The unnatural coupling: Food and global finance

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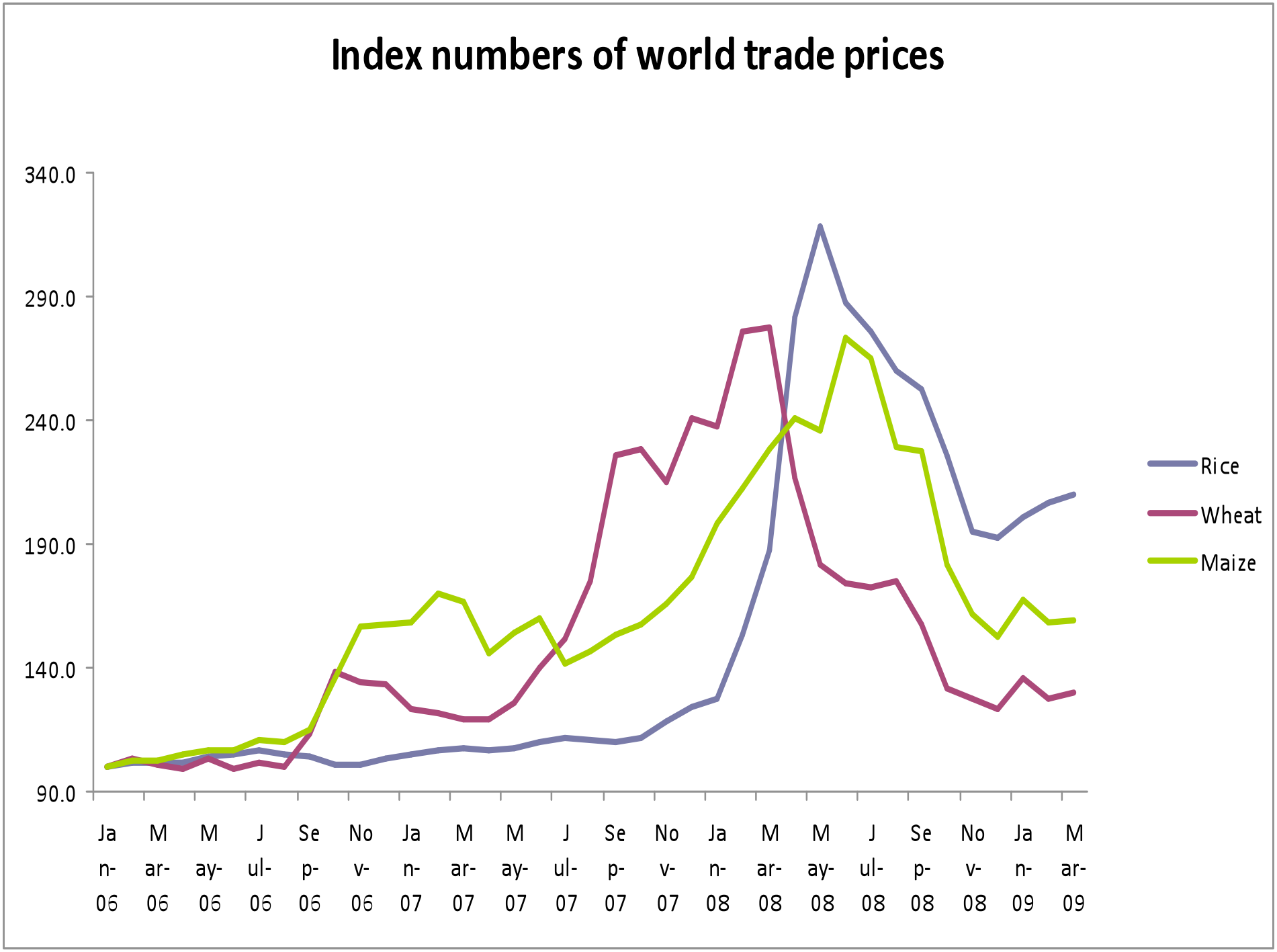
The global food crisis

- Still continues even though it has lost public and media attention.
- Has sharp and disproportionate impact on women and girls because of continuing gender discrimination within households.
- Intimately connected with financial speculation which affected global trade prices.
- Massive – and unprecedented – changes in global trade prices of basic food grains and important cash crops especially over past two years.
- Current complacency because international prices have fallen is not warranted.
- Food insecurity in many developing countries is now even greater than before.


