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Testimony of

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Rising Food Prices: Budget Challenges

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Food, Family Budgets, Wages, and Prices

Chairman Spratt, Ranking member Ryan, I thank you for the opportunity to testify, and I commend the committee for targeting this critical issue of rising food prices and the resulting budget constraints facing families both here and abroad. While there are many dimensions to this issue, including international shortages and the underlying causes of rising global food prices, my testimony will focus on one aspect of the rise in these costs: the food challenge facing low-income families in this country.

Of course, many Americans are facing steep economic challenges. Prices are rising quickly across the board, with inflation, driven largely by food and energy costs, rising at 5% over the past year, and 6.1% for groceries (food purchased specifically for at-home consumption). A year ago, those inflation rates were 2.7% and 4.6%.

While even families with significant resources tell pollsters they are experiencing financial stress, a number of factors render the current period particularly challenging for low-income families. First, in part due to the weak and highly unequal recovery of the 2000s, poverty is actually higher now than it was in 2000 and median family incomes, adjusting for inflation, are lower.[1] Second, as discussed below, current labor market conditions are leading to broad losses in real earnings. Measured on a year-over-year basis, Bureau of Labor Statistics data show that real earnings are down every month since last October. And of course, home values are declining, lowering the net worth of homeowners, millions of whom face defaults on their mortgage loans and even foreclosure.

These factors are all germane to the topic of today's testimony. As noted, food prices are rising faster than overall inflation, and as I stress below, low-income families spent a larger share of their income on food. Second, there is evidence that the poor pay higher food prices, and that they face slightly faster food price inflation. United States Department of Agriculture data on food budgets facing low-income families show even faster price increases. Over the past year, their low-cost budget for a family of four with two children rose 9.6%.

The combination of these factors is giving rise to steep increases in the food stamp rolls, which in April (most recent data) hit their second highest level on record, 28.1 million, a 1.8 million increase over last April. Even with this increase, the Food and Research Action Council (FRAC) points out that one out of three eligible persons fails to access the food stamp rolls.

Taking these facts and trends into account, I recommend that Congress consider investing increased resources in the food stamp program, a step that was proposed, though not taken, in the first stimulus package that passed earlier this year. As I stress in my conclusion, including a food stamp expansion in a second stimulus would fulfill two purposes. First, it would help to alleviate some of the budget constraints documented

[1] The poverty rate was 11.3% in 2000 and 12.3% in 2008. My forecast is that poverty fell to 12.1% last year.

below. Second, it would act as an effective stimulus, as an increase of food stamp grants has been found to create the "biggest bang for the buck" in terms of its multiplier effects.

Food Prices and Family Budgets

The United States Department of Agriculture website section on food prices begins with this assertion:

"In 2008, the Consumer Price Index (CPI) for all food is forecast to increase 4.5 to 5.5 percent, as retailers continue to pass on higher commodity and energy costs to consumers in the form of higher retail prices. The CPI for food increased 4.0 percent in 2007, the highest annual increase since 1990."[2]

