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EcoFair Trade Conference

EcoFair rules!

The new role of agricultural trade within the conflict area of the climate, food, and economic crises

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Conference Background Paper

By Peter Wahl

One rhetorical swallow does not make a summer of reform The financial and food crisis, and how it was managed by the G20 and G8

According to the final declaration of the G20 Summit held in London in April 2009, the global financial crisis is '*the greatest challenge to the world economy in modern times*' (G20 London Leaders' Declaration, 1). And indeed, no financial crisis since the global economic crash of 1929 has shaken the world quite as badly as this one. Since the financial system is as it were the nervous system of the economy, its collapse inevitably led to a global economic crisis. No end to the crisis is yet in sight, and we will be dealing with its impacts for years to come. Particularly hard hit are the vulnerable economies of the poor countries. While the industrialised countries and China made around USD 5 billion available to bail out the banks and stimulate the economy – orders of magnitude that would otherwise be conceivable only in times of war – the poor countries have barely any reserves to cushion them against the crisis.

Poverty has increased correspondingly, and with it hunger: '*Between 109 million and 126 million people may have fallen below the \$1 per day poverty line since 2006 owing to the increase of food*

prices. ... *The incidence of extreme poverty in sub-Saharan Africa may have risen by almost 8 percentage points, implying that the recent food price increases have more than offset the poverty reduction achieved between 1990 and 2004.*' (UNO 2009, 26). Unless a miracle occurs the MDGs, and especially the goal of halving the proportion of people who suffer from hunger, will not be achieved.

In the year of the crisis - 2009 – their number surpassed the one billion mark for the first time in the history of mankind, reaching 1.02 billion (FAO, 2009a 10/11). Although the food situation had also been deteriorating continuously since 1997 independently of the crisis, in 2009 alone a steep increase of eleven percent was recorded, of which nine percent can be directly attributed to the impacts of the financial crisis (ibid.).

1. Speculation in food prices

The immediate cause of the catastrophic increase in the number of people suffering from hunger was the dramatic increase in food prices that began in 2007 and peaked in mid-2008. The FAO index climbed from 122 points at the end of 2006 to 214 in June 2008 – a 75 percent increase in just 18 months! Particularly dramatic were the increases in the prices of rice and grain, which shot up by 126 percent (FAO, 2009b). Prices then fell sharply again – by February 2009 they had even fallen slightly below the 2007 level (see graphic). They remained higher than they were before the crisis, though, and have been rising ever since (FAO, 2009c). The abrupt rise and even more abrupt fall are an unmistakable sign that we are looking at a price bubble fuelled by speculation. In September 2008 the US Commodity Futures Trading Commission noted that *'commodity markets have begun to price commodities' value as an asset class as well, creating a price distortion or possibly even a bubble.'* (CFTC, 2008: 2).

