Rampant Speculation Inflated Food Price Bubble

Stephen Leahy

UXBRIDGE, Canada, Jan 28 (IPS) - Billions of dollars are being made by investors in a speculative "food bubble" that's created record food prices, starving millions and destabilising countries, experts now conclude.

Wall Street investment firms and banks, along with their kin in London and Europe, were responsible for the technology dot-com bubble, the stock market bubble, and the recent U.S. and UK housing bubbles. They extracted enormous profits and their bonuses before the inevitable collapse of each.

Now they've turned to basic commodities. The result? At a time when there has been no significant change in the global food supply or in food demand, the average cost of buying food shot up 32 percent from June to December 2010, according to the U.N. Food and Agriculture Organisation (FAO).

Nothing but price speculation can explain wheat prices jumping 70 percent from June to December last year when global wheat stocks were stable, experts say.

"There is no food shortage in the world. Food is simply priced out of the reach of the world's poorest people," said Robert Fox of Oxfam Canada in reference to the estimated one billion people who go hungry.

"Hunger is not a food production problem. It is an income problem," Fox told IPS.

The conditions that created the 2007-08 price hike and food riots have not changed, he said. It is no surprise to see record-high food prices and riots again in Egypt, Algeria, Jordan and elsewhere.

Weather used to be the big determinant of food prices, but not anymore. Trillions of dollars have been pumped into food commodities markets in the last few years thanks to deregulation of commodities trading in the U.S., reports Olivier De Schutter, the United Nations Special Rapporteur on the Right to Food.

In an analysis of the food price crisis of 2007-08, De Schutter documents how the U.S. government passed legislation in 2000 deregulating the food commodity markets and for the first time permitted speculation on speculation.

Here's how it used to work. In January, Farmer Brown would sign a contract to sell his 2011 future crop to a grain trader like industry giant Cargill for 100 dollars a tonne. In the fall, Cargill would then sell Farmer Brown's grain at whatever price they could get to a bakery or feedlot company for cattle. These "futures" contracts insulated both the farmer and the grain trader from wild price fluctuations.

Now, after the passage of the U.S. Commodity Futures Modernisation Act in 2000, Cargill could sell Farmer's Brown "futures" contract to an investment bank on Wall Street for 120 dollars a tonne, who could in turn sell it to a European investment company for 150 dollars a tonne and then sell it to a U.S. public pension fund for 175 dollars a tonne and so on. Add in some complex financial instruments like 'derivatives', 'index funds', 'hedges', and 'swaps', and food become part of yet another highly-profitable speculative bubble.

A deeply-flawed global financial system was largely responsible for the 2007-08 food crisis, concluded De Schutter in a September 2010 briefing note.

"Speculators increasingly entered the market in order to profit from short-term changes in price," wrote agricultural economist Jayati Ghosh, in a more recent analysis of the 2007-08 food price spike.

With the pending implosion of "the U.S. housing finance market, large investors, especially institutional investors such as hedge funds and pension funds and even banks, searched for other avenues of investment to find new sources of profit," said Ghosh, a professor at Jawaharlal Nehru University in New Delhi in the Journal of Agrarian Change.

Food commodity speculation became the "hot ticket" and unregulated trading zoomed from 0.77 trillion dollars in 2002 to seven trillion dollars in 2007. Food prices shot upwards until the speculators took their profits in the first half of 2008 to cover their losses in the U.S. housing and other markets, she concluded. By the fall of 2008 prices stabilised but remained substantially higher than they were before the speculative bubble.

"At the end of December 2008, the FAO estimated that 33 countries were experiencing severe or moderate food crises, with conditions in at least 17 countries worse compared to October 2008," Ghosh said.

And 2008 was a year of record grain production internationally.

Now there is a new and bigger food price bubble that began midway through 2010. It's no surprise since nothing was done to change the conditions, Ghosh wrote. Regulations that could prevent or at least limit such speculative financial activity are not in place. The 2010-11 food price bubble is blamed on last summer's Russian drought and increased consumption by India and China. However, FAO figures clearly show grain consumption by those latter two countries has actually fallen, mainly because many simply can't afford to buy as much grain, Ghosh told IPS in an email interview. In India, there has also been "diet shifts to more vegetables and dairy products", she said.

The Russian drought simply sparked this latest speculative bubble. Russia did lose 33 percent of its wheat harvest, but it had plenty of wheat stocks on hand to make up the difference. Instead of using those stocks, the Russian government was persuaded by multinational grain companies to ban wheat exports.
That enabled those companies to break their low-price export contracts with Egypt, Bangladesh and other countries and sell their grain on the inflated domestic wheat market, says Devlin Kuyek of GRAIN, a small international non-profit organisation that works to support small farmers.

"Big companies now control much of the Russian agriculture," Kuyek said in an interview.

GRAIN has documented how foreign and local investors have set up huge, vertically integrated "agro-holdings", particularly in the southern grain belt where they now control 40-50 percent of total grain production.

Russia is a major wheat exporter and Swiss-owned Glencore exports most of Russia's wheat. However, GRAIN research reveals that Glencore lobbied to get an export ban allowing the company to cancel its low-price contracts without penalty.

To ease the 'sting' of the ban, Russia also promised one billion dollars in low-interest loans and subsidies for grain producers.

"Countries like Egypt really got screwed and the grain traders made a killing," Kuyek said.

(END/2011)