Index numbers of world trade prices
340.0
290.0
240.0
190.0
140.0
90.0
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
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Nov-07
Jan-08
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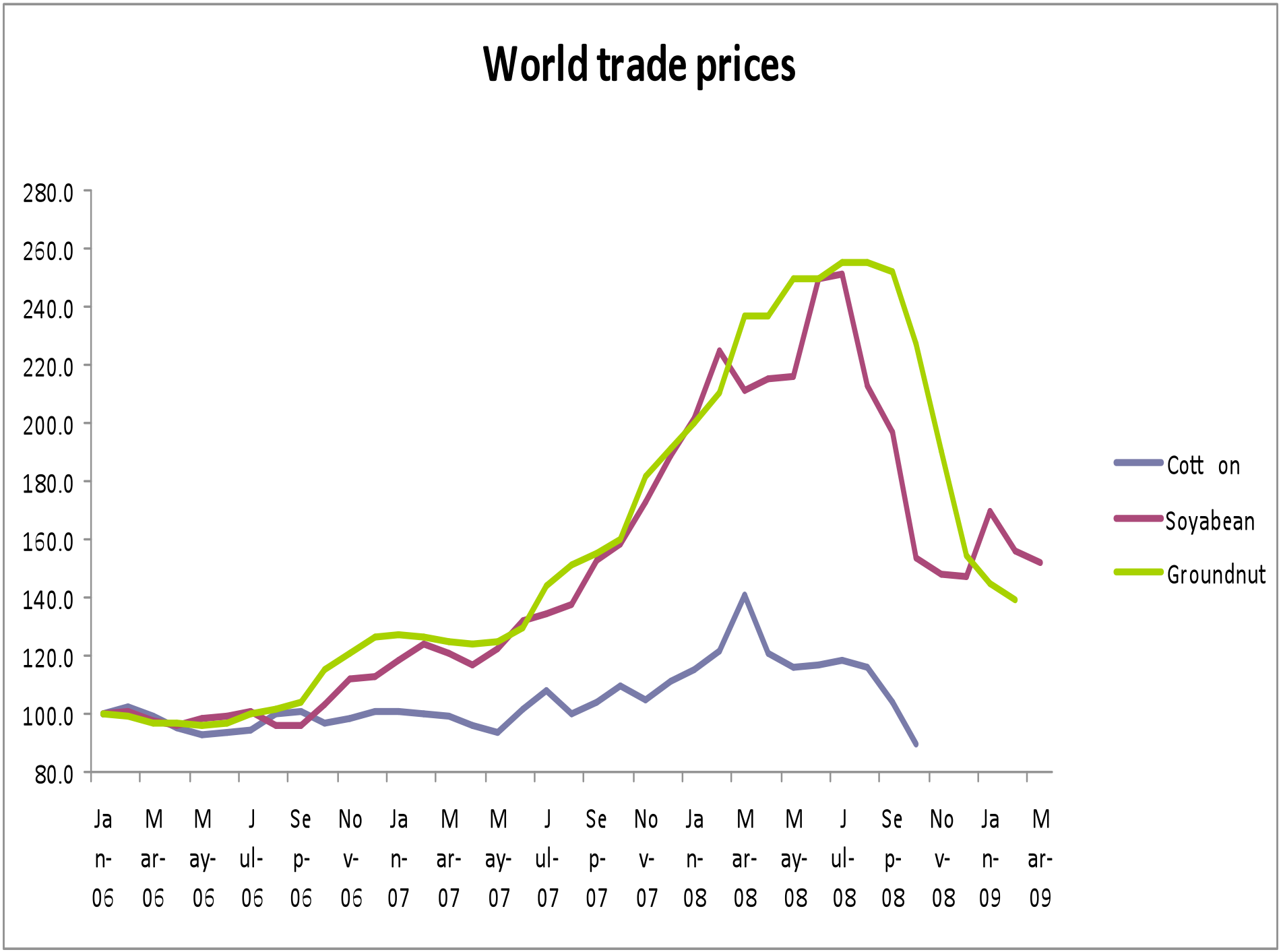
Sep-08
Nov-08
Jan-09
Mar-09
Rice
Wheat
Maize


World trade prices
280.0
260.0
240.0
220.0
200.0
180.0
160.0
140.0
120.0
100.0
80.0
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Nov-07
Jan-08
Mar-08
May-08
Jul-08
Sep-08
Nov-08
Jan-09
Mar-09
Cott on
Soyabean
Groundnut

Prices do not reflect real demand and supply

- Production has increased much faster than utilisation, leading to increase in stock holding (from admittedly low levels).
- Amount traded has actually fallen.
- Claim that increased demand from China and India has led to rising prices is completely unjustified, because both aggregate and per capita consumption has fallen in both countries.

Basic facts of the world cereal situation (million tonnes)

	2006-07	2007-08	2008-09	Per cent change: 2008-09 over 2007-08
PRODUCTION [1]	2 010.4	2 129.2	2 244.8	5.4
Wheat	596.6	610.8	682.2	11.7
Coarse grains	985.1	1 078.4	1 111.5	3.1
Rice (milled)	428.7	440.0	451.0	2.5
SUPPLY [2]	2 481.1	2 553.4	2 675.5	4.8
Wheat	776.3	767.9	832.4	8.4
Coarse grains	1 171.0	1 240.9	1 282.5	3.4
Rice	533.8	544.7	560.6	2.9
UTILISATION	2 064.3	2 125.2	2 198.3	3.4
Wheat	622.0	617.5	647.6	4.9
Coarse grains	1 015.3	1 070.9	1 106.1	3.3
Rice	427.1	436.8	444.5	1.8
Per capita cereal food use (kg per year)	151.8	152.3	152.4	0.1
TRADE [3]	256.8	271.6	265.0	-2.4
Wheat	113.3	111.2	120.0	7.9
Coarse grains	111.2	129.6	114.0	-12.0
Rice	32.3	30.9	31.0	0.3

