailers do not need to trim pork cuts as they do beef cuts. Also, most trim is usually used in making sausage.

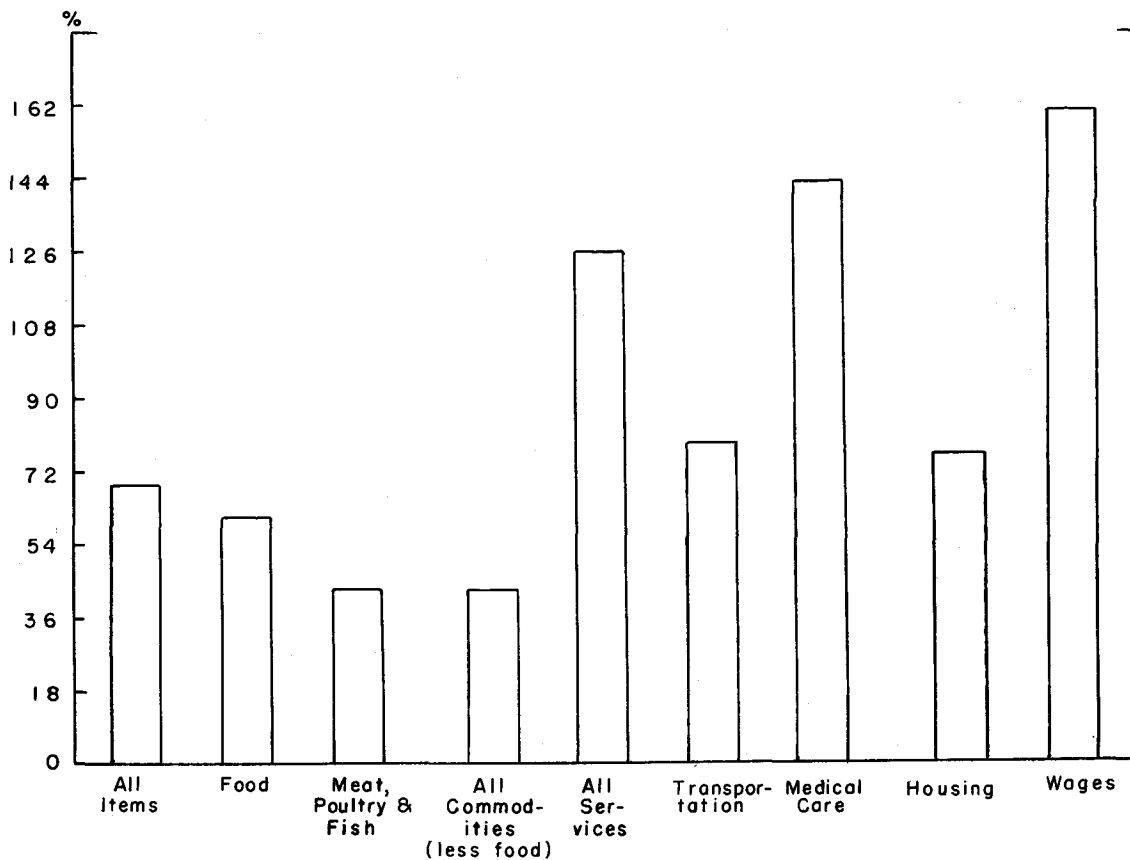


The wholesale to retail price spread for lamb generally has been wider than for beef or pork. This is probably because of the relatively smaller volume of lamb retailed. In 1971 the wholesale to retail spread for lamb averaged 34.8 cents a pound compared to 28.7 cents for beef and 18.2 cents for pork.