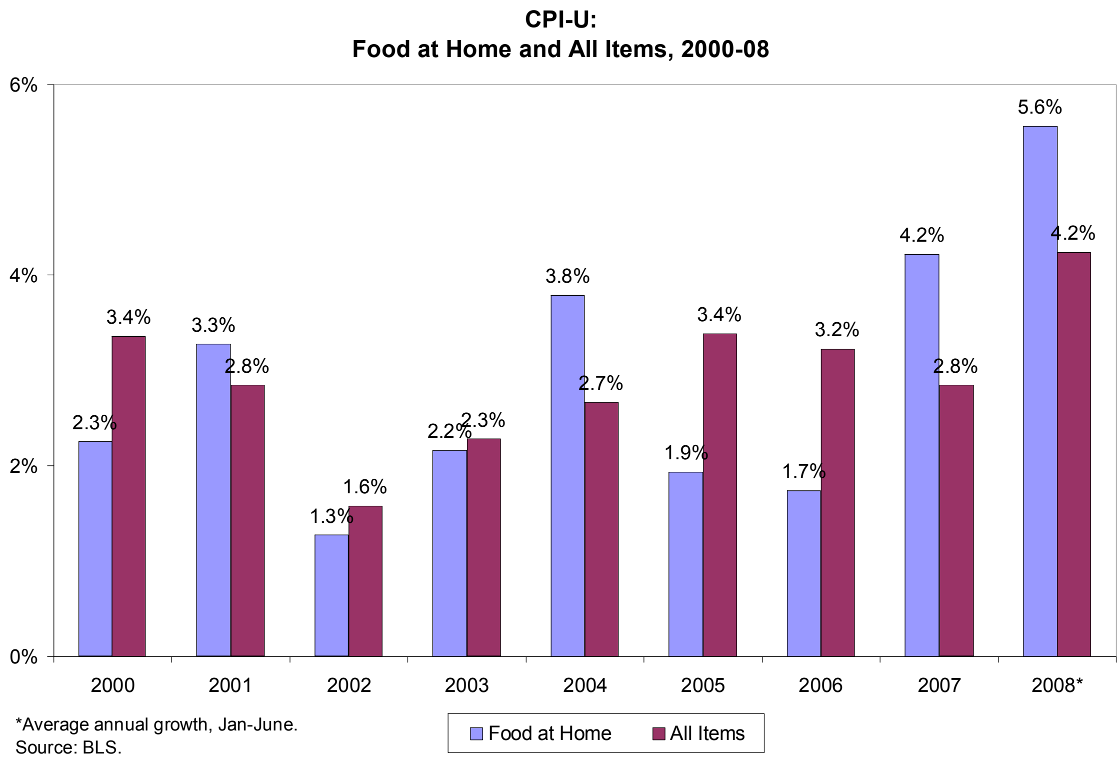
The food category includes both food purchased for home consumption and food away from home. The analysis in this paper focuses on both of these, with an emphasis on the latter, because groceries—food at home—is the significantly larger budget category for low-income families, and because, unlike food away from home, it is non-discretionary.

Consumer Expenditure Data reveal that groceries comprise a significantly larger share of the food budget for low-income families. In 2006, for families in the bottom income fifth, food in total comprised 15.6% of spending, while food at home was 10.5%, or 2/3 of food expenditures. For families in the highest fifth, food at home was 50% of food spending (the relevant shares were 10.9% overall and 5.5% for food at home).

Figure 1 shows the rate of price growth for food at home and all items in the CPI since 2000. The two measures grew at different rates over these years, with food prices behind overall prices in some years and ahead in others. But in the last three and a half years, the pattern has been clear: food prices have jumped significantly ahead of overall prices. Thus far this year grocery prices are up 5.6% compared to 4.2% of overall prices.