Basic facts of the world cereal situation cont. (million tonnes)

	2006-07	2007-08	2008-09	Per cent change: 2008-09 over 2007-08
END OF SEASON STOCKS [4]	424.3	430.7	474.3	10.1
Wheat	157.0	150.2	182.9	21.8
- main exporters[5]	36.6	27.7	42.7	54.1
Coarse grains	162.5	171.0	175.2	2.5
- main exporters[5]	62.3	73.7	64.8	-12.1
Rice	104.7	109.6	116.2	6.0
- main exporters[5]	23.1	26.0	29.2	12.2
Cereal production [1]	887.2	916.6	934.9	2.0
excl. China and India	306.4	303.5	313.7	3.3
Utilization	935.5	960.2	978.3	1.9
Food use	650.4	663.5	673.1	1.5
excl. China and India	276.5	283.7	290.8	2.5
Per capita cereal food use (kg per year)	155.5	156.3	156.3	0.0
excl. China and India	157.3	158.1	158.9	0.5
Feed	166.8	172.0	176.4	2.6
excl. China and India	48.9	49.2	50.1	1.9
End of season stocks[4]	238.2	255.9	278.1	8.7
excl. China and India	58.0	52.4	53.0	1.2

Some supply factors are and will be significant

- short-run factor
  - diversion of both acreage and food crop output for biofuel production
- medium term factors
  - rising costs of inputs
  - inadequate credit to cultivators
  - falling productivity because of soil depletion
  - inadequate public investment in agricultural research and extension
  - impact of climate changes on harvests

Speculation and commodity futures markets

- Function of speculators is to predict future market patterns and thereby reduce the intensity of change - that is, reduce volatility and stabilise prices!
- Similarly, commodity futures markets are supposed to reduce risk for cultivators and purchasers:
  - allow better risk management through hedging by different layers of producers, consumers and intermediaries;
  - enable open-market price discovery of commodities through buying and selling on the exchanges;
  - and therefore lead to lower transaction costs.

Financial deregulation and commodity speculation - 1

- 2000: Commodity Futures Modernization Act in US deregulated commodity trading, by exempting over-the-counter (OTC) commodity trading (outside of regulated exchanges) from CFTC oversight.

- Unregulated commodity exchanges allowed all investors, including hedge funds, pension funds and investment banks, to trade commodity futures contracts without any position limits, disclosure requirements, or regulatory oversight.

- The value of such unregulated trading was around $9 trillion at the end of 2007, more than twice the value of the commodity contracts on the regulated exchanges.

Financial deregulation and commodity speculation - 2

- "Swap-dealer loophole" in the 2000 legislation allowed traders to use swap agreements to take long-term positions in commodity indexes.
- Emergence of commodity funds that were "index traders" profiting from returns from changes in the index of a commodity, by periodically rolling over commodity futures contracts prior to their maturity date and reinvesting the proceeds in new contracts.
- Such commodity funds dealt only in forward positions with no physical ownership of the commodities involved.

Financial deregulation and commodity speculation - 3

- As US housing finance market imploded, finance searched for other avenues of investment to find new sources of profit, like commodity speculation .
- By around June 2008, when the losses in the US housing and other markets because intense, it became necessary for many funds to book their profits and move resources back to cover losses or provide liquidity for other activities.
- Commodity markets became like other financial markets, prone to information asymmetries and associated tendencies to be led by a small number of large players.
- Between Jan 2007 and May 2008, markets were in "**contango**" (futures prices higher than spot prices) whereas if they were only for hedging than they should have shown "**backwardation**" (futures prices lower than spot prices).

