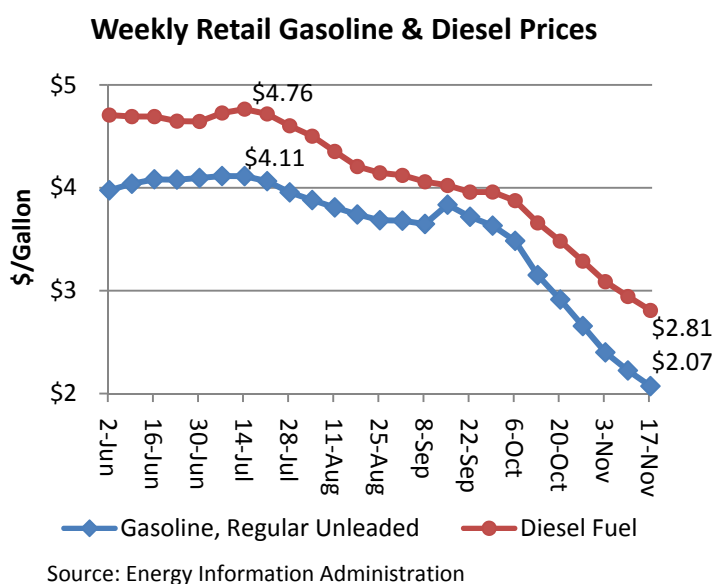
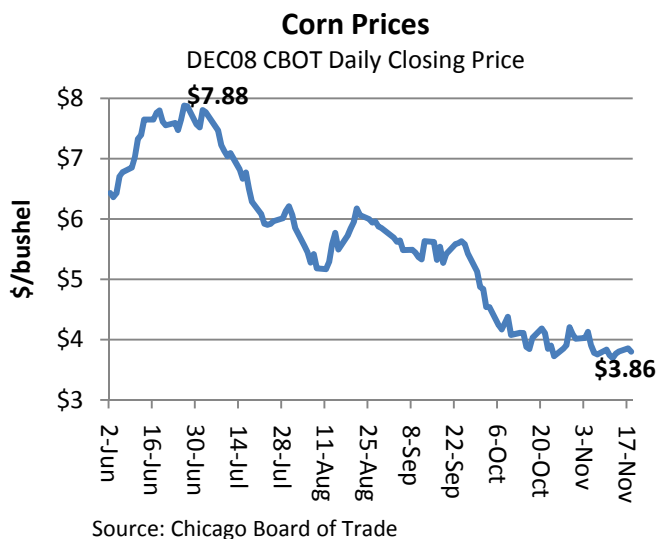


WHY AREN'T FOOD COMPANIES REDUCING PRICES?

After facing record high prices for motor fuel earlier this year, Americans are finally experiencing some relief at the gas pump. In response to the 60% drop in oil prices, regular unleaded gasoline prices have dropped by 50% to an average of \$2.07 per gallon from a peak of \$4.11 in mid-July. Unfortunately for consumers, there has been no similar measure of relief at the grocery store. Food prices continue to escalate, despite precipitous drops in the costs of food production, packaging, and transportation. According to the October Consumer Price Index released Nov. 19, food prices continued to rise in October 2008 and were 6.3 percent higher than a year ago. At a time when American families are facing the largest economic crisis since the Great Depression, food companies seemingly refuse to lower their prices. Evidence is mounting that lower food prices are economically justified and actively being sought by grocery chains.

