The beginning of the end of cheap food?

How should we prepare for food inflation and true cost food?

A report of the Business Forum meeting on Tuesday 31st January 2017
About the Business Forum

Ethical questions around climate change, obesity, food security, people and animal welfare, and new technologies are becoming core concerns for food businesses. The Business Forum is a seminar series intended to help senior executives learn about these issues. Membership is by invitation only and numbers are strictly limited.

The Business Forum meets six times a year for an in-depth discussion over an early dinner at a London restaurant.

To read reports of previous meetings, visit foodethicscouncil.org/businessforum.

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Introduction

The late 20th and early 21st century has arguably been the era of cheap food. Food prices and price volatility are a significant political and economic issue around the globe, including in the UK. With rising oil prices, depreciation of the pound, the introduction of the national living wage, increased pressure on land and the impacts of climate change being felt in many parts of the world, food cost rises look likely – and at least some of those increases will surely end up being passed onto the buying public.

Rising food prices are likely to have a disproportionate impact on the poorest and most vulnerable. Is there a way to cope with increased food prices without harming people, or do there always have to be some that lose out?

If the health, social and environmental impacts of food are incorporated, then the price paid at the checkout is often a long way from the ‘true cost’ of food. Does the pending introduction of a soft drinks industry levy signal that the UK Government will more actively seek to internalise more externalities into food prices?

Squaring the circle between making food high quality (including incorporating environmental and animal welfare concerns) and keeping it affordable remains one of the biggest challenges facing the food industry.

The January 2017 meeting of the Business Forum explored whether higher food prices are inevitable, the drivers of food price inflation, how and whether price rise impacts can be mitigated, what true cost accounting means for food, the importance of mechanisms to ensure food is affordable for all and the value of food.

We are grateful to our keynote speakers, Patrick Holden CBE, Founding Director of the Sustainable Food Trust and David Read, CEO and Founder of Prestige Purchasing. The meeting was chaired by Professor David Pink, Emeritus Professor of Crop Improvement at Harper Adams University and Chair of the Food Ethics Council.

The report was compiled by Liz Barling and Dan Crossley and outlines points raised during the meeting. The report does not necessarily represent the views of the Food Ethics Council, the Business Forum, or its members.

Key Points

- The late 20th and early 21st century has arguably been the era of cheap food.
- Food inflation is affected by many complex – sometimes interdependent – factors. These relate to the value chain, trading, supply, and demand. It was argued that many, or indeed most, of these factors are already in an inflationary place and are likely to remain there for the next three to five years. Production costs and labour (particularly post-Brexit) are two of the key factors.
- The UK’s poorest 20% of people spend between 17 and 22% of their household income on food (compared to the average of around 10%). Squaring the circle between making food high quality (including incorporating environmental and animal welfare concerns) and keeping it affordable remains one of the biggest challenges facing the food sector.
- It was argued that what is happening in food systems amounts to false accounting, because although businesses work on profit and loss statements, the balance sheet does not take account of the impact of ‘hidden’ costs like the impact on natural capital or human health. Ignoring this means that the balance sheet seems artificially healthier, and entrenches the position that doing the ‘wrong’ thing pays better than the ‘right’ thing.
- Food price inflation will affect everyone, but the poorest will be hardest hit. It will also affect food producers, retailers and all along the supply chain.
- Initiatives proposed that might help the UK Government think through the issues include the Natural Capital Coalition, which the UK Government is already part of, and TEEB for Agriculture and Food, which involves research institutes all over the world searching data on food.
- Is the era of cheap food over? It was argued that it most probably is. Brexit affords an exciting opportunity to reshape the way farming is done and make sure that food is produced in a more sustainable way. But it is just as possible that Brexit will see a race to the bottom in the UK’s food system.
Entering a new era?

Have we entered an era where we see the end of cheap food? It may be that a number of factors – a perfect storm – cause food costs to rise, hitting manufactures, retailers and customers hard. What are the factors that might drive these price rises? Can – and should – they be stopped? What’s wrong with paying more for our food anyway, if it means that we all end up with food that’s better for our health, for animal welfare and for our environment (if there are compensatory mechanisms to support those on low incomes)?

