Speculation and the economics of hunger

A recent report of the UN Special Rapporteur on the Right to Food, Olivier de Schutter, provides a damning indictment of the role of speculation in food commodities in fuelling the global food crisis. The report – ‘Food Commodities Speculation and Food Price Crisis’ – was released on the eve of an emergency meeting of the UN-FAO on the instability in agricultural markets.

The global food crisis in 2007-08 led to an unprecedented number of people – close to a billion – sleeping hungry as global food prices shot through the roof. The global price of rice in this period rose by 165% and wheat by 67%. While there has been considerable debate since, on the reasons for this sharp spike in prices including the promotion of bio-fuels at the expense of foodgrain and the global crude oil shock, it is now clear that the magnitude of the price rise could not have been due to these factors. Nor could it have been due to changes in market fundamentals of demand and supply for food commodities, even though there were some murmurs from the IMF and one not so insignificant whimper from the then American president, of higher consumption in emerging economies like China and India.

What emerges from the UN Rapporteur’s report is perhaps the most definitive account so far of the role of what he calls the “speculative bubble” as the price rise happened in an environment of rapacious speculation in food commodities. This speculation was led by large, powerful institutional investors, including hedge funds and investment banks who have otherwise little to do with agricultural commodities. This new form of predatory speculation which picked up during the course of the last decade was dramatically different from the traditional forms of speculation in agricultural commodities which has existed ever since trade in agriculture started. While traditional speculation is based on demand and supply, and for most parts, helps in price discovery, the “momentum-based speculation” that powerful global investors indulged in was based on herd mentality which led to a vicious upward spiraling of prices.

Even traditional speculation can encourage hoarding and has led to devastating events like the Bengal Famine of 1943 which claimed three million lives. The extent of momentum-based speculation in recent years can be gauged from the fact that holdings in commodity index funds jumped from $3 billion to $837 billion between 2003 and 2008. This worrying trend was reported, through the crisis, by UNCTAD and FAO and also by those who profited most from this enterprise, including entities like Morgan Stanley and Lehmann Brothers.

With increasing acknowledgement of the need for reforming the global financial system in order to safeguard food security of the poor, the recent Dodd-Frank Act passed by the US Congress which limits the extent of such speculation, seems to have set the precedent for similar legislation proposed by the EU and other countries.

India, for once, remained relatively insulated from the food crisis of 2007-08 as compared to other nations because of a stronger regulatory framework in commodities trading, a much stronger intervention of the state.

India was also prescient in setting up the Abhijit Sen Committee to consider minimizing the impact of futures trading on commodity prices in 2007, before the crisis unfolded.

The supplementary notes make for far more interesting reading than the report itself. Sen sounded the right note of caution on the role of futures trading and emphasized the need to deepen public procurement of foodgrain, retaining buffer stocks and supporting the public distribution system. This should be the lesson that India takes forward as it goes about drafting the National Food Security Act.

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