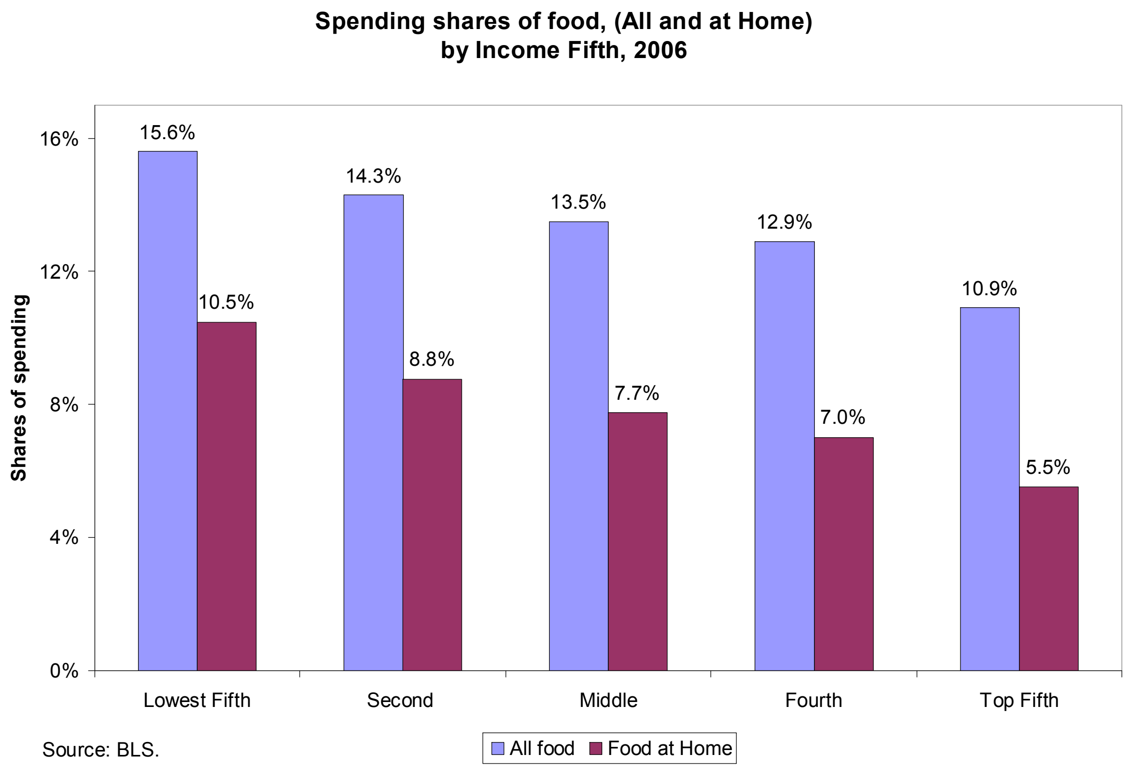
Of course, the other key consumer good that has been speeding ahead of overall inflation in recent months is energy. In fact, once we take gas and food prices out of the overall index—which leaves the so-called core price index, often cited by the Federal Reserve—inflation was up only 2.4% this year (annualized). Clearly, these two commodities are currently driving prices up much faster than the other items in the consumer market basket.

[2] http://www.ers.usda.gov/Briefing/cpifoodandexpenditures/consumerpriceindex.htm



These values are averages, of course, and the focus of my testimony is on lower-income families whose budgets are more stressed by higher prices. By dint of their lower incomes, and often, their lack of assets and borrowing constraints, these families have less “wiggle room” in their budgets and have to shift from one category to another to make ends meet when an inelastically demanded good like food or gas rises in price. Also, as I stress in a later section, the weakening economy is eroding the wages and incomes of many families right now, right when these commodity prices are spiking.

Figure 2 shows the variation around the average budget share for all food and for food at home. Each bar represents the share of expenditures on food for families ranked by their income. The lowest income families spend 10.5% (15.6%) of their expenditures on groceries (all food), compared to about 8% (13.5%) for middle-income families and 5.5% (10.9%) for families in the top fifth. This expenditure pattern is characteristic for necessities, since families tend to purchase relatively similar amounts on these types of items compared to “luxury goods.” Note, for example, that the ratio of food at home expenditures of the top to the bottom fifth was 2.4 in 2006, while the same ratio for overall spending (including all expenditures, not just food) was 4.6.



Source: BLS.

Thus far, we have established that low income families spend more of their budgets on food, and that food prices are rising faster than average, implying a greater consumption burden on these families relative to higher income families. But we have only looked at average food prices. Do the poor face higher food prices relative to those faced by higher income families? And do they rise more quickly?