There has generally been a downward trend in food prices over the past century on the percentage of disposable income spent on food. But there are currently a number of disruptive factors that are increasing volatility in food prices, including, in the UK at least, the Brexit vote.

There are lots of ‘true’ costs that most mainstream businesses are not factoring into the price of food at the checkout, including health and environmental impacts. Whether the introduction of the sugary drinks levy is the first move in a shift in government policy to try and internalise some of those external costs remains to be seen (although there was a feeling that this was more of a political move than the start of a major shift to true cost accounting).

When the UK’s poorest 20% of people spend between 17 and 22% of their household income on food (compared to the average of around 10%), affordability is key.

Whether it is possible to make high quality food available (including incorporating environmental, animal welfare, human health and other externalities) whilst keeping it affordable, is a major challenge for the UK food supply system.

Away from ‘false accounting’

It was agreed that people are not currently paying the true cost of their food. The cost of bad diets to the NHS, or the cost of nitrogen pollution to the natural environment for example are rarely factored into the price people pay at the checkout. It was noted that citizens, governments and businesses have a shared responsibility when it comes to people’s health.

It was argued that what is happening in food systems amounts to false accounting, because although businesses work on profit and loss statements, the balance sheet does not take account of our impact on ‘hidden’ costs like our impact on natural capital or human health. Ignoring this means that the balance sheet seems artificially much healthier, and entrenches the position that doing the ‘wrong’ thing pays better than doing the ‘right’ thing. Every food business is essentially trapped by those economic conditions, and so the food system is trapped in a vicious circle.

The organic food market, where citizens are asked to pay an extra cost associated with more sustainable production systems, was developed to make sustainable agriculture pay as well as to educate people. But, it was suggested, the organic market potentially ‘ghettoised’ sustainable food, creating a two-tier market, where only people who could afford it were able to access organic food.

So, if creating a separate organic market is not necessarily the answer to ensuring that the true cost of food is reflected in its price, what is? It was argued that it is necessary to undertake a process of identifying, categorising, quantifying and even where possible monetising, the range of costs and beneficial outcomes of different food and farming systems. Such work will help to identify mechanisms where economic distortion has taken hold. The good news is that this work has already started.

How might this work in practice? One example given was that of nitrogen fertiliser. In a hypothetical example, assume nitrogen fertiliser costs £1 per kg. If a farmer buys 1kg worth of nitrogen fertiliser and spreads it on his or her land, at the cost of £1, we might assume a £2-3 benefit in yield (according to the European Nitrogen Assessment, the ‘ENA’). However, what are the costs in terms of the nitrogen oxide emissions, the energy cost in terms of carbon dioxide equivalent of the manufacturing process (which uses lots of natural gas), the damage of nitrogen pollution in water and associated clean-up costs, and the public health damage in air pollution and other serious health effects?

An ENA assessment looked at those undisputed negative externalities and concluded that if they were charged to the manufacturer or the user of nitrogen fertilisers, it would wipe out the business case for using nitrogen. So, it is perhaps
understandable why the industry might not be keen to incorporate these externalities. On the other hand, it was argued that this assessment makes the case for a nitrogen tax. Would it not be sensible to make those who are using nitrogen fertiliser financially accountable for their negative externalities? In the short-term it would be an inflationary driver on food prices, which is politically very challenging, and there might well be extremely vociferous lobbying from the fertiliser industry and from some farmers.

The holy grail, it was suggested, was to go into the engine room of policy and economic instruments and try to make sure that all the known environmental and social externalities are factored in. In such a way, the difference in the premium between the ‘sustainable, fairly produced food’ and the industrially produced food, which causes a lot of negative externalities, would reduce until you get a tipping point, and then both the production of sustainably produced food, and the market, can become mainstream.

However, it takes a bold and visionary government to design and implement policies that would deliver this sea change in our food system.