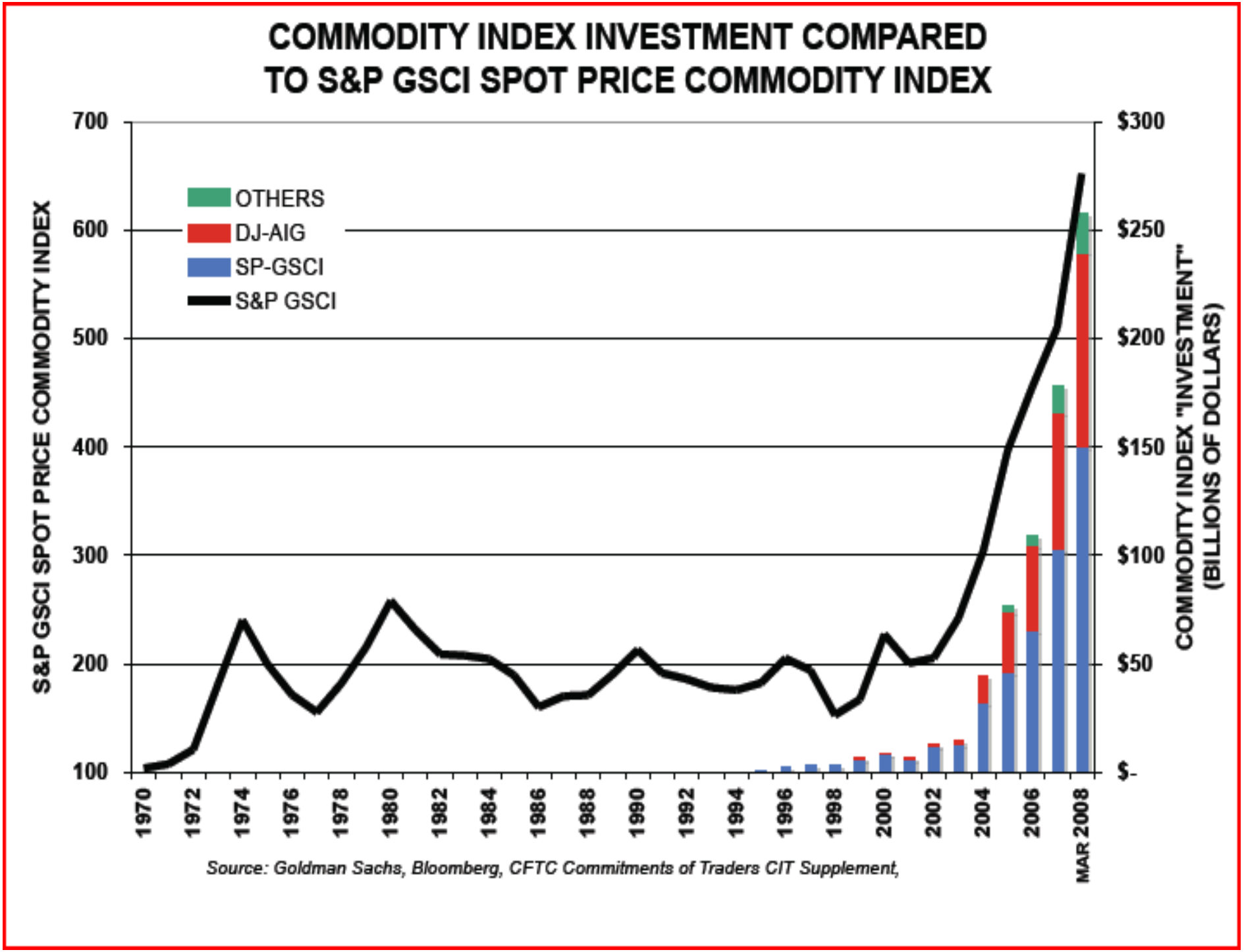
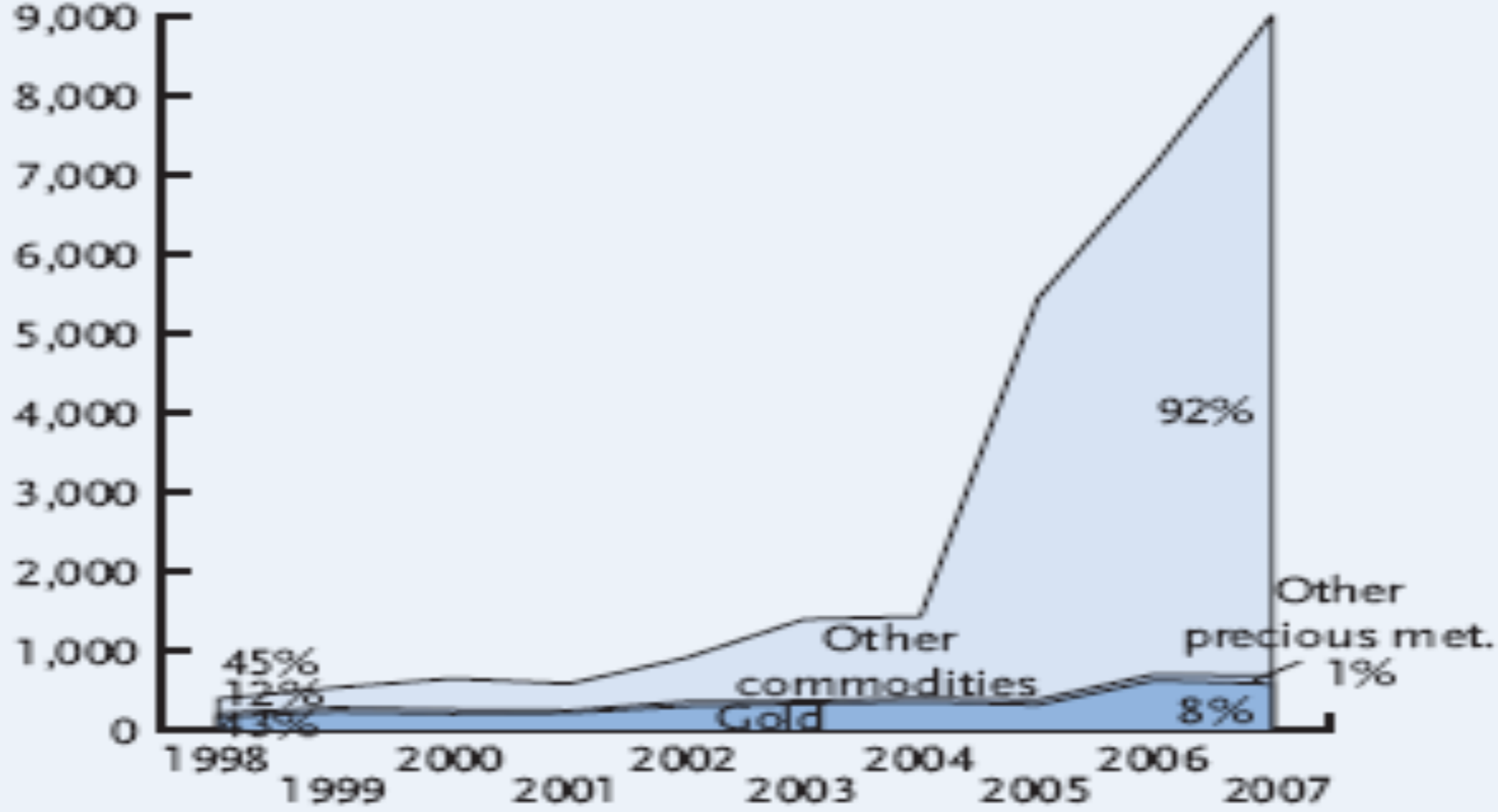