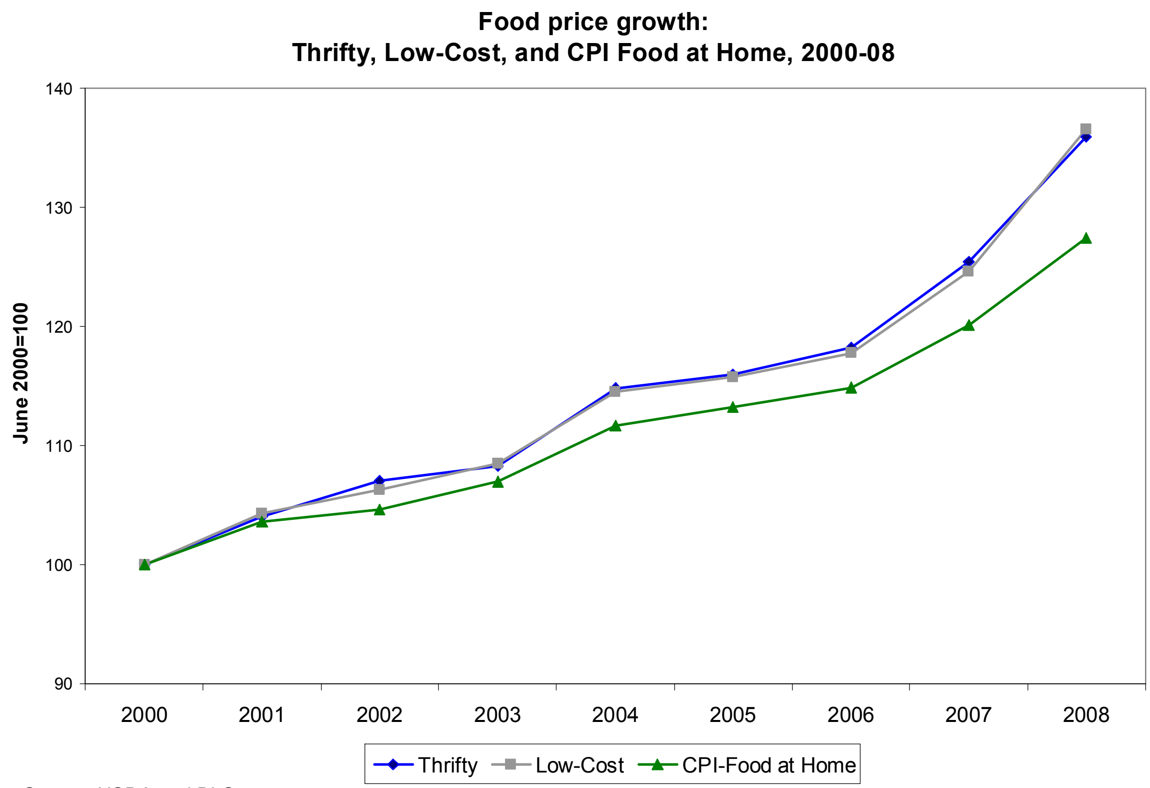
Throughout the years, researchers have found this to be the case. Part of this stems from simple exploitation of vulnerable populations. For example, there is evidence from the recent meltdown in housing markets suggesting the poorer households were steered into more expensive loans. Part also stems from reduced mobility of poorer persons such that they do not have the same mobility to avoid relatively bad deals.

Most recently, Matt Fellowes finds the following:

> "About 4.2 million lower-income homeowners paid higher than average prices for their mortgages in 2004. About 4.5 million lower-income households paid higher than average rates for auto loans. And countless more paid higher prices for other necessities like basic financial services, food and insurance than did their wealthier neighbors."[3]

[3] http://www.brookings.edu/opinions/2006/0807metropolitanpolicy_fellowes.aspx

By comparing trends in the USDA thrifty (lowest cost) and low-cost food plans to those in the CPI, we can get a sense of how the food prices faced by low-income families are trending in recent years.[4] **Figure 3** plots the prices of the two low cost food budgets (four-person family with two young children) against that of the CPI food-at-home index using data from June in each year. Over the full period, the low-income budgets grow about 36% each compared to about 27% for the CPI food-at-home index. Much of the gap between the two series evolved over the past two years. Between 2007 and 2008, for example, the thrifty budget rose 8.4%, the low-cost budget was up 9.6%, while CPI food-at-home was up 6.1%.