The need for long-termism

At a recent event in Oxford, Professor Johan Rokström, the inventor of the Planetary Boundaries concept, gave a talk which focused on the major areas where planet earth is exceeding its carrying capacity (e.g. greenhouse gas emissions, water use, pollution, soil degradation, nitrogen). He argued that these areas all link back to food and farming. His argument is that if the world is to get back within the planetary boundaries before it is too late, there has to be action on food and farming, otherwise there will be irreversible climate change or some other sort of ecological and social breakdown.

Responding to this kind of thinking requires a political and economic environment that embraces long-term responsibilities. But, it was argued, the current political and economic systems are chained to short-term electoral cycles and short-term shareholder dividends. Not to mention the key economic measure of success being growth (but that is a whole other Business Forum).

It was suggested that health could be a way to help governments think more long term. An alliance of progressive food businesses, civil society organisations and other interested parties might effectively put over the argument that factoring in the true cost of food would deliver short to medium-term gains to the NHS (as well as long-term benefits). This argument would have to face the fact that investments in improving public health are outside of an electoral cycle, so it would have to be very well formulated.

There are a diversity of approaches to tackling the problem, as is shown by the differing approaches of the Devolved Administrations. It may be that getting government – and citizens – to take responsibility for future generations is the best way to frame the argument, particularly around health, but also the environment. Wales has the Wellbeing of Future Generations Act, a law forcing the Welsh government to take account of the impact of their policies on future generations, that has the potential to be very powerful.

Such a UK-wide act, combined with a genuine open conversation with citizens about how the choices they make now about their food and their health impacts on their children and grandchildren, could be a powerful motivator for government and businesses to think more long term.

Subsidies

It could be said that agricultural and other subsidies tie food producers into ‘business as usual’ models of production. For instance, in the US, agricultural subsidies encourage farmers to grow Roundup Ready GM corn and soy, which is arguably detrimental for soil health. Despite knowing this, and wanting to make their soils healthier, most farmers stick with the mainstream, subsidy-supported methods because they are more profitable (in the short-term at least).

In the UK, it was suggested that some subsidies are slightly more enlightened than others. However, with the UK coming out of the EU, the Common Agricultural Policy will need to be replaced. This could be a real opportunity to redistribute subsidies, support and incentives in different ways that support farmer education and farmer collaboration. Rethinking how the
government supports farming could also prove to be an opportunity to encourage change by implementing tax incentives for certain farming practices.

One potential example is a French idea of soil carbon payments. This would mean a target for all farmers to build a 0.4% increase to their soil carbon in a year.

There are many other ideas for creating more sustainable farming through subsidies. It was suggested that an independent commission to look at the opportunities provided by coming out of the CAP arrangement could be very timely. At the moment, farming is subsidising cheap food – this has to change, and one way to do that could be through progressing and far sighted subsidies. But this message must come from the farming industry as well as from NGOs. It has to be remembered also that if subsidies are taken away from farmers, the cost of food will go up at the checkout. So instead, subsidies have to be smarter – providing a public good as well as support to farmers.

**Food price inflation**

The factors that drive food prices are incredibly complex. Food inflation is affected by a large number of – sometimes interdependent – factors. For instance, the historically low prices that were seen in the two decades leading up to 2008 were driven mostly by distribution gains by the supermarkets, who centralised and went to hub and spoke distribution. Shopping habits also changed in the ‘90s, with the big shop replacing high street convenience. Supermarkets also began to import from low cost countries, driving the price in the UK downwards. This was accompanied by a concentration of power in the supermarkets which also helped them drive the cost of food down.

Then 2008 saw the global financial crash, and instead of seeing even more food price falls, we saw the opposite. This was mostly driven by the activities of brokers in the market. These brokers jumped in to soft commodities – and the biggest soft commodity of all was food. This activity pushed the price of food up massively. But that wasn’t the only factor in driving prices up post 2008. Other factors included high exchange rates and oil prices.

Post 2013, there has been another fall in prices. This time the key driver has been supermarket competition. The German discounters Aldi and Lidl have taken a 12% share of the UK grocery market, and Waitrose has in recent times been growing its share. This has squeezed the middle big four, where they are struggling to maintain their 70% share of the market.

In addition the ‘big shop’ has begun to decline, with shoppers going back to the high street convenience shop, and home delivery.