COMMODITY INDEX INVESTMENT COMPARED
TO S&P GSCI SPOT PRICE COMMODITY INDEX
OTHERS
DJ-AIG
SP-GSCI
S&P GSCI
S&P GSCI SPOT PRICE COMMODITY INDEX
COMMODITY INDEX "INVESTMENT"
(BILLIONS OF DOLLARS)
700
600
500
400
300
200
100
$300
$250
$200
$150
$100
$50
$-
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
MAR 2008
Source: Goldman Sachs, Bloomberg, CFTC Commitments of Traders CIT Supplement,

Chart 4 OTC derivatives trading of commodities

Notional value outstanding, US dollars billions, end-year[1]



[1] Based on the BIS interpretation of commodity derivatives

Source: Bank for International Settlements

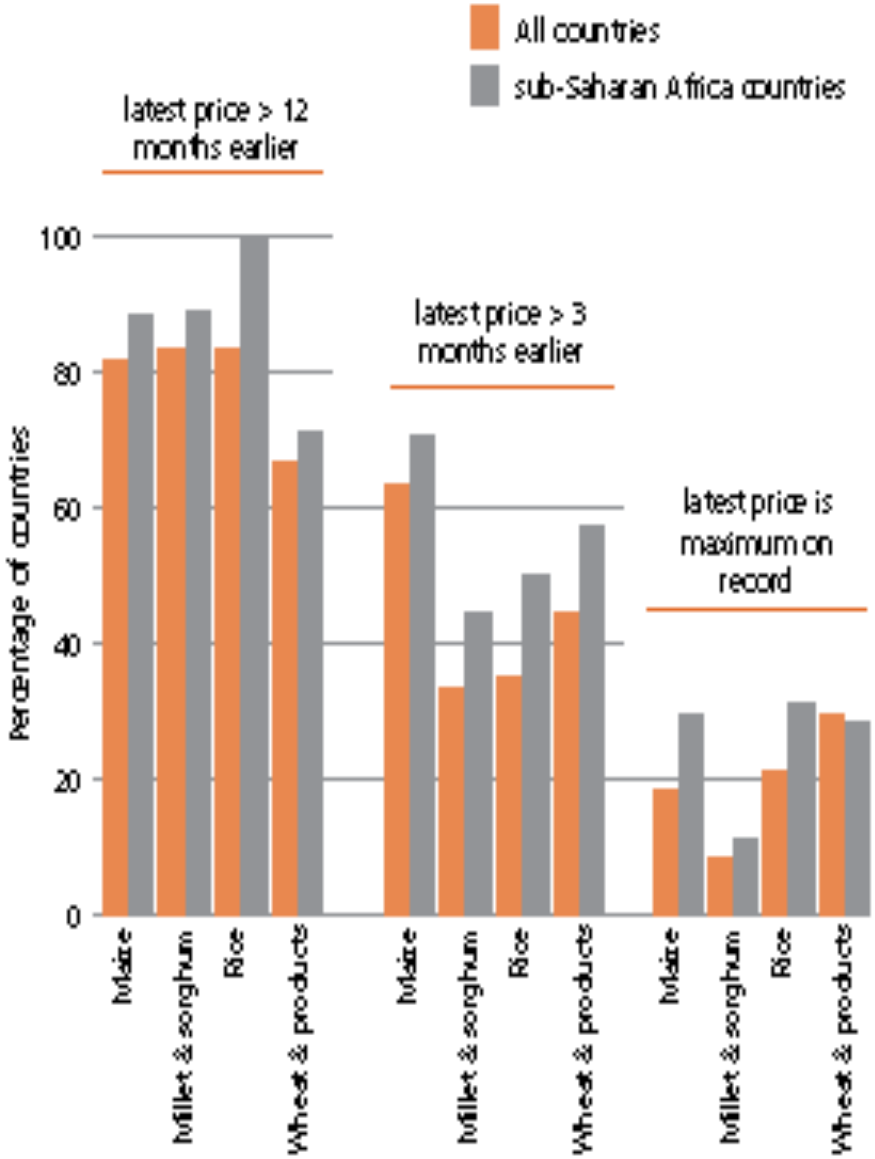
Implications of financial speculation on food prices

