



PRICE INFLATION AND THE AGRIBUSINESS INDUSTRY

For purposes of illustration, consider the following:

Robert Ask has been a long-time, good customer of your retail farm supply store. In fact, Bob's father had served as a member of your store's first Board of Directors at the time of its organization some 27 years ago. As you glance out your office window this particular morning, you see Bob driving his pickup into the loading area on the south side of your store's warehouse. It's a pattern which has been repeated every 8 to 10 weeks for as long as you can remember: i.e., Bob has driven in to buy his usual load of cattle feed supplement, perhaps a salt block, and maybe some other small items like an oil filter for his truck or a gallon of antifreeze. On this particular morning, you are less than anxious to engage in the usual chitchat with Bob. The reason is painfully evident in the price you will be charging Bob for his supply of feed. Earlier this week you were forced to increase, dramatically, all your mixed feed supplement prices. Moreover, this was the third such increase in the past three months. Despite your fears and within moments, you turn around at your desk to find Bob's reddened face looking at you through your office door. The normal amenities of a greeting are cast aside as you begin to deal with the rapid-fire sequence of questions directed at you by your maddened friend and long-time customer.

While the above episode has been totally fabricated, its real life counterpart has been reenacted time and time again throughout

the agribusiness industry this past year. No doubt you too have been subjected to numerous questions from anxious customers. In some cases you may even have been the recipient of some customer heckling or direct emotional outrage. Never before has the agribusiness manager been more severely tested by the reactions of his clients and/or customers to the direct effects of inflation. Chances are that for many residents of the rural areas, your business and the local grocery store represent their total perception of how inflation affects them. As a result, your confused and disenchanted customers look to you for an answer to such concerns as: "What has caused the rapid price increase?" "Why must I be forced to carry the burden of higher costs while large corporate profits grow to record levels?" "How can inflation be combated?" and "What can I do to minimize the detrimental impact of inflation?"

Perhaps you have already developed a stock answer to customer's questions such as these. If not, the purpose of this letter is to provide answers, where they exist, to such plaguing questions. Obviously, simple answers do not always exist. At times, more than one answer can be secured from a single question. In short, the phenomenon so glibly referred to as "inflation" is a very complex process. Its causes, effects, and cures are not thoroughly understood by even the brightest economists. As a result, this author can hardly come forth with any startling or innovative declarations. Instead, an attempt shall be made to provide the reader with a better understanding of that which is both known and agreed to about inflation.

Inflation--What Is It?

In an overly simplified sense, economists might choose to define inflation as "too much money chasing too few goods." The standard textbook definition might be "inflation is an increase in the volume of money and credit relative to available goods, resulting in substantial and continuing rise in the general price level." So if your customer asks, tell him that inflation, as evidenced by rapidly rising prices, is the result of the money-after-goods chase. The purchasing power of the money surplus decreases and, as an end product, the Robert Asks of this country pay higher prices for cattle feed.

The traditional monitors over the inflationary rate are the Consumer Price Index (CPI) and the Wholesale Price Index (WPI). Each is a measure of the general price level and is reported monthly. While the WPI concentrates on wholesale prices of resources, services, and products, the CPI concentrates on prices at the retail level. Each has shown a continuous rise over recent years and a much more dramatic increase in recent months. At the present time (1974), the CPI is rising at an annual rate of 12 to 14 percent, while the WPI is exceeding 20 percent on an annual basis. Perhaps worst of all, there are few signs that this rate will diminish significantly in the next few months.

Inflation - What Are Its Causes?¹

It should now be apparent that inflation is not the result of a single flaw in our economy. The causes of inflation are rooted deeply to three fundamental patterns: 1) the set of tastes and preferences we have become accustomed to as a consuming society, 2) the structure of the economy as we have shaped it, and 3) the economic policies that we have adopted in our attempt to mold both 1 and 2 above. Let's now look at each of these fundamental patterns in more detail.

¹ Many of the ideas presented here are taken from "Inflation: Some Sources and Effects." Virginia Agricultural Economics, by J.P. Marshall, September, 1974.