**Brexit and food prices**

What will Brexit mean for food prices? We have already seen an increase in some iconic brands, Marmite being one that particularly hit the headlines. Since the referendum result we have seen a big correction in the UK £ exchange rate, which has already driven up food prices to a degree. This will only become more apparent in the next six months to a year. Big retailers are already seeing suppliers demanding 10-20% price increases. Clearly, they will not get that, because the sector will resource from different places, and negotiations with suppliers will push some of the costs back up the supply chain. But analysis has shown that the UK is probably looking at 3-4% food price inflation this year.

Looking further forward, there are many additional unknown factors that will affect food price inflation post Brexit. As yet, it is unknown what the impacts of tariffs will be, or of farm subsidy changes. What will come out of the trading agreements that the UK Government makes? These uncertainties will certainly have an impact on food prices, but whether up or down remains to be seen.

**Factors driving food price inflation**

It was argued that there are roughly sixteen factors that drive the cost of food, which fall into four boxes – value chain, trading, supply, and demand. These factors all indicate that the era of cheap food is ending (and has been since 2008). Many of the 16 are already in an inflationary place and are likely to remain there for the next three to five years.

The most important factors are arguably production costs and labour (particularly post-
Brexit. Rising costs of energy and oil are also likely, particularly in an era of economic and political instability. It was suggested that oil prices will continue to rise for the coming few years. However, there are competitive pressures in the UK retail sector, which may peg prices. There are likely to be more mergers and acquisitions, such as the recent purchase of Bookers by Tesco. Brexit will affect exchange rates and commodity markets (which sit in the trading area). Exchange rates may have already taken the Brexit ‘hit’, and in the short to medium term the pound may start to strengthen, as negotiations become clearer. However, it was argued that the exchange rate is likely to remain fairly weak.

Commodity markets around the world are becoming more volatile, mostly driven by a range of other issues like climate and disease, and in some cases even production issues. Climate change is a big driver of food price inflation, but also the one that is hardest to predict. However it is, alongside population growth, likely to make a huge difference to our ability to produce food. Statistically there is already growing evidence of crop failure due to climate change.

Disease has emerged into specific supply chains, particularly those reliant on intensive farming. The most recent example is salmon farming, which has a huge disease issue in its two mayor centres (Norway and Chile). In response, salmon has more than doubled in price, and it was argued that it might increase by another 30-40%.

Food trends and fashion also play an important part in food price inflation. Coffee, for instance, has become a global drink which has recently caused a global shortage. Avocado is another example, as is quinoa.

Finally, it was argued that specification is a key issue when it comes to the price of food. Specification management, or value engineering, means reducing the size of a pack of something. But sometimes it is not about reducing the size of the product, it is about de-specifying it in terms of its sustainability or quality. If this is done without communicating this properly to customers, this qualifies as unethical behaviour.

What price values – food affordability

With the average household spending on food in the UK hovering at around 10%, it was suggested that there needs to be a conversation about what is the optimum share of income that should be spent on food.

Clearly it is not a good thing to be spending half of household income on food, especially when mortgages and rents are so high in the UK. The country’s poorest households are already spending 20% of their incomes on food, a percentage that they struggle with – part of the ‘poverty premium’. Arguably this encourages many households on low incomes to buy ‘empty calorie’ food rather than high quality fresh ingredients.

There is, it was suggested, an interesting question about what value do – or should – we place on food. Where the UK and other developed countries are spending 10% or less on their food, this is often driven by a combination of very effective supply chain management, and creating products that are very cheap, but not very sustainable.

So, one question is whether we want to drive down the percentage that we spend on food – and if so, what gets put by the wayside? What price do we pay as we decrease our spending? And is that acceptable? Is there a role for retailers and caterers to guide people to make the ‘right’ or ‘better’ choices at the checkout? On the other hand, if we externalise the internalities of food production, and all food becomes more expensive, will that push more people into household food insecurity? How can this be mitigated? By capping rents or mortgage repayments, or by increasing social security? These are big questions that, arguably, need to be debated by society. It was argued that the ‘solutions’ to the affordability challenge lie outside of the food sector and away from a cheap food model.

