

**Surge in Commodity Prices
Increases Concerns for Rising Food Costs**

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The recent surge in commodity prices is causing concerns for a potential significant increase in food costs. Commodity prices reached record or near-record highs in 2008, but weakened in 2009 and most of 2010. Food prices increased in 2008 just as the U.S. was entering into what many economists describe as the worst recession since the Great Depression. The basic question is, what effect do rising farm commodity prices have on retail food prices? Will rising farm commodity prices today result in the same escalation of food prices we saw in 2008?

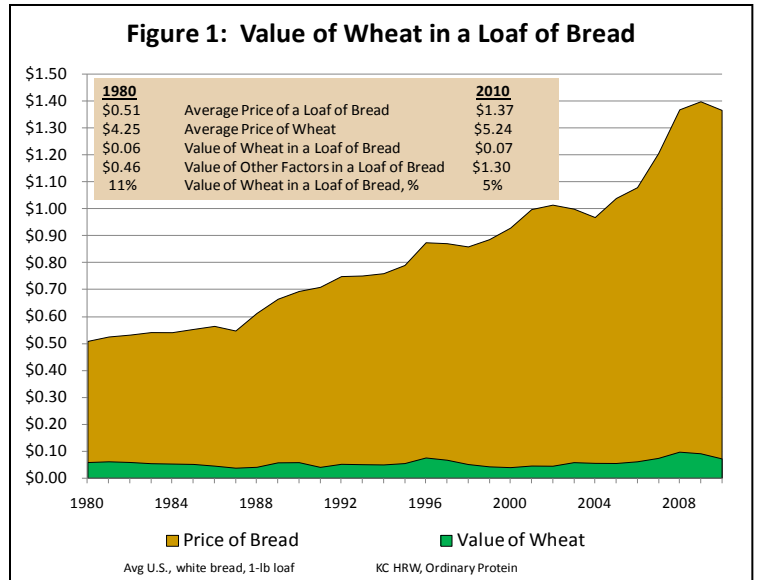
Even with 2008's increase in commodity prices, the impact on retail food prices was relatively small. According to USDA, the farm share value of all farm products averages less than 20 percent of the retail value. That means farmers get less than 20 cents of every dollar spent on food. Of course the percentages are higher for foods consumed closer to their raw form (fresh fruits and vegetables for instance) than more processed food items (baked goods and cereal products). On average, a fifty percent increase in the price received by the farmer results in only a 10 percent increase in the retail cost of food. Farm commodity prices fell sharply in 2009 and 2010 after reaching record levels in 2008. However, food prices continued to rise in 2009 and 2010 even as farm commodity prices returned to 2007 levels.

USDA announced last week that the consumer-price index for food will rise

between 0.5% and 1.5% this year and forecasts an increase of 2 to 3 percent in 2011. From 1990 to 2006 the average annual food price increase was 4 percent and the increase in 2010 will be the smallest since 1992. While prices for basic commodities like corn and wheat are higher than they were in 2007, they remain well below the record highs of 2008. Again, due to the small percentage of farm value associated with retail food prices, the recent upward movements in commodities markets are expected to have little immediate effect on the prices of basic food items. Consumers may see some modest price increases for meat, poultry, and dairy products but this is more a reflection of livestock and poultry supplies than increased feed costs. Commodity prices weakened in 2009 and 2010 before reports emerged from Russia of severe drought, record high temperatures, and extended wildfires causing a shortage of wheat. This was followed by USDA's October 8, 2010 supply/demand report that lowered the U.S. corn production estimate by almost one-half billion bushels—in contrast to a forecast since May of another record corn crop. Adverse weather, a weaker U.S. dollar (making our exports more affordable in world markets), increased exports, higher crude oil prices, and heavy commodity contract buying by speculative investor funds are all contributing to higher commodity prices once again.

Even with tighter grain supplies and a slight increase in food costs this year, we are not on the verge of a food crisis. Abundant supplies of the very best, safest food in the world at the most inexpensive costs will continue to be available in the U.S. Currently, the U.S. population spends about 9.6 percent of their disposable income to pay for food, at home and away.

Many factors contribute to the final level of food prices—labor, advertising, packaging, transportation, energy—besides the cost of the base raw commodity. The costs components of a loaf of bread is provided as an example (Figure 1). Even with record high wheat prices the last few years, the farm value of wheat in a loaf of bread has fallen from about 11 percent of retail value in 1980, to about 5 percent today.



Appreciation is expressed to Dr. J. Mark Welch, Extension Economist for his contribution to and review of this article.