EVERYTHING COSTS MORE

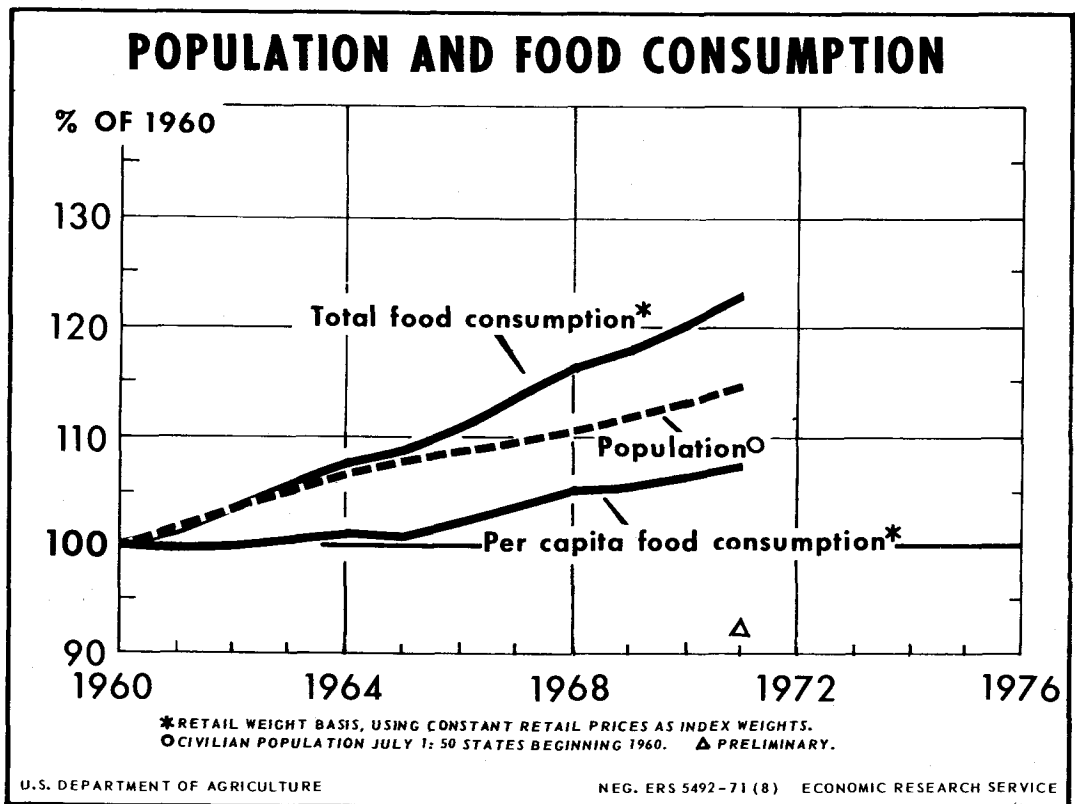
Food isn't the only item that costs more these days. Prices have been increased on all consumer goods and services as well as wages.

