

# Origins of the Current Food Crisis

By

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Presented to the Assembly Committee on  
Human Services Informational Hearing  
Sacramento, CA

May 15, 2008

Mr. Chairman, members of the Committee, thank you for the opportunity to discuss the current food crisis and prospects for retail food prices. Several key factors are shaping the current food environment and have led to what is now being referred to as a “food crisis”. Here the food crisis is defined as low stocks of primary commodities, together with large jumps in the price of final food products. Factors contributing to the crisis include crop failures in major producing areas, increased biofuels production, rising input costs for energy, and changes in domestic and global economic growth. Some of these developments are factors affecting the food crisis in the short-run, while others are factors with long-run implications for food supply, demand, and prices. I will describe the current global food crisis, its causes and effects, and other non-food economic factors that are putting upward pressure on food prices.

## **Primary food prices**

Food prices jumped up significantly during 2007 and continue to rise for many primary commodities. The price index for primary, farm commodities increased by 18 percent in 2007.

During the first quarter of 2008, prices received for all crops were up 20 percent, while prices for livestock and livestock products increased by 10 percent. In recent months; however, record supplies of red meat and poultry have moderated or even lowered the farm prices for cattle and hogs. The last time prices increased by double-digit amounts was during the 1970s when double-digit inflation rates were also being experienced.

#### *Wheat and coarse grains*

The consumer price index (CPI) for cereal and bakery products increased by 4.4 percent in 2007 and is projected to rise 7.5-8.5 percent in 2008. The increase in prices at the retail level for products made with wheat reflects, in large part, a sharp increase in the price of wheat due to global crop failures. The 2007/08 world wheat production declined below global demand for a third straight year due to crop failures in Australia and Canada, and below average yields in the U.S. Consequently, world wheat stocks are at their lowest level in the 30 years. With export restrictions being imposed by other major producing areas such as Argentina, Ukraine, and Russia to satisfy their domestic demand, demand by the rest of the world for U.S. wheat has increased, causing U.S. stocks to fall to their lowest levels in 60 years. With higher world and U.S. populations compared to 30 to 60 years ago, the reserves per person are even lower.

With lower production and stocks, wheat prices have risen to their highest level. The farm price for wheat is projected to be a record \$6.55-\$6.75 per bushel, about 54% than last year's price of \$4.26, and shattering the previous record of \$4.55 per bushel.

For 2008 higher prices for wheat have lead to an increase in acreage planted. If weather conditions remain favorable, records harvests are expected this year, allowing some recovery in world wheat stocks; however, forward markets indicate that prices will still increase. Prices may

increase because with low wheat stocks, government commodity purchases to replenish stocks both here and in other countries will place a large demand on current wheat production.

### *Corn*

While production of wheat during the last several years has suffered from crop failures, corn has seen record production and prices. Acreage planted in corn in the U.S. is at its highest level since 1944; however, with much higher yields per acre, production is expected to be 10.6 billion bushels, up 17 percent from last year. The record production and prices is fueled by strong demand for corn both domestically and abroad. Domestically, demand for corn used for ethanol production has increased dramatically. Ethanol use, projected at 3.1 billion bushels for 2008, will account for about 29 percent of corn production. With high prices for wheat and lower stocks of feed quality wheat for livestock, the demand for corn as a substitute particularly in the European Union, remains strong. Corn exports are projected at a record 2.5 billion bushels, up 18 percent from last year.

The increase in demand for corn has helped push corn prices to record levels. The farm-level price of corn for 2007/2008 is expected to average \$4.10 - \$4.50 per bushel, a 35% increase in the 2006/2007 price per bushel of \$3.04. Corn prices are expected to rise again in 2008/2009 due to strong demand and lower acreage being planted in corn. Lower acreage is being planted in corn due to a shift into production of both wheat and soybeans, which has also seen an increase in price.

### *Rice*

Rice has been prominent in the news recently due to reports of rationing by the large warehouse distributor, Costco. Rationing is the result of tighter domestic supplies, and higher rice prices by other distributors compared to Costco, which had purchased rice under forward

contracts at a price substantially below current market prices. Tighter supplies in the U.S. are a result of less acreage planted in rice. Producers in much of the South cut back on rice area in 2007 because higher returns could be realized on other crops such as corn and soybeans.

With tighter supplies and high prices for wheat and corn, the world demand for rice as a substitute has increased above the current production levels, resulting in export restrictions from rice producing countries such as Thailand, Egypt, Vietnam, and India. With export restrictions being imposed by other countries, the world demand for U.S. rice has increased, lowering U.S. rice stocks, and putting increased pressure on rice prices.

#### *Other commodities*

While prices for other food commodities have increased, the price increase has not been nearly as dramatic as the price increases for cereal crops. Retail prices for fruits and vegetables increased 3.8 percent in 2007 and are projected to increase by 3-4 percent in 2008. The CPI for meat, poultry and fish also increased by 3.8 percent in 2007, but is only expected to increase by 2-3 percent in 2008. The relatively low increase in meat prices is due to increased slaughter of cattle and poultry in response to higher feed costs and drought conditions in the Southeast. Egg prices, which rose by 29% in 2007, are only expected to increase by 3-4 percent as production increases. The price for dairy products increased by 7.4 percent in 2007, and is projected to increase by 3-4 percent in 2008.