- Inherently "wrong" signalling devices became very effective in determining and manipulating market behaviour.
- The result: excessive price volatility of commodities in 2008 – not only the food grains and cash crops, but also minerals, metals and oil.
- This had very adverse effects on both cultivators and consumers of food:
  - Confusing, misleading and often completely wrong price signals to farmers that caused over sowing in some phases and under cultivation in others.
  - High pass through of rising global prices on consumer prices in developing countries, but low pass through of falling prices on consumers.
- So both cultivators and food consumers lost out through extreme price instability. The only gainers were the financial intermediaries who were able to profit from rapidly changing prices.

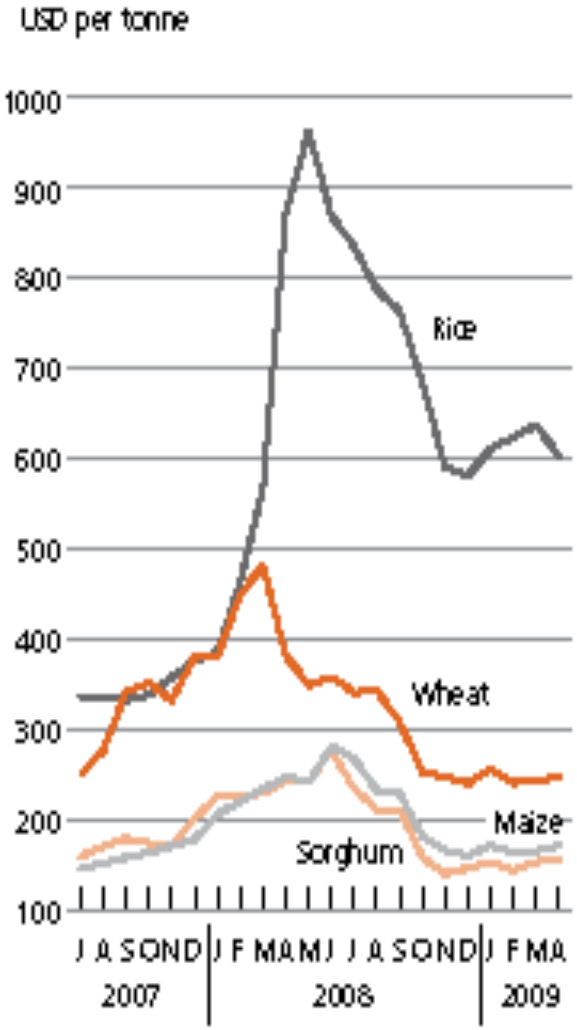
Continuing food crisis in developing world

- April 2009: FAO estimated that 33 countries were experiencing severe or moderate food crises, with conditions in at least 17 countries worse compared to October 2008.
- Many developing countries in which widespread and persistent hunger was already a problem, have experienced significant increases in the prices of staple foods in the past two years, and there has been hardly any decline even after global trade prices started falling.
- Already evidence of declining nutrition indicators especially among women, in some African countries, Indonesia, etc.

Percentage of countries in database where latest price quotation is higher than specified period or the maximum on record



Selected international cereal prices: latest quotations compared to specified period or the maximum on record