CONSUMER PRICE INDEXES PERCENTAGE CHANGE 1949 - 71



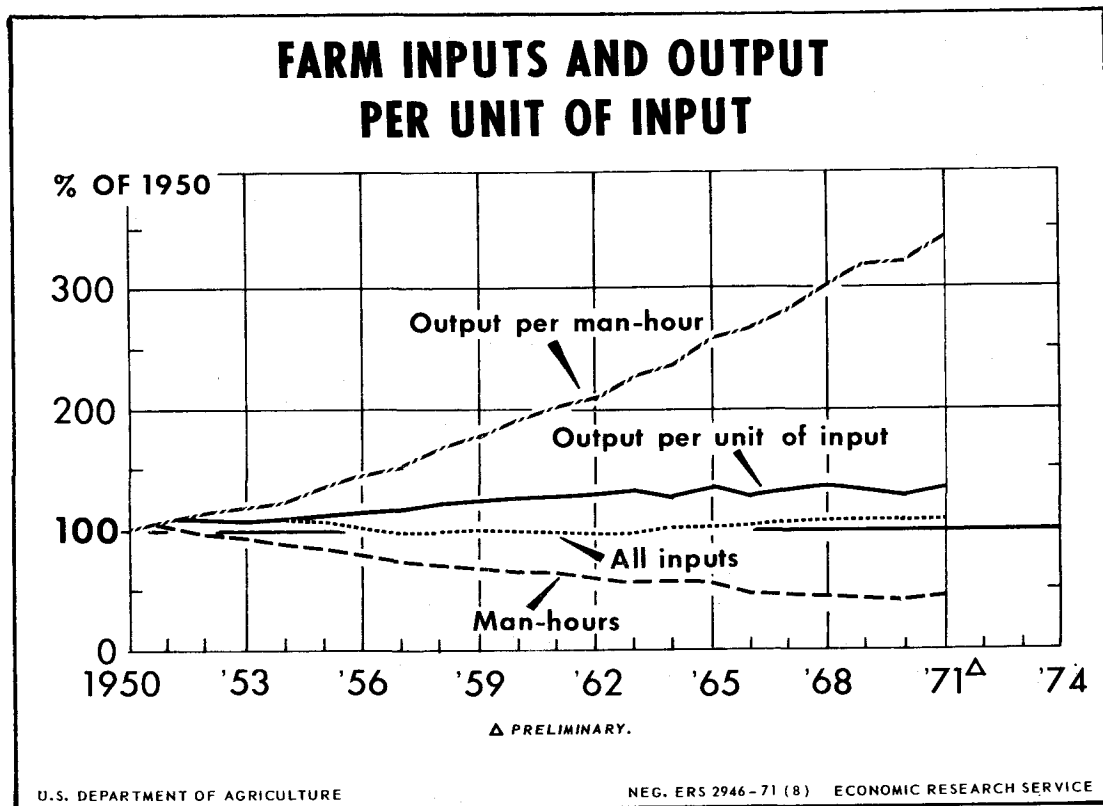
FOOD NEEDS INCREASE

And as U.S. and as world population and income increase more meat and other foods must be produced.



FARM EFFICIENCY BOOSTS FOOD OUTPUT

Today, less than 5% of U.S. population is engaged in producing our food. Thanks to our food growers' efficiency, one farm worker produces enough food to feed himself and 50 other people.



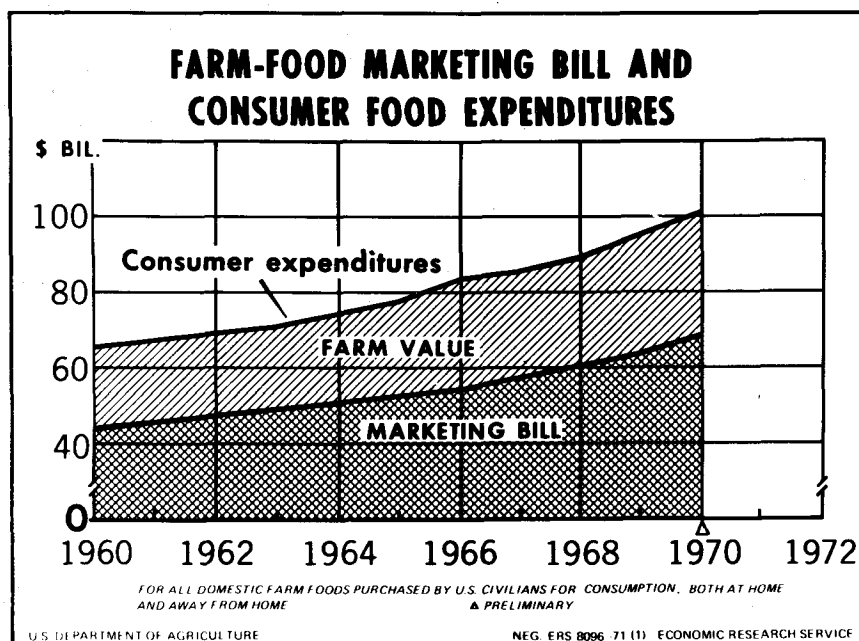
WHY FOOD PRICES ARE UP

So if our farmers are so productive why do food prices keep going up? Who is responsible for the increase in food prices? No one in particular. The increase is a phenomenon of the market place basically caused by the interaction of changes in the supply and the demand for food.