Our tastes and preferences. Over the years, we have always been faced with the choice between the risk of recession and the risk of inflation. We have always opted in favor of the risk of inflation. The reasons are quite clear. Recessions are politically unpleasant. A recession means unemployment and a general drop in the total economy's level of output. In brief, our total output of goods and services grows more slowly than does our level of tastes and preferences for these goods and services. To attain a low level of unemployment and a moderate annual increase in GNP, we have chosen to encourage a high rate of borrowing and a low rate of saving. The truth is; our consuming psychology is such that we are quite willing to accept annual price increases as long as an adequate supply of goods and services is maintained.

Our economic structure. That prices and wages have shown little tendency to adjust downward in recent periods is evidence of a major component of rigidity within our economy. Wages, in particular, are not permitted to decline due to the bargaining strengths of our unions. Management, however, is also a contributor because it operates under the assumption that wage increases can be passed directly to the consumer.

In its initial stages, inflation thrives on itself. For example, an awareness of inflation tends to accelerate the rate of price increases as consumers stockpile their purchases in expectation of still further price rises. Labor immediately inserts escalator clauses into its contracts and lenders immediately insert variable interest rate clauses into their mortgages and other financial instruments.

Shortages caused by other structural problems within our economy also contribute to inflationary pressures. Agricultural products and oil are classic examples of shortages arising from rigidities in the economic structure. Other shortages, such as electrical energy, are

the result of inadequate investment and capacity constraints which make it impossible to meet demand at the existing price.

Our economic policies. Economic policy is not created in an arbitrary manner. In fact, it is created in direct response to the existing consumer preferences and our economic structure. Efforts to control inflation are most often focused on a reduction of government expenditures or a decline in the rate of growth in the money supply. While these efforts may have a moderating influence on inflation, adjustments made only in these two areas will not control inflation. To do so would require some-perhaps major-changes in our system of consumer preferences and the adoption of policies that will alter the economic structure and, thereby, dampen inflationary tendencies on a more permanent basis.

Inflation--Two Major Types

Classical economic thought proposes that there are two major types of inflation, "Demand-Pull Inflation" occurs when there is an increase in the amount of money available to buy a fixed supply of goods. This situation was very much in evidence when U.S. food prices raced dramatically upward in 1973 after nearly two decades of relative stability. "Cost-Push Inflation," on the other hand, is largely the result of rises in costs (especially labor) not offset by increases in productivity. As a result of this situation, the general price level is forced upward.

Let's now consider some of the particulars of our agricultural economy for the purpose of identifying which of the two types of inflation now exists.

Background considerations. To provide some perspective to the origin of price inflation, as it now exists, we shall consider some historical facts as they relate to U.S. agriculture. First of all, the price elasticity of export demand for feed grains is such that a 1.5 percent increase in quantity

exported will result in a one percent decrease in price received. Second, we find that the markets for agricultural products are growing at varying rates, with vegetable oils and beef experiencing the most rapid market growth. Third, livestock is the principal means by which a large share of our crop production may be utilized. Given these three items, during the late 1960's and early 1970's our feed grain production grew by about 25 percent, while our exports of feed grains grew by nearly 50 percent. Markets for other U.S. farm products also expanded, and domestic food prices were kept stable via the market regulating effects of substantial grain carryovers.

In 1972, however, the Russians suffered a severe drought. The Russian government, therefore, was confronted with the choice of reducing the number of grain-consuming livestock or initiating a massive grain-buying program. As we all know, it was the latter action, which ultimately led towards our involvement in the now infamous "Wheat Deal." Following the sale of grain to Russia, our carryover stocks were all but eliminated and along with it the loss of the price stabilizing influence. The subsequent rise in feed grain prices to their current record levels is now well known by all.

On the demand side, perhaps the most important influence causing inflation in food prices was the change in consumer diets in both the United States and other countries. Quite simply, people in Western Europe, Japan, and here at home shifted from consuming grain directly to consuming it indirectly in the form of red meats and poultry. Thus, people's preferences for improved diets were consistent with their rising incomes and this resulted in increased pressures on the world stocks of grain.