#### **Retail prices**

The increase in commodity prices is only one factor in the increase in retail prices. During the past year the price of energy increased. On May 14, 2007, the retail price of a gallon of gasoline was \$3.069. Since then the price of gasoline has risen by 20 percent to \$3.69 a gallon nationwide, with parts of California averaging just over \$4.00 a gallon.

Energy is used throughout the agricultural industry from fertilizer and pesticide production to fueling equipment. It is used to process crops and transport them to markets, and to heat or cool stores. These higher energy costs are then passed on to consumers. ERS (The USDA Economic Research Service) estimates that direct energy and transportation costs account for 7.5 percent of the overall average retail food dollar. Thus, every 10 percent increase in energy costs causes a 0.75 percent increase in food costs if fully passed onto consumers.

**Other factors affecting long-run costs of production for food commodities.**

During the past several decades there has been an increase in travel by people between countries, and an increase in imports and exports of both fresh and processed foods. Along with this increase in traffic has been an increasing rate of introduction of exotic pests and diseases. During the past 15 years infestations of fruits flies (Mediterranean, Oriental, Mexican and Caribbean) into California and Florida, citrus canker and citrus psyllids into Florida, rice blast, avocado thrips, sting nematodes, pitch canker, sudden oak death, glassy-winged sharpshooters, silverleaf whiteflies, red imported fire ants, Diaprepes root weevils, karnal bunt (a wheat disease), chrysanthemum white rust, and the light brown apple moth into California just to name a few, have all caused, or threatened to cause, economic damage.

Some of these pests have been eradicated, some are undergoing an eradication program, and some have become established. The costs keep adding up. The establishment of avocado thrips caused the costs of production for avocado growers in California to increase by 4.5 percent, resulting in net losses of \$4.45 million a year. Should the Diaprepes root weevil become established, costs of production for avocado growers are expected to increase by another 3.0 percent; however, the costs for the production of fresh oranges are expected to increase by 29 percent. If the light brown apple moth becomes established most of California's fruit industries,

including the avocado, citrus, grape, pome (i.e. apples and pears) and stone fruit industries, will experience some kind of economic cost. Ultimately these costs are passed on to the consumer, either through higher prices or through less production and local availability.

### **Economic growth.**

Economic trends in both the U.S. and the rest of the world are affecting commodity prices. Higher incomes in rapidly developing economies such as China and India have increased the demand for food. With a combined population of 2.4 billion people, or 36 percent of the world's population, even small changes in demand due to growth in incomes can have an impact on food prices worldwide. For Asia, except Japan, the expected rate of growth for 2008 is 7 percent, equal to the rate of growth for the past five years.

Within the U.S., an economic slowdown is putting increased pressure on consumer incomes during a time in which there are record prices for basic commodities such as wheat and corn, and energy. An economic slowdown usually signals falling prices, or at least small increases in prices; however, the supply conditions in cereals, strong global demand, and increased energy costs are putting upward pressure on prices. Just as there is no one factor that is causing the food crisis, no one factor is causing the economic slowdown. Some factors in the economic slowdown are increased energy costs as higher energy costs affects all industries and households, higher interest rates, increased foreclosures, and greater unemployment.

From 2005 to 2007 there was a steady increase in interest rates, causing an increase in mortgage payments for people with adjustable rate mortgages. For some this meant foreclosure and in 2007, the foreclosure rate in the U.S. reached an all time high. In the U.S. property is a means to hold wealth. A loss of property, or a decrease in house values as foreclosures increase mean a decline in real wealth, leading to more conservative spending.

For people who kept homes purchased with an adjustable rate mortgage, greater mortgage payments, higher utility bills and food costs are putting a squeeze on family finances. While many people will be able to adjust by cutting back on discretionary spending for items such as meals in restaurants, or search for better bargains, people in low-income households will feel an increasing strain on resources. For households earning between \$20,000 and \$30,000 a year, food and utilities account for 23.2 percent of total expenditures. In comparison, households earning over \$70,000 spend only 16.8 percent of their income on food and utilities. Low-income households have fewer resources to adjust to rising food costs, and, because basic necessities account for a larger share of expenditures than for higher-income people, higher food and energy costs have a more dramatic impact on total household budgets.

The economic downturn has caused the rate of unemployment to increase. The unemployment rate now stands at 5.0 percent, up from 4.6 percent in 2007, and is forecasted to remain between 5.2 and 5.4 percent through 2008. With less people working and greater pressures on low-income budgets, the demand for food assistance is increasing. Many community food assistance programs are feeling a pinch as more people are looking for assistance, and fewer people are left to contribute.

### **The future of the food crisis.**

In the short-run, as long as weather remains good, stocks of primary commodities will recover, bringing down food prices. U.S. economy will also recover allowing people more resources that can be used to purchase food. In the long-run, increased demand for corn for biofuels, global economic growth and the spread of exotic pests and diseases will continue to put upward pressure on food prices. This concludes my testimony.