Approaches to tackling the problem

Food price inflation will affect everyone, but will affect the poorest people hardest, as has already been seen. It will also affect food producers, retailers and everyone along the supply chain.

Ensuring that as the UK exits the era of cheap food, sustainable food production can be
embedded into government policies, is crucial. But, how might that be done?

One initiative that might help our Government think through the issues is the Natural Capital Coalition, which the UK government is already part of. Historically it has not focused much on food, but it was argued that the initiative is beginning to understand that food is at the crux of the issue, and will begin to focus much more on food in the very near future.

Another international initiative is the TEEB for Agriculture and Food. It involves research institutes all over the world searching data on food. This will feed into government policies across the globe, and to the UK Treasury and the Natural Capital Coalition.

Conclusions

Is the era of cheap food over? It was argued around the table that it most probably is. Brexit affords an exciting opportunity to reshape the way we farm and make sure that food is produced in a more sustainable way. But it is just as possible that Brexit will see a race to the bottom in the UK’s food system.

It was noted that complexity is often used as an excuse to do nothing. This must not be the case. An independent food Brexit commission could bring together likeminded food businesses, farmers and NGOs to deliver a strong message to government about what kind of food system we want. But time is running out. The opportunity needs to be grasped now.

Will true cost accounting for food ever make it into the mainstream? It was felt by some that this was unlikely, due to the short term political pressures on governments. But by engaging the public in the debate about the food system we want, and reflecting that back to government may go some way to putting pressure on it to think more seriously about the long-term future of farming. Likewise, a UK Wellbeing of Future Generations Act would force some serious long-term policy making.

Government could also show leadership through public procurement and by intervening where there is market failure. Could these make a difference to providing decent food for decent prices?

At the end of the day, there are many uncertainties, both about the direction of food prices, and the impact that will have on how we grow food, and on household food security. It is incumbent on all of us, growers, buyers, citizens and government, to tackle these issues head on to make sure that the UK’s food system provides for everyone – not just some people, but all people, and for the environment and animals too – now and in the future.
Speaker biographies

Patrick Holden is founder and chief executive of the Sustainable Food Trust, an organisation working internationally to accelerate the transition towards more sustainable food systems. Between 1995 and 2010 he was director of the Soil Association, during which time he pioneered the development of UK and international organic standards, policy incentives for organic production and the organic market. His policy advocacy is underpinned by his practical experience in agriculture on his 100-hectare holding, now the longest established organic dairy farm in Wales, where he produces a raw milk cheddar style cheese from his 80 native Ayrshire cows. Patrick is a frequent broadcaster and speaker, was awarded the CBE for services to organic farming in 2005 and an Ashoka Fellowship in 2016.

David Read is Chairman of supply chain consultancy Prestige Purchasing, which David established in 1998, since when it has become recognised as the thought leader on procurement and distribution within the Foodservice sector. The company’s annual Food Inflation report has become an important part of the sector’s calendar, and is widely respected as the major source of insight into historic and future food market performance. He writes extensively in the trade press and during 2016 appeared on BBC Breakfast, and twice on BBC Radio 4’s You & Yours discussing food inflation, and the future of food and drink in the UK. In recent times, he has founded a fast casual restaurant business serving fresh and healthy Indian inspired food called Kheera Kitchen. David also sits on the Board of the Academy of Food & Wine Service. Living in Oxford, his spare time is absorbed by composing, recording and playing material with indie rock band TuftycluB.

David Pink is Emeritus Professor of Crop Improvement at Harper Adams University and is Chair of the Food Ethics Council. David is an expert in plant breeding and crop genetics with 30 years’ experience of breeding research. Until September 2010 he led the crop improvement group at Warwick HRI, University of Warwick in multidisciplinary research in field vegetables, narcissus and oil seed rape, funded by Defra, the Biotechnology and Biological Sciences Research Council and breeding companies. He is a member of various organisations including the steering group for the BBSRC’s horticulture and potato initiative, and the LEAF advisory board and is an assessor for the TSB agritech catalyst fund.

(David chaired the discussion)