

Statement of  
Dr. Ephraim Leibtag, Research Economist  
Before the Committee on Education and Labor  
July 9, 2008  
Hearing on  
The Rising Cost of Food and Its Impact on Federal Child Nutrition Programs

Mr. Chairman and Members of the Committee, my name is Ephraim Leibtag and I am an economist with the USDA's Economic Research Service researching retail food prices and the dynamics of retail food markets. I appreciate the opportunity to speak to you today about trends in U.S. food prices.

In 2008, the Consumer Price Index (CPI) for all food is projected to increase 4.5 to 5.5 percent, as retail prices reflect higher commodity and energy costs. The main factors behind higher food commodity costs include stronger global demand for food, increased U.S. agricultural exports resulting from stronger demand, weather-related production problems in some areas of the world, and the increased use of some food commodities, such as corn, for bioenergy uses.

Food-at-home prices are forecast to increase 5.0 to 6.0 percent, while food-away-from-home prices are forecast to increase 3.5 to 4.5 percent in 2008. The all-food CPI increased 4.0 percent between 2006 and 2007, the highest annual increase since 1990. Food-at-home prices, led by eggs, dairy, and poultry prices, increased 4.2 percent, while food-away-from-home prices rose 3.6 percent in 2007.

Because a full assessment of crop damage was not available at the time of this forecast, this update does not explicitly account for potentially higher corn and soybean prices due to crop damage from recent flooding in the Midwest. Estimates of the impact of potential supply disruptions on food prices will be included in this data series once an assessment of the flood losses becomes available.

***Measuring Food Price Change***

To better understand recent trends, we need to know how food prices and price changes are measured. Food prices are measured by the Federal government through monthly collection of prices from a representative group of food-stores and foodservice establishments. Items selected for price measurement cover all consumer goods and services.

The Federal government has two basic measures of price change, both of which compare prices in a base year to prices in a current year: The Consumer Price Index (CPI), and the Producer Price Index (PPI). For products purchased by consumers, the All-Items CPI is used to represent average increases or decreases in prices paid for retail goods and services. The All-Items CPI is composed of a number of sub indexes, including the Food CPI.

There are separate food indexes reported for food-at-home, which consists of food sold in retail outlets, and food-away-from-home, which consists of meals, entrees, and other prepared foods sold in eating and drinking establishments, and non-commercial (institutional) foodservice outlets. To obtain the Food CPI, the separate indices of the at-home and away-from-home segments are combined, using their respective expenditure shares.

Food accounts for 13.8 percent of all expenditures in the All-Items CPI. Of total expenditures, food-at-home accounts for 7.66 percent while away-from-home accounts for the remaining 6.17 percent.

### ***May 2008 Retail Food Prices Compared to Last Year***

The CPI for all food in May 2008 is 5.1 percent higher than the May 2007 level. The food-at-home index is 5.8 percent above last May, while the food-away-from-home index is 4.3 percent above last May. The all-items CPI is currently 4.2 percent above the May 2007 level.

Beef prices are 1.5 percent above last May, as higher energy and feed costs have begun to increase beef prices. Pork prices, while increasing in recent months, are down 0.6 percent from last May's level. Strong short-term pork supplies have been the main factor behind recent retail price declines, but pork prices may rise over the next 2 years as current supplies are sold and future production slows due to higher production costs. Poultry prices are up 4.5 percent from last year at this time. Higher feed and energy costs in 2007 and early 2008 have caused poultry prices to rise faster than normal over the past 18 months.

Egg prices are 18.2 percent above the May 2007 level. Increased demand overseas and higher prices for chicken feed lead to higher egg prices at grocery stores. Dairy prices are up 11.0 percent from the May 2007 level. Within the dairy category, prices changed as follows: milk prices are 10.2 percent above last May's prices; cheese prices are 14.0 percent above last May's level; ice cream and related product prices are 5.9 percent above last May; and butter prices are 3.8 percent above last May.

Fresh fruit prices are up 4.7 percent from last year at this time, with apple prices up 7.4 percent and banana prices up 21.7 percent, while orange prices are down 15.3 percent. Since last year at this time, fresh vegetable prices are up 1.8 percent, with lettuce prices up 1.0 percent, tomato prices up 4.0 percent, potato prices up 3.5 percent, and other fresh vegetable prices up 0.5 percent.