Even as diets change, a basic economic fact must be acknowledged, i.e., the price elasticity of demand for food is low. In other words, when food shortages occur, relatively large price increases may be expected. We long suffered under the

illusion that our productive capacity was nearly unconstrained. Such was painfully untrue as evidenced by our most recent production records. World food shortages became known and, domestically, our food prices rose four times as rapidly during 1973 as prices of nonfood items. As a result, our policymakers are now confronted with a type of inflation that traditional monetary and fiscal tools are unable to deal with. Accentuated by our own production restraints due to unfavorable weather conditions, world stocks of grain have now reached a level so low that a significant shock to the total production system could no longer be absorbed by storage supplies.

Earlier in this discussion I mentioned labor contract escalator clauses and variable interest charges. Each provides evidence for the existence of the cost-push type of inflation. At the present time, some 4 million workers are covered by contracts with active escalator clauses. Wages of workers covered by escalators have advanced more than 9 percent annually for each of the last two years. Unfortunately these wage increases were not offset by gains in productivity. Of course, the majority of these contracts are not found in the agricultural sector. They are most common in the manufacturing industry, where actual labor productivity has decreased for each of five consecutive quarters beginning in April 1973.² Hence, the inflationary adjustment provided workers by escalated wage gains is not being offset by increases in goods. Costs per unit rise, and the general price level increases. Cost-push inflation is the result.

So, Who Is To Be Blamed?

At a recent Food and Agriculture Conference on Inflation, each of the 40 conference participants (mostly agricultural economists) were surveyed as to their views regarding the major causes of

² Source: Jerome M. Statter and Loren M. Solnik, "Effects of Escalators on Wages in Major Contracts Expiring in 1974," Monthly Labor Review, Washington D.C., U.S. Bureau of Labor Statistics, July 1974, p. 31.

inflation.³ The results of this survey are of value for two reasons. First, they do confirm that some consensus is forming amongst professionals as to what the major contributing causes are. Second, they serve to illustrate that the list of causes is both long and varied. For example, deficit spending by government was the cause most often blamed and rated as a major cause by 70 percent of the respondents.

Supply shortfalls were also considered to be a significant cause. Natural causes, such as droughts and floods, were rated as a major cause by 45 percent of the respondents and shortages caused by economic and political action, for example, the oil embargo, were rated as a major cause by 63 percent. Concentration of power in unions and businesses, inefficient government programs, overly ambitious monetary policy, and unfavorable weather were other causes listed, but by a much smaller percent of the respondents.

In Conclusion?

Cures to the inflationary process are not unknown. The taproot of inflation can be cut either by increasing the quantity of goods available or by reducing the volume of money spent and credit extended or by doing both. Unfortunately, the cures, once administered, are often painful and may cause side effects nearly as damaging as the illness itself.

It seems clear that efforts to remove inflation in food prices by reducing the domestic volume of money and credit extended are of no value. Only the slow process of rebuilding world grain stocks will moderate this source of inflation. However, as such stocks are rebuilt to abundant levels, U.S. food prices will go down and our agricultural economy may be unable to adjust.

³ Hildreth, R.J. "Main Causes of Inflation." Agriculture and Food Conference on Inflation, September 12-13, 1974, Chicago, sponsored by the White House.

Labor productivity continues to decline. As a result, income is redistributed, and the economic position of workers lacking bargaining power worsens as they appear among the growing ranks of the unemployed. For every one-tenth of one percent increase in the nation's unemployment rate, some 90,700 people have lost a paying job. Current studies show that stable prices will be achieved when the unemployment rate reaches 8 percent (current level is around 6.7 percent). If you are unmarried, between

the ages of 16 and 19, and black, the odds are only about 50:50 that you will be able to secure and retain employment during the adjustment period. The major unanswered question is whether or not the people of this country are willing to accept the burdens and inequities resulting from the total corrective process.

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