Source: USDA and BLS.

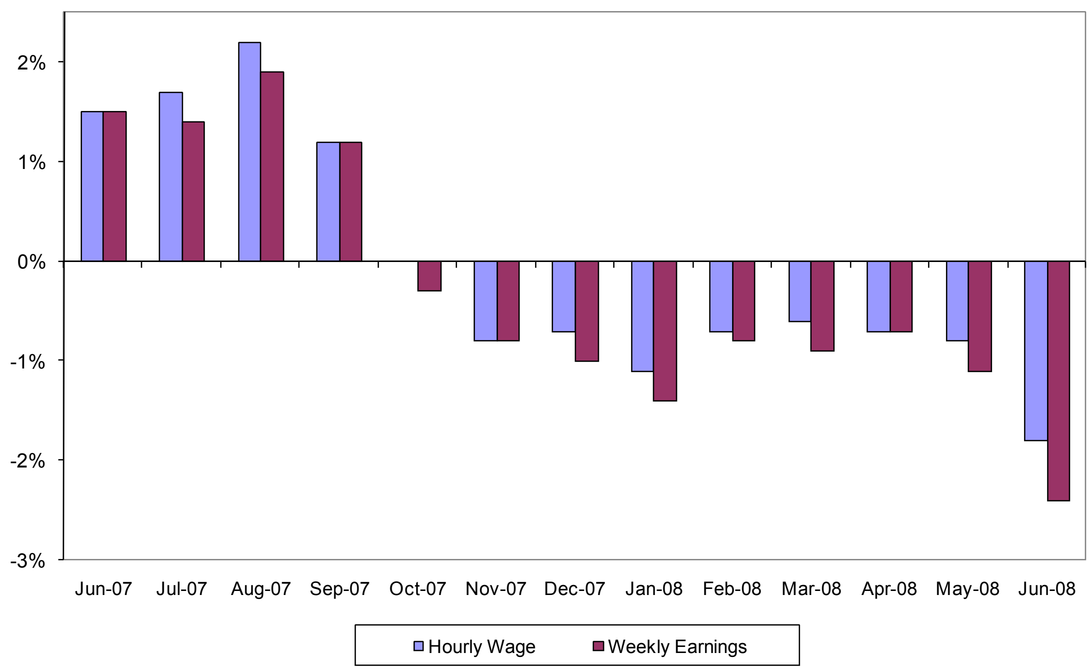
Wages and Food

Though the economy is not officially in recession, key aspects of current economic conditions are clearly recessionary. The job market in particular has notably weakened, with net employment down about 440,000 jobs, and unemployment up about a point compared to one year ago, to 5.5%. The underemployment rate, a more comprehensive measure of diminished job opportunities, was 9.9% in June.

[4] http://www.cnpp.usda.gov/USDAFoodCost-Home.htm

The slowing job market has meant diminished wage pressure and fewer hours of work. At the same time, prices, driven by energy and food, have spiked. The result, as shown in **Figure 4**, is a consistent negative trend in real wages. The figure plots the annual changes in the average hourly and weekly earnings of the 80% of the workforce in blue-collar or non-managerial jobs. As of late 2007, both series were falling in real terms. Note that weekly earnings—the second bar for each year—are falling more quickly than hourly earnings, due to declining weekly hours worked.

Annual changes in real wages and weekly earnings, June 2007-08



Source: BLS.

These wage dynamics are, of course, a stressor on family budgets. In order to simply quantify the issue for low-wage workers, I took ½ of the average production, non-managerial wage and divided this by the price of a gallon of unleaded gas and five consumer food staples, as shown in the table. Half the production worker wage is a good proxy for low wages, as it tends to be at a level between the 10th and 20th percentile wage and it moves consistently with these measures. We use it here because since it is released monthly, it allows for up-to-date analysis.