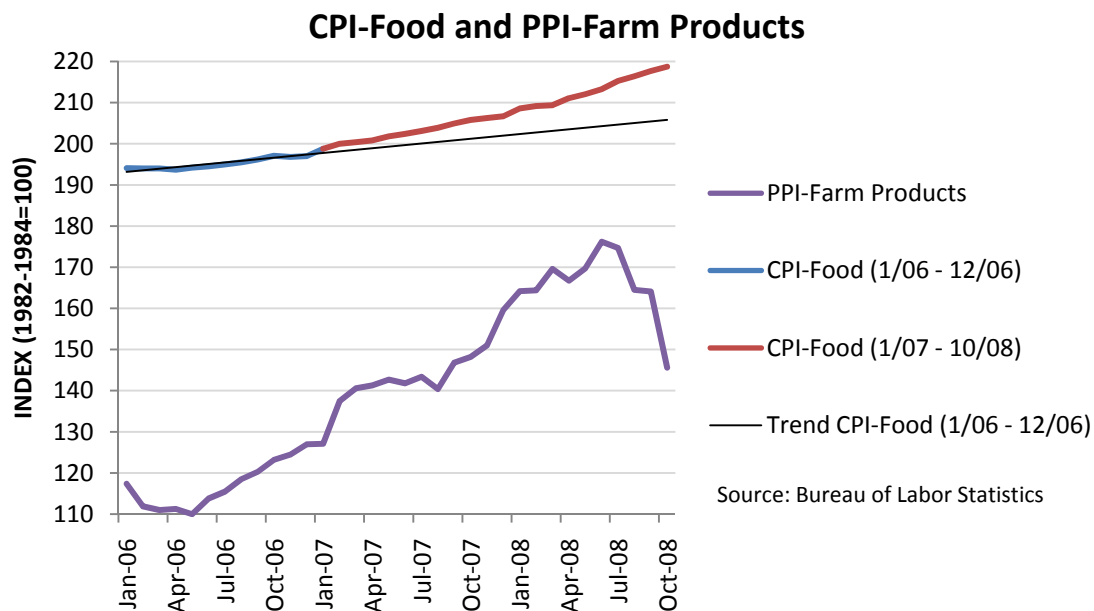
In attempting to defend the rapid food price hikes that began in early 2007, food makers pointed to then-rising costs for agricultural commodities like corn, wheat and vegetable oil. Further, Big Food deceptively attempted to single out expanded grain ethanol production as the main driver of escalating grain and food prices. As an afterthought, they assigned a portion of the blame for higher food prices to oil and natural gas prices that were sky-rocketing at the time. For months, the Grocery Manufacturers Association (GMA) and others in the food industry publicly bemoaned high prices for agricultural products and energy and called for an end to programs that support expansion of biofuels.

But now, five months after the “commodity bubble” began to deflate, food prices remain at levels much higher than normal. The price for corn—the would-be scapegoat of food price hikes—has fallen more than 50% since peaking in late June. Wheat prices have plunged 55%, while soybean prices are down nearly 50%. And oil prices have fallen dramatically from their highs, resulting in a 50% reduction in retail gasoline prices and a 40% drop in diesel prices.



So, why haven't food prices receded along with prices for other staple consumer items? According to economists, consumers are facing "sticky prices" for food items. Sticky prices, as reported by the Associated Press, occur "when companies slap higher prices on products and keep them there even though the rationale for the price hikes — such as soaring oil prices — is gone."¹

As shown in the chart below, in early 2007, food prices began to accelerate faster than in previous years. Food companies blamed higher prices for corn and other farm commodities for the immediate increases in wholesale prices, which translated into higher retail prices. Big Food often suggests a "lag effect" exists before changes in commodity prices are reflected at the retail level (they say that's why food prices haven't come down, despite the plunge commodity prices). However, it is clear there was no "lag effect" in early 2007. When the producer price index (PPI) for farm products increased rapidly, food companies reacted quickly, as demonstrated by the accelerated trend in the consumer price index (CPI) for food. And as producer prices for farm products have dropped dramatically since June, food inflation continues to increase at a faster-than-normal rate.



While consumers have been pinched by higher food prices in recent months, food company profits have swelled. For example, food giants Kraft Foods Inc. and Kellogg Co. both reported higher-than-expected earnings for the quarter that ended in September 2008, due in large part to higher prices for consumers.