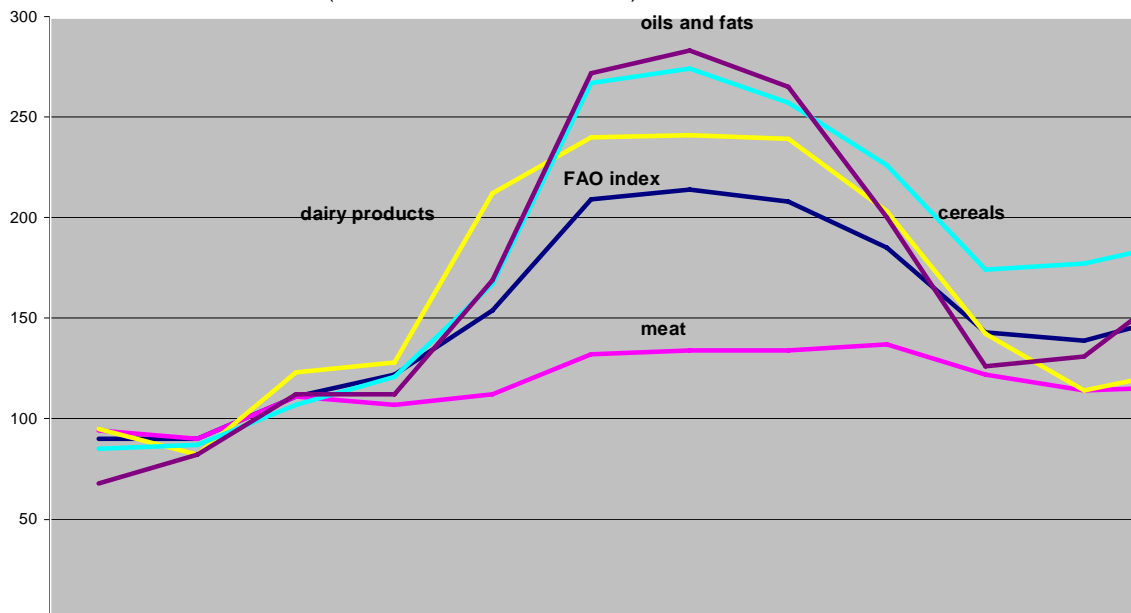
When prices were rising, the possibility that speculation might be a factor was initially vehemently disputed. Since price formation for agricultural commodities is indeed complex, and prices have been rising for years independently of the financial crisis, every reason possible was put forward to explain the rapid upswing in 2008. These included for instance growing demand in emerging economies, stagnating productivity and underinvestment in agriculture, and the production of biofuels. These factors were certainly still in play, but they were further compounded by the effects of speculation.

This became clear once prices fell again from July 2008 onward. This is because the aforementioned factors take effect only in the long term, and do not rise or fall sharply within a period of 18 months. Although quicker acting factors such as a poor harvest in Australia and the reduction of storage capacities might have been partially responsible for the rise in prices, this steep increase followed by a fall no less steep is a classic case of a bubble driven by speculation. Even the agriculture ministers of the G8 have now acknowledged that speculation is a problem, and have indicated that there should be further analysis of *'factors potentially affecting price volatility including speculation.'* (G8 Agriculture Ministers Meeting 2009. Para. 7).

Graphic

Food prices Dec. 2000 - May 2009

(mean value 1998-2000 = 100)



Source FAO 2009b

How did the wave of speculation arise? After the mortgage crisis in the USA had turned into the credit crisis – and before *Lehmann Brothers* went bankrupt – entire market segments collapsed, such as the segment for structured products or Collateral Debt Obligations (CDOs). To the extent that deals in the financial sector were becoming riskier and unprofitable, institutional investors (investment banks, hedge funds, pension funds etc.) went in desperate search of new markets. They then leapt into commodity markets, particularly oil and agricultural commodities. They did so, however, not by pursuing real trade in physical commodities, but by doing deals with derivatives, mainly futures. In anticipation of further price increases, agricultural futures were bought on a large scale. *'Speculators looking for assets with rising prices have reoriented their portfolios to buy food commodity assets (commodity indices, futures and options contracts).'* (UNCTAD 2008a:7).

In 2007 trade grew by 32 percent (UNCTAD 2008b: 21). At the same time, the value of trade in over-the-counter commodity futures rose by 160 percent between June 2005 and June 2007 (BIS 2008). On the commodity market in Chicago the number of contracts rose by 65 percent between October 2007 and the end of March 2008, even though real agricultural production had not increased (for more details on the entire process, see: Wahl, 2009).

The rise in the price of futures also entailed a rise on the spot market¹. This was due first of all to the fact that purchasers there were buying up stocks in anticipation of further price increases. This

¹ On the spot market, deals are completed on the spot (i.e. delivery and payment are wrapped up within 24 hours at the most).

increases demand and drives prices up. Secondly, sellers – also anticipating higher prices – waited before selling, thus squeezing supply. In other words, the trade in futures had set off an entire chain reaction of speculative behaviour.

A further aspect is that speculation affects food prices not only directly, but also indirectly, through the price of oil. The price of oil is a strategic price, which is to say it forms part of the price of all those products in whose production and marketing oil is used as a fuel – which includes virtually all agricultural products. Speculation therefore drove the food price bubble via two channels: first of all directly through agricultural commodities, and secondly through the price of oil. The outcome of this is that many poor people in developing countries are no longer able to afford their daily ration of bread or rice. In 40 countries people protested against hunger, and in 19 of these cases violent confrontations ensued.