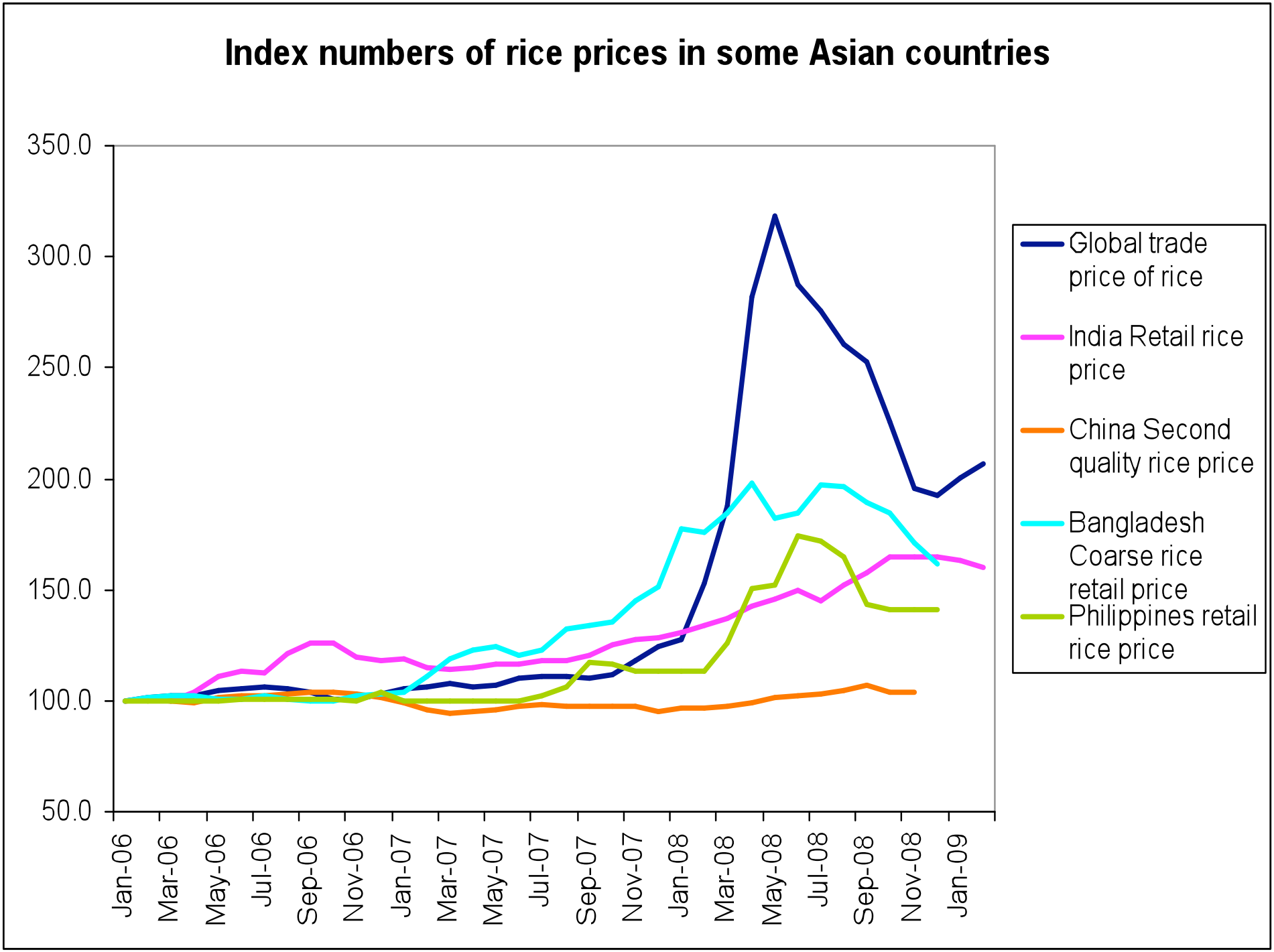


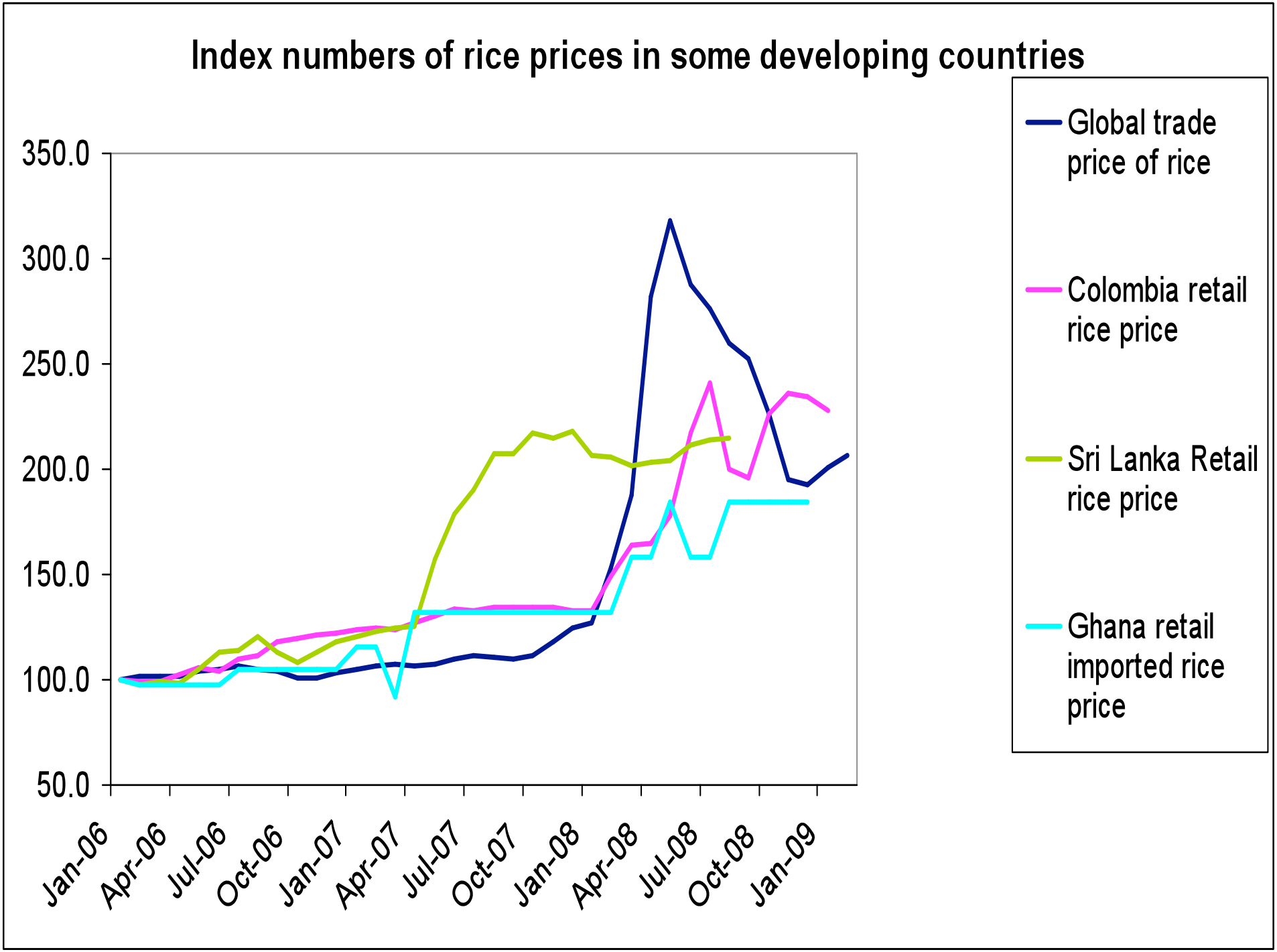
Latest quotation compared to:		
12 months earlier	3 months earlier	Max. on record
-30 %	-1 %	-37 %
-39 %	-8 %	-53 %
-31 %	-1 %	-44 %
-38 %	+3 %	-48 %