Indeed, Kellogg's quarterly earnings report announced, "Successful innovation, brand-building (advertising and consumer promotion) investment, as well as our **recent price increases** continued to drive the growth."² Similarly, Kraft cited "**higher net pricing**" as a driver of increased net revenues.³

¹ "Grocery bill still high? Blame sticky prices." AP. Oct. 19, 2008. <http://www.msnbc.msn.com/id/27269544/>

² Kellogg Co. Form 10-Q. Aug. 5, 2008. <http://biz.yahoo.com/e/080805/k10-q.html>

³ Kraft Foods, Inc. Form 10-Q. Oct. 31, 2008. <http://biz.yahoo.com/e/081031/kft10-q.html>

Tyson Foods—the world’s largest meat processor and an outspoken opponent of renewable fuels—reported a 50 percent increase in net income in the quarter ended September 27, 2008.⁴ Tyson’s latest earnings press release cited “**higher average sales prices**” for pork, beef, and chicken as a major reason for the boost in revenues.⁵

The reluctance of food companies to reduce prices has drawn the ire of consumer advocates, members of Congress, and others. In a recent letter to GMA, Sen. Charles Grassley (R-Iowa) wrote, “Now that grain and energy prices have nearly been sliced in half, surely we can expect that the grocery manufacturers will pass on these savings to American consumers who are suffering from economic hardship. Please let me know how the GMA and its member companies plan to reduce food prices commensurate with lower input costs. I also look forward to your assurances that this will happen soon, so that consumers can measure the benefit.”⁶

Even supermarket proprietors are protesting the artificially high prices being paid to wholesale food suppliers. According to a recent *Wall Street Journal* article, “...grocery chains in the U.S. and abroad are balking at food makers’ efforts to raise prices further.”⁷ Iowa Grocery Industry Association president Jerry Fleagle said grocers are at the mercy of their suppliers when it comes to food pricing. “The retail grocer is basically buying the goods from the manufacturer...Obviously grocers would like to see costs lower because then they could sell it for lower,” Fleagle told a Des Moines television news station.⁸

Despite paying more for wholesale products, some grocery chains have even implemented retail price cutting measures to alleviate the impact on consumers of artificially high grocery prices. For instance, Wegmans Food Markets, a 72-store supermarket chain on the East Coast, recently announced price cuts in early November on certain bakery, meat, produce and deli items. The company stated, “Though the lower costs we expect in 2009 haven’t arrived yet, we think it’s necessary to lower prices now.”⁹ Wegmans’ executives estimate the price cuts will save the average family **\$40-60 per month**.

Ultimately, the unwillingness of food companies to lower prices translates into American consumers spending billions of dollars more for food than is economically justified. If every grocery store in the United States implemented cost cuts similar to those undertaken by Wegmans to deflate artificially high food prices, the total savings to Americans would be in the range of **\$5 to \$7 billion per month, or \$60 to \$84 billion annually**.¹⁰

⁴ “Beef Feeds Tyson’s Bottom Line.” Nov. 10, 2008. Dow Jones newswires. <http://www.smartmoney.com/breaking-news/on/?story=ON-20081110-000349-0859>

⁵ Tyson Foods. Form 8-K. Nov. 10, 2008. Viewed on Edgar Online.

⁶ Austin, Anna. “Grassley Urges GMA to Lower Food Prices.” Nov. 3, 2008. Ethanol Producer Magazine web exclusive. http://www.ethanolproducer.com/article.jsp?article_id=4962

⁷ Jargon, Julie. “Grocers find food prices hard to swallow.” *Wall Street Journal*. Oct. 30, 2008.

⁸ “Grassley Asks Why Grocery Prices Remain High.” KCCI TV. Nov. 19, 2008. <http://www.kcci.com/money/18018939/detail.html>

⁹ “Wegmans starts cutting prices in anticipation of lower costs in the future.” Press release. Nov. 6, 2008. <http://www.wegmans.com/webapp/wcs/stores/servlet/PressReleaseDetailView?storeId=10052&catalogId=10002&langId=-1&productId=658029>

¹⁰ Assumes 119 million U.S. households (Bureau of Labor Statistics, 2006 Consumer Expenditure Survey)