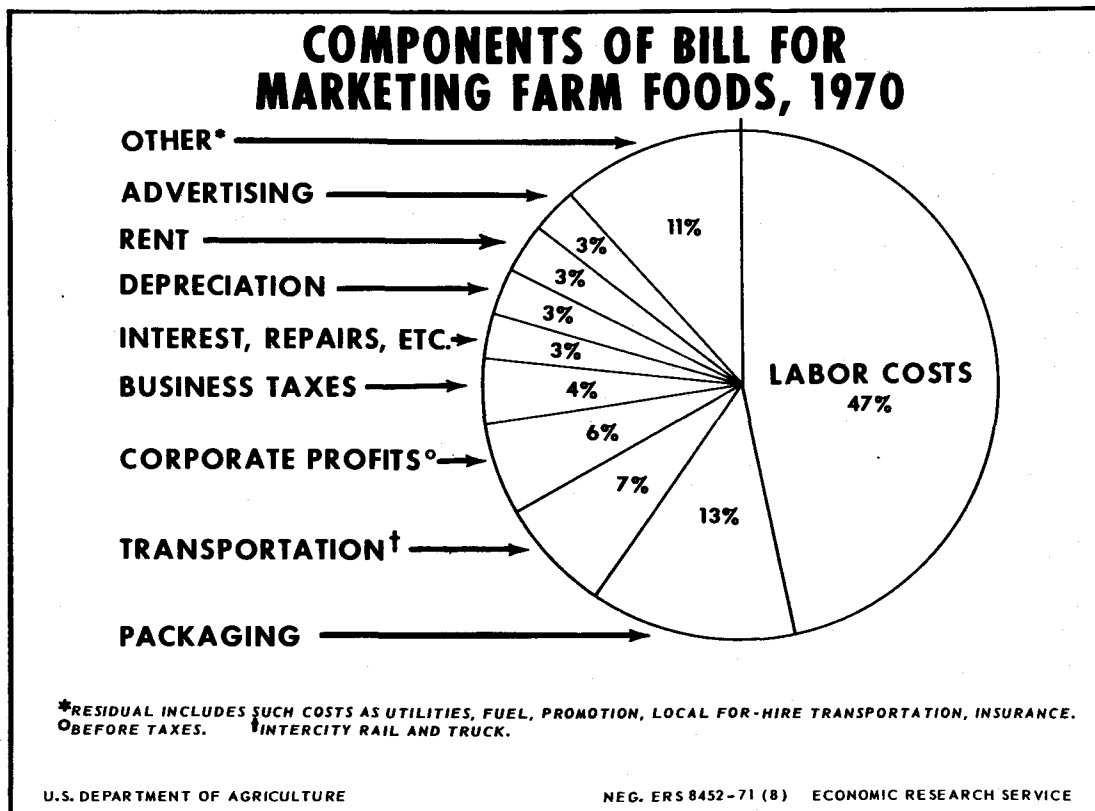
Demand continues to grow with gains in population, personal income and federal food aid programs such as the food stamp program, school lunches and hot breakfasts and, starting July 1, a daily hot meal for senior citizens over 60 years of age.

Costs incurred in the marketing system beyond the farm gate are passed along to the consumer.

Marketing services enter the picture in a big way. More than two-thirds of the money spent by consumers for food goes to pay for the services that bring the food from the farm to the retail counter in the form and at the time and place consumers want it.



Labor costs make up the lions share of the retail cost of most consumer goods and essentially all of the services. In food marketing, about half the cost that occurs between the farm gate and the retail store counter is due to labor.



SUMMARY

In summary, most of the latest increase in the farm-to-retail spread occurred between the wholesale and retail levels, most likely reflecting both a realignment of price relationships in the food marketing channels and a passing-on by retailers of pent-up cost increases. Prices received by farmers for hogs and cattle began rising sharply in the fourth quarter of 1971. While wholesale prices of meat increased rapidly, too, in this period, retail prices lagged behind. As a result, the wholesale-retail price spread for beef narrowed, dropping about 3 cents per pound, or 9 percent, during the fourth quarter of 1971 according to the U.S. Department of Agriculture. Hog prices began rising in November of 1971, and by January 1972 the wholesale-retail price spread narrowed by about 1 cent per pound, or 5 percent.

Retailers' profits were squeezed not only by the higher wholesale cost of meat but also by higher labor and other operating expenses. Direct labor costs amount to about half of all operating expenses of food retailers. Average hourly earnings of food retail employees increased more than 2 percent from November (post-freeze) to January, and during January were 6.5 percent higher than a year earlier. In addition, other operating costs, which reflect higher labor charges indirectly, have been creeping upward. In February, these combined cost increases plus strong consumer demand for meat erupted in an increase of over 4 cents per pound in the wholesale-retail price spread for beef, and a jump of 2 cents per pound in the retail spread for pork.

These increases have triggered an investigation by the Cost of Living Council into the profits and pricing practices of food processors and distributors. In the meantime, major retail food chains have volunteered to temporarily freeze prices, and some have declared they will roll back their meat prices.

An industrywide freezing or rolling back of retail food prices is most likely to result in lower prices for the farmer, rather than slimmer operating margins for the middleman. The retailer, whose operating costs are largely uncontrollable and rising, will likely seek to maintain his profits by paying less for his wholesale products. The wholesaler, in a similar cost position, in turn, will bid less for farm commodities. The effect will be to keep farm prices below the level that true consumer demand and available supplies would dictate.

Farm prices were already on the decline as a result of the normal interaction of supply and demand forces when voluntary price restraints were announced by major food retailers. But such controls seldom stay attuned to market conditions for long. Consumer demand will most likely continue to increase, while artificially low farm prices will tend to curb farm production, causing further upward pressure on food prices.

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