Note: Prices refer to monthly average.

Changes in prices of food staples in some food-deficit developing countries

Country and food item	Per cent increase in price Jan 2007-Dec 2008	Country and food item	Per cent increase in price Jan 2007-Dec 2008
Zimbabwe wholesale white maize	994	Afghanistan retail wheat flour	114
Ethiopia wholesale white maize	141	Pakistan retail wheat flour	82
Malawi wholesale white maize	107	Thailand wholesale rice	73
Kenya wholesale white maize	81	Colombia wholesale rice	76
Zambia wholesale white maize	32	Bolivia wholesale rice	30
South Africa wholesale white maize	**-38**	Senegal imported rice	85
Honduras retail white maize	36	Burkina Faso imported rice	65
Guatemala retail white maize	25	Niger imported rice	44
Ethiopia wholesale wheat	119	Sri Lanka retail rice	30
Eritrea wholesale wheat	114	Haiti retail rice	94
Sudan wholesale wheat	**4**	Nicaragua retail rice	54


Index numbers of rice prices in some Asian countries
350.0
300.0
250.0
200.0
150.0
100.0
50.0
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Nov-07
Jan-08
Mar-08
May-08
Jul-08
Sep-08
Nov-08
Jan-09
Global trade price of rice
India Retail rice price
China Second quality rice price
Bangladesh Coarse rice retail price
Philippines retail rice price


Index numbers of rice prices in some developing countries
350.0
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250.0
200.0
150.0
100.0
50.0
Jan-06
Apr-06
Jul-06
Oct-06
Jan-07
Apr-07
Jul-07
Oct-07
Jan-08
Apr-08
Jul-08
Oct-08
Jan-09
Global trade price of rice
Colombia retail rice price
Sri Lanka Retail rice price
Ghana retail imported rice price

Differential performance

- Some countries (e.g. China) have managed food situation much better than other.
- Domestic food production critical factor in this.
- Countries with high import propensity for food have been very badly affected, especially if they export cash crops.
- **Lesson:** No country, however small and open, can afford to neglect domestic food production and must ensure at least some domestic supplies or regional arrangements to ensure food, if it does not want to get caught in a vortex of price volatility that can dramatically affect national food security.

Role of national policy

- Effective state intervention for food price stability and food security requires fiscal resources – but developing countries already have large fiscal deficits as outcome of financial crisis.
- They are crowded out of international capital markets by US and other developed economies, as they guarantee their own private debt and expand fiscal deficits.
- Private capital moving out also causes currency devaluation, so food imports become more expensive in local currency.
- So developing countries caught in pincer movement between volatile global prices and falling exports on the one hand, and reduced fiscal space and depreciating currencies on the other hand.

Real economy measures required

- National government interventions
  - to protect developing country agriculture,
  - to provide more public support for sustainable and more productive and viable cultivation patterns
  - to create and administer better domestic food distribution systems.

- International arrangements and co-operative interventions, such as
  - strategic grain reserves,
  - commodity boards
  - other measures to stabilise world trade prices, ESPECIALLY:

Control of finance to stabilise food prices

- Very strict limits (even bans) on the entry of financial players into commodity futures markets.
- Elimination of the "swap-dealer loophole" that allows financial players to enter as supposedly commercial players.
- Banning of futures markets for grain trade in countries where public institutions play an important role in grain trade.
- Capital account management techniques to prevent destabilising impact of capital flows on exchange rates and thereby on domestic food prices.

Prognosis

- Some increase in global food prices likely for variety of reasons
- This may once again lead to speculative capital movements that cause prices to rise because such financial regulation is STILL not in place.
- Recent moves by Obama administration are somewhat positive but far from adequate, and will not work if they only cause capital to move to European commodity exchanges, so need to have co-ordinated regulation.
- Therefore this is URGENT demand to be made by women and other progressive groups.

Thank you
for your attention!