CENTER FOR TRADE POLICY STUDIES

Free Trade Bulletin

No. 31 • January 31, 2008

Food Fight

by Sallie James, policy analyst, Center for Trade Policy Studies, Cato Institute

The Bureau of Labor Statistics recently confirmed what shoppers have been noticing for months: the price of food is increasing at an unusually rapid rate. And failed government policies—supporting domestic farmers through restrictions on cheaper imports and stimulating demand for corn-fed ethanol—are adding to consumers' woes. The federal government can and should take this opportunity to alleviate the effect of higher prices at the grocery store by reducing taxes on imported rice, dairy products, and sugar and by abandoning its misguided support for biofuels.

Paying More for Food

During the calendar year 2007, food prices in the United States increased by 4.9 percent, with especially marked hikes for staples such as milk, cheese and bread (see Table 1). That was higher than the overall inflation rate for urban consumers (the CPI-U) of 4.1 percent over the year to December 2007 and much higher than the 2.1 percent increase in food prices in 2006.[1] In other words, food prices are rising more quickly than consumer prices overall, and more quickly than in the previous year. In the seven years 2000 to 2006, food prices increased by a comparatively modest average of 2.5 percent a year.

Table 1
Food Product Price Increases (12 months ending December 2007)

Product[1]	Price increase (percent)
Milk	19.3
Cheese	13.0
Bread	10.5
Poultry	6.3
Fruits and vegetables	5.9
Cereal and bakery products	5.4
Meats, poultry, fish, and eggs	5.4
Beef	5.0
Food away from home	4.0
Alcoholic beverages	3.8
Nonalcoholic beverages	3.5
Pork	1.4

[1] The product categories reflect those used by the Bureau of Labor Statistics when compiling their price indices.
Source: Bureau of Labor Statistics, "Consumer Price Index: December 2007," news release, January 16, 2008, www.bls.gov/news.release/pdf/cpi.pdf.

Although U.S. government policies are clearly contributing to higher prices, other international factors are also at play. The food price index used by the Food and Agriculture Organization of the United Nations increased by almost 40 percent in the one year period since September 2006, primarily because of increases in the prices of dairy products and grains. That compares to a 9 percent increase in the 12-month period to December 2006.[2]

Poorer people are especially hurt by higher food prices, because those with lower incomes spend a higher proportion (up to 50 percent) of their disposable income on food. To the extent that they prepare meals at home, the effect is more direct as they are closer to the origin of the supply chain (where there is less potential for absorbing higher prices). For those low-income countries that are net food importers, and therefore receive little offsetting gain for their farmers from higher food export prices, the situation looks worse: the FAO recently estimated that the total cost of imported food for this group of countries in 2007 would be some 25 percent higher than the previous year.[3] American (and European) biofuels policies that artificially inflate food prices abroad are harming the poorest of the world.

The frustration is showing. Rising soybean prices have seen mass street protests in Indonesia recently.[4] Other governments, such as those in Egypt, India, Kenya, Morocco, the Philippines and Vietnam have implemented what lamentably few governments will acknowledge is the right policy and have reduced tariffs on imported food (some of them have also restricted exports).[5] China has recently introduced price controls on grains and their products, edible oils, dairy products, milk, and eggs in an effort to control inflation.[6]

The European Union recently suspended its land set-aside requirements in order to replenish grain stocks.

Growing demand for food, feed and fuel, combined with tight supply conditions, is driving this phenomenon. Global commodity stocks are at historic lows: wheat stocks, for example, are the lowest level since FAO began keeping records in 1980. Add this to a drought in wheat-exporting Australia and the price for wheat is at an all-time high, having doubled since early 2007. Without increased agricultural productivity, the trend is set to continue. The International Food Policy Research Institute recently estimated that global cereal prices will be 10 to 20 percent higher by 2015.[7] Futures prices for commodities indicate that the market expects high prices to continue for the foreseeable future.

In the past, agricultural commodity prices have been characterized by volatility around a trend decline, with periods of low prices typically outlasting temporary rallies. That was because commodity prices were mainly supply-driven: technology and productivity improvements increased agricultural yields, with weather conditions causing short-term fluctuations. While agriculture is still subject to the vagaries of the weather and will continue to benefit from productivity improvements, drought in Australia and the end of dairy export subsidies in EU have contributed to lower global supplies. Higher fuel prices have increased the cost of transporting commodities.

Facts on the demand side suggest that the recent price increases are more structural compared to the cyclical, supply-driven booms of the past. Government policies in developed countries that seek to support farmers by creating artificial demand for ethanol are an important culprit. In addition, economic growth in countries such as China, Brazil, and India has created a large and growing middle class that is acquiring western-style eating habits. The Chinese, for example, have almost doubled their consumption of meat from about 44 lbs. per capita in 1980 to 110 lbs. per capita today.[8] That in turn has pushed up demand for feed grains, because one lb. of beef requires about 13 lbs. of grain to produce.[9] Although high prices will encourage entrepreneurs to increase production, and infrastructure investment will help increase yields and correct the current market imbalance, government actions are impeding the efficient allocation of resources that would normally see lower prices.