Cereals and bakery product prices are up 10.5 percent from last year at this time as higher wheat, corn, and energy prices have pushed up production costs for these products. Sugar and sweets prices are 5.5 percent above last May. Within the nonalcoholic beverages category, carbonated drink prices are up 2.8 percent from May 2007; coffee prices are 8.5 percent higher than last May; and non-frozen noncarbonated juices and drinks prices 7.7 percent above the May 2007 level.

### ***Why Higher Food Prices?***

Record U.S. trade, driven by economic growth in developing countries and favorable exchange rates, combined with tight global grain supplies, resulted in record or near-record prices for corn, wheat, soybeans, and other food and feed grains in 2007 and 2008. For corn, these factors, along with increased demand for ethanol, helped push prices from under \$2 per bushel in 2005 to \$3.40 per bushel in 2007, and over \$7 as of the middle of this year. Higher corn prices motivated farmers to increase corn acreage in 2007 at the expense of other crops, such as soybeans and cotton, raising their prices as well.

What effect do these higher commodity costs have on retail food prices? In general, retail food prices are much less volatile than farm-level prices and tend to rise by a fraction of the change in farm prices. The magnitude of response depends on both the retailing costs beyond the raw food ingredients and the nature of competition in retail food markets.

Several key factors influence how an input cost increase affects the prices of food under conditions of competition. For a given increase in an input's cost, the larger will be an increase in the food product's price when:

- The share of the input in the total cost of producing food products is larger.
- The input has fewer good substitutes in the food production process—that is, few other inputs or processes could be used to produce the food product.
- Consumers have few good substitutes for the food product, in which case consumers do not decrease purchases substantially when the price is higher.
- Prices are expected to remain high for a long period of time.

Retail prices for fresh fruits, vegetables, and eggs have a relatively high farm value share compared to other commodities. Changes in farm-level prices of these products have a larger impact on retail prices as a result. There are also seasonality factors contributing to volatility of produce (fresh fruits and vegetables) prices. Produce supply and price variation are also influenced by extremes of weather and growing conditions, such as droughts, floods, freezes, and pests. Because most produce commodities are highly perishable, supply and prices are highly sensitive to adverse growing conditions.

In contrast to raw commodities, the farm value share in many processed products is quite small, which moderates the effect of rising prices. For example, an 18-ounce box of corn flakes contains about 12.9 ounces of milled field corn. When field corn is priced at \$2.28 per bushel (the 20-year average), the actual value of corn represented in the box of corn flakes is about 3.3 cents (1 bushel = 56 pounds). (The remainder is packaging, processing, advertising, transportation, and other costs.) At \$3.40 per bushel, the average price in 2007, the value is about 4.9 cents. The 49-percent increase in corn prices would be expected to raise the price of a box of corn flakes by about 1.6 cents, or 0.5 percent, assuming no other cost increases.

### ***Prices Paid by Food Service***

The Producer Price Index, measures prices received by processors, suppliers, and wholesalers, depending on the product. Both farm and processed products are included

in the PPI. Similar to the CPI, the indexes are reported monthly and annually. The PPI should more closely represent the price change in food products purchased by food retailers and food service operators. For many food commodities, the PPI is much more volatile compared with consumer price indexes.

Food service operators purchase both products with a high farm value component, such as milk or apple juice, as well as more highly processed foods having lower commodity/farm value, such as cereal or pizza. Suppliers to the food-away-from-home segment offer both traditional foods requiring additional preparation, as well as highly processed, value-added foods such as heat-and-serve entrees.

***Looking Ahead***

The Department's current long-term projections indicate that retail food price inflation will gradually moderate over the next several years. Continued expansion of biofuels production will likely maintain corn and soybean prices at historically high levels and livestock producers will adjust to the increase in feed costs by reducing production, leading to higher retail prices for beef and pork in the longer term. In contrast, future upward movements in retail dairy product prices may be limited following the strong increase in 2007. In addition, global agricultural production is expected to rebound, especially for wheat, relieving some of the pressure on retail food prices for cereal and bakery products. Of course, future increases in retail food prices depend heavily on energy prices and other food marketing costs.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions the Committee may have.