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Food Prices

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Toward Understanding Food Prices

Grocery food prices are generally thought to be determined by three factors: prices farmers receive for their commodities, marketing costs incurred in changing these commodities into foods and delivering them to consumers, and consumer demand for food. Farm prices and marketing charges determine how much it costs to produce and market food, and consumer demand determines what consumers are willing to pay.

However, these relationships have become more complex because of significant changes in the ways foods reach our plates and in consumers' eating patterns. USDA's Economic Research Service (ERS) began a vigorous program to understand how food prices are formed. This knowledge helps policymakers anticipate how changes in policies will affect food prices for consumers. This issue of *FoodReview* explains the general determinants of food prices and explores the effects of some important, new developments on food prices.

Over the last three decades, the public's need to maintain a reasonable balance between work, leisure, and family has resulted in a dramatic shift toward consuming convenience foods and eating out. In 1995, almost half of the amount we spent on food (47 percent) went to eating places. Because of this and the fact that farm values are a smaller component of menu and grocery store prices, overall food price changes are determined more and more by general economic conditions—such as inflation, interest rates, and wages—than by movements in farm commodity prices.

Food prices are also affected by structural conditions in industry—such as concentration and integration. Some fear that rapid increases in industrialization or coordination will cause uncompetitive pricing behavior because production is concentrated among a few large plants. However, recently increased coordination of different stages of pork production has enabled companies to supply greater quantities of higher quality pork at competitive prices. This finding helps policymakers decide on the proper policy for dealing with the situation where fewer and fewer suppliers provide the meat we consume.

Changes in tastes and preferences also have been important factors affecting prices. For example, growing demand for organic baby food, as shown by a 2,000-percent increase in sales since 1989, has some consumers paying up to a 21-cents per serving premium. Among other things, this information helps the Government decide if it should establish a national definition for "organic."

Retail food prices are also affected by nonfood costs. Studies suggest that smaller foodstores have 10-percent higher prices than supermarkets. Prices are lower in large supermarkets because costs for labor, utilities, advertising, and other retailing expenses are spread over more units, reducing per unit costs and allowing for lower prices. Low-income households are most affected by this difference in prices levels, since they generally have less access to shopping around. Policymakers need information on whether low-income consumers face higher food prices in the determination of food-assistance benefits.

ERS is currently examining the role of other important factors, such as quality and variety of products. While the price effects of these other factors could be significant, the extent and the mechanics of the impacts are not well understood. What is known is that consumer behavior is central to producers' pricing strategies and food-price determination. Knowledge of such information means that a producer can supply the desired variety and quality and set prices at the highest level that consumers are willing to pay.

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