Table 1 looks at the change in wages and commodity prices over the past five years. Back in the second quarter of 2003, this hourly wage could buy just under five gallons of gas, 2.9 gallons of milk, 7.8 pounds of apples, etc. Of course, gas is much less affordable, and given the price and wage movements, the low-wage workers can get only 2.4 gallons in the most recent quarter, half a gallon less than five years ago. An hour of work yields seven fewer pounds of flour, five fewer pounds, and about one pound less of bread.

Commodities per hourly wage (see text for explanation)

	Unleaded Gas	Milk	Apples	Flour	Rice	Bread
Apr-Jun 2003	4.9	2.9	7.8	23.7	17.7	7.7
Apr-Jun 2008	2.4	2.4	7.1	17.0	13.1	6.5

Note: Data are from BLS. Liquid measures are per gallon, others, per pound.

Conclusion

All Americans are facing rising prices right now, led by energy and food. But a few factors make this challenge particularly acute for low-income families. First, food prices are rising faster than overall inflation, and low-income families spent a larger share of their income on food. Second, there is evidence that the poor pay higher food prices, and that they face slightly faster food price inflation. Third, the downturn in the job market has led to fewer job opportunities and slower wage growth.

How should Congress consider responding to these stressors? One useful policy response would be to increase food stamp benefits as part of a second stimulus package.

The rationale for a second stimulus package is beyond my scope for this testimony.[5] I will only note that most analysts believe the first stimulus package will raise the economy's growth rate in the middle of this year, but that real GDP growth will then slow to well below trend, barring further government intervention. In this regard, Congress has begun discussing the utility of a second stimulus package.

Though an increase in food stamp benefits was proposed in the first stimulus debate, it was ultimately left out of the first stimulus, which largely emphasized checks to households and tax cuts to businesses. There are two reasons to include a food stamp expansion in the next package, if there is one.

First, increasing food stamp benefits would offset some of the budgetary constraints stressed in my analysis. Of course, food stamp eligibility—generally, family income must be below 1.3 times the poverty threshold to get the benefits—will preclude some who need food assistance from the program. But among those who do get food stamps, an extension of benefits is needed.

As the Food Research Action Council documents, food stamp rolls stand at historically high levels. Most recent data, from April, show 28.1 million recipients, the second

[5] See this testimony for a discussion of the rationale for a second package: http://www.epi.org/content.cfm/webfeatures_viewpoints_testmony_bernstein_squeeze

highest monthly number in the history of the program, and 1.8 million above last year's level. Even so, FRAC stresses that only 2 out of 3 eligible persons access the program.[6]

Second, research suggests that among the various programs typically considered in the context of fiscal stimulus, food stamp benefits provide the biggest "bang for the buck." According to a study by Moody's economy.com, for every extra dollar spent on the program, real GDP grows by $1.73. Of the thirteen tax cuts or spending increases considered, food stamps had the largest so-called multiplier impact.

The Congressional Budget Office agrees with the thrust of this analysis, stating that "the vast majority of Food Stamp benefits are spent extremely rapidly. And because Food Stamp recipients have low income and few assets, most of any additional benefits would probably be spent quickly."[7]

Typically, implementation of a food stamp expansion is discussed in terms of ratcheting up the benefits of food stamp recipients, as opposed to expanding eligibility guidelines and covering more persons. Given the FRAC point regarding missing eligibles from the program, Congress might consider some combination of the two approaches: both raising the benefit level and devoting some resources to boosting states' administrative and outreach capacity with the goal of identifying and signing up eligible families that are currently not on the program.

[6] http://www.frac.org/html/news/fsp/2008.04_FSP.htm
[7] http://www.cbo.gov/ftpdocs/89xx/doc8916/01-15-Econ_Stimulus.pdf