How U.S. Government Policy Exacerbates Food Costs

Of the extra money that Americans are spending on food, some of it is as a direct result of government action. Consumers paid an implicit food tax of $5 billion in 2006, according to the Organization for Economic Cooperation and Development, because the federal government supports some farmers by maintaining price floors for their products.[10] The U.S. government also constrains supply by paying farmers to leave land idle as part of its Conservation Reserve Program.

In addition to taxing American consumers of rice, sugar, and dairy products, and subsidizing farmers to take land out of production, the federal government has contributed to higher commodity prices globally by encouraging the ethanol industry. Primarily derived from corn in the United States, ethanol affects the price of corn directly by adding to demand, and other commodities indirectly by drawing cropland away from their production. Indeed, in the last year the supply of corn has increased 24 percent in the northern United States during 2007, primarily because of higher corn acreage (the highest since 1933). Ethanol capacity has risen by around 40 percent in the last year because of government incentives. As farmers shifted production to meet surging demand for ethanol, the acreage devoted to rice, cotton and soybeans has decreased by 3 percent, 18 percent, and 16 percent respectively.[11]

The ethanol boom has knock-on effects in the rest of the rural economy. The growing use of cereals, sugar, oilseed and vegetable oils to produce ethanol and biodiesel is supporting crop prices and, indirectly through higher animal feed costs, raising costs for livestock production. As Table 1 shows, the prices for poultry, beef, and eggs have all increased by more than 5 percent this year. (Pork prices have risen relatively slowly because production has been very high compared to demand, although producers are expected to lower production during 2008 because of losses from low prices and higher feedcosts.[12]) Farmland prices in key corn-growing states such as Iowa, Nebraska, and South Dakota have increased by more than 20 percent in the last year.[13]

To be sure, higher commodity prices mean lower taxpayer outlays on price-triggered agricultural subsidies. The Congressional Budget Office predicted in January 2008 that higher agricultural prices would reduce farm and income support payments in fiscal years 2008–18 to an average of $7–8 billion per year, compared with recent peaks of over $20 billion.[14] But what these higher prices give to taxpayers with one hand, they take away with the other because the government must pay higher prices for the food they buy for school-lunch and other welfare programs such as food stamps (indexed somewhat to food prices). More importantly, the policies place an implicit tax on food and increase the prices that American families pay at the grocery store.

Then there are the biofuels subsidies themselves: the International Institute for Sustainable Development recently estimated that U.S. subsidies for biofuels will cost about $93 billion in the years 2006–12.[15] And to ensure that cheaper ethanol does not make its way to the U.S. market and harm domestic producers and distillers, the government levies a 54 cent-per-gallon tax on imported ethanol.[16]

Unfortunately for consumers, politicians' obsession with ethanol does not appear to be waning yet. The new energy bill signed by President Bush in December 2007 mandates an almost doubling of corn-based ethanol usage in 2008—9 billion gallons annually, up from 4.7 billion gallons in 2007—and a five-fold increase in ethanol blending to 36 billion gallons a year by 2022. The European Union has recently joined the party, too, by agreeing in March 2007 to use renewable sources (primarily rapeseed—or canola—oil) for 20 percent of power production and biofuels for 10 percent of transport fuel by 2020. None of these trends bode well for consumers looking for relief.

Although current high prices reflect largely global events, Americans should remember that, thanks to the federal government, they have traditionally paid up to double the world price for dairy products and close to triple the world price for sugar. Because of U.S. policies that protect the domestic markets for these products from import competition, Americans will still pay high prices for those products, even in the event that global commodity prices fall.

Instead of conflating the harm done to consumers from high global food prices, the federal government should abandon its protection of U.S. farmers from competition and its pursuit of a misguided biofuels policy whose environmental benefits are spurious at best. Politicians especially keen to "stimulate" the economy by putting more money in the hands of consumers should start by reducing the taxes on imported dairy products, sugar, rice, and ethanol.

Notes

1. Bureau of Labor Statistics, "Consumer Price Index: December 2007," news release, January 16, 2008, http://www.bls.gov/news.release/pdf/cpi.pdf, accessed January 17, 2008.
2. Food and Agriculture Organization of the United Nations, "Food Outlook: Global Market Analysis," November 2007, www.fao.org/docrep/010/ah876e/ah876e00.htm.
3. Jacques Diouf, Food and Agriculture Organization of the United Nations, Press Conference on Soaring Food Prices and Action Needed, December 17, 2007, www.fao.org/newsroon/common/ecg/1000733/ed/facts99.pdf, accessed January 17, 2008.
4. R. Minder, J. Aglionby and J. Song, "Soaring Soyabean Price Stirs Anger among Poor," *Financial Times*, January 18 2008, www.ft.com /cms/s/0/508be5de-c552-11dc-811a-0000779fd2ac.html.
5. Diouf.
6. R. McGregor and J. Blas, "China Vows to Act on Prices," *Financial Times*, January 9, 2008, www.ft.com/cms/s/0/a1199c74-be9c-11dc-8c61-0000779fd2ac.html.
7. Joachim von Braun, "The World Food Situation: New Driving Forces and Required Actions," IFPRI's Biannual Overview of the World Food Situation presented to the CGIAR Annual General Meeting, Beijing, December 4, 2007, www.ifpri.org/pubs/agm07/jvbagm2007.asp.
8. Diouf; and author's kilograms-to-pounds conversion.
9. Cornell University News Service "U.S. Could Feed 800 Million People with Grain That Livestock Eat, Cornell Ecologist Advises Animal Scientists," press release, August 12, 1997, www.sciencedaily.com /releases/1997/08/970812003512.htm.
10. Organization for Economic Cooperation and Development, Agricultural Policies in OECD Countries: Monitoring and Evaluation 2007 (Paris: OECD, 2007), Table 15.1 (provisional figure).
11. National Agricultural Statistics Service, *Crop Production: 2007 Summary* (Washington: United States Department of Agriculture, January 2008), http://usda.mannlib.cornell.edu/usda/current/CropProdSu/CropProdSu-01-11-2008.pdf.
12. C. Hurt, "Pork Producers May Face Worse Year Ever in 2008", *Weekly Outlook*, Purdue University and University of Illinois at Urbana-Champaign, January 7,2008, www.farmdoc.uiuc.edu/marketing/weekly/html/010708.html.
13. J. Perkins, "Iowa Farmland Prices Rose Nearly 23% in 2007," *Des Moines Register*, January 22, 2008, www.desmoinesregister.com/apps/pbcs.dll/article?AID=/20080122/BUSINESS01/801220375/1029/BUSINESS.
14. Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2008 to 2018", January 2008, http://cbo.gov/ftpdocs/89xx/doc8917/01-23-2008_BudgetOutlook.pdf.
15. D. Koplow, "Biofuels—at What Cost? Government Support for Ethanol and Biodiesel in the United States: 2007 Update," Global Subsidies Initiative, October 2007, www.earthtrack.net/earthtrack/library/BiofuelsUSupdate2007.pdf
16. For more on ethanol, see Jerry Taylor and Peter Van Doren, "The Ethanol Boondoggle: Who's Kidding Who?" *Milken Institute Review* (First Quarter 2007).

CENTER FOR TRADE POLICY STUDIES

The mission of the Cato Institute's Center for Trade Policy Studies is to increase public understanding of the benefits of free trade and the costs of protectionism. The center publishes briefing papers, policy analyses, and books and hosts frequent policy forums and conferences on the full range of trade policy issues.

Scholars at the Cato trade policy center recognize that open markets mean wider choices and lower prices for businesses and consumers, as well as more vigorous competition that encourages greater productivity and innovation. Those benefits are available to any country that adopts free trade policies; they are not contingent upon "fair trade" or a "level playing field" in other countries. Moreover, the case for free trade goes beyond economic efficiency. The freedom to trade is a basic human liberty, and its exercise across political borders unites people in peaceful cooperation and mutual prosperity.

The center is part of the Cato Institute, an independent policy research organization in Washington, D.C. The Cato Institute pursues a broad-based research program rooted in the traditional American principles of individual liberty and limited government.

For more information on the Center for Trade Policy Studies, visit www.freetrade.org.

Other Free Trade Bulletins from the Cato Institute

"The Fiscal Impact of Immigration Reform: The Real Story" by Daniel Griswold (no. 30; May 21, 2007)

"Comprehensive Immigration Reform: Finally Getting It Right" by Daniel Griswold (no. 29; May 16, 2007)

"Growing Pains: The Evolving U.S.-China Trade Relationship" by Daniel Ikenson (no. 28; May 7, 2007)

"Are Trade Deficits a Drag on U.S. Economic Growth?" by Daniel Griswold (no. 27; March 12, 2007)

"Expand Visa Waiver Program to Qualified Countries" by Daniel Griswold (no. 26; January 26, 2007)

"The New Iron Age: Steel's Renaissance Beckons New Trade Policies" by Daniel Ikenson (no. 25; November 27, 2006)

"U.S. Response to Gambling Dispute Reveals Weak Hand" by Sallie James (no. 24; November 6, 2006)

"All Quiet on the Antidumping Front? Take a Closer Look" by Daniel Ikenson (no. 23; (September 14, 2006)

"Blowing Exhaust: Detroit's Woes Belie a Healthy U.S. Auto Market" by Daniel Griswold and Daniel Ikenson (no. 22; July 27, 2006)