The fact that from July 2008 onward prices then fell even more rapidly than they had risen was also a result of the crisis. Given the crisis in the real economy and the ensuing decline in commodity prices, speculation in commodities now became too risky for hedge funds and other institutional investors, and a wave of flight into US government bonds took hold – as it were the last haven to which capital can take flight in particularly hard times.

One man's meat is another man's poison, though. In May 2008 it was possible to buy bread in bakers' shops in Frankfurt with the following advertising slogan on the wrapper: *'Do you like it when prices go up? The whole world is talking about commodities – with the Agriculture Euro Fund you can own a share in the further development of seven key agricultural commodities.'* This offer was being made by *Deutsche Bank*, which was seeking to solicit custom for an agricultural investment fund. This example clearly illustrates how pin-striped respectability can mask business models that threaten the livelihoods of millions of people in the South.

Yet it is not only speculation that has fatal effects on food security and agriculture. A further general problem is that the financial crisis is impacting on the real economy, and is thus hitting agriculture twice over.

2. Spreading to the real economy

In 2009 the industrialised countries were caught up in the recession. This led to a fall in demand, and for the first time since 1982 world trade shrank. Particularly keenly felt is the fall in demand from the USA. Hardest hit are those regions dependent on exports to the USA such as Mexico, Central America and the Caribbean. For Latin America and the Caribbean a contraction of 0.2 percent is forecast for 2009, as opposed to a growth of 5.5 percent in 2007, although a more optimistic scenario does at least foresee a growth of 2.3 percent. For Africa, which experienced an enormous growth of 6 percent in 2007, the growth forecast for 2009 is 0.1 percent or – more optimistically – 4.1 percent (UNO, 2009).

The declining demand from the industrialised countries is felt most painfully by developing countries for those commodities that formed the basis of the preceding economic boom. Parallel to demand, the industrialised countries' Foreign Direct Investment (FDI) in poor countries is also declining (UNCTAD 2009a: 57).

Private capital flows to the South were also hit very rapidly and hard by the crisis. From the third quarter of 2008 onward they fell, while the cost of capital rose. Interest went up, and the volume of bank loans fell by 40 percent (UNO 2009).

Countries that are major sources of migrant labour are also being hit by the fall in remittances, because migrants are the first to be affected by unemployment in their host countries.

Declining export revenues, investment and capital flows together are pushing many countries toward a new debt trap. Because if imports become more expensive than the export revenues generated, a balance of payments deficit will be created that must be offset either through debt or through savings.

It goes without saying that all these effects of the crisis are also impacting on agriculture and food security.

3. How the G8 and G20 managed the crisis

The peak of the food crisis coincided with the G8 Summit in Tokyo, Japan. The Summit therefore picked up the issue and adopted a *Leaders Statement on Global Food Security* (G8 2008), in which USD 10 billion were pledged for food aid and to boost agricultural production. Having said that, these ten billion were funds from the ongoing humanitarian and development aid budgets, not additional money. In other respects too the statement remains vague and lacking in firm commitment – business as usual, failing to engage effectively with the critical situation in any way.

At the first G20 Summit of heads of state and chiefs of government held in Washington in November 2008 in Washington – the final appearance made by George W. Bush – the food crisis was then no longer mentioned. By contrast, one of the key outcomes of the G20 Summit held in London in early April 2009 was the provision of the enormous sum of USD 1.1 trillion through the IMF, World Bank and multilateral development banks to cushion emergent and developing countries against the impacts of the crisis (London Summit 2009 Art. 5). 250 billion of this amount are special drawing rights that can be claimed without conditionalities. A further 250 billion are to be loaned through the regional development banks, and 100 billion are to be loaned on concessionary terms.

The package is thoroughly appropriate as emergency aid, as well as being potentially beneficial for agriculture, although the other side of the coin is that it raises the status of the two undemocratic Bretton Woods institutions. With the advent of Obama, and influenced by the crisis, the summit rhetoric has also changed significantly. The problems of the developing countries are acknowledged expressly and in detail.

In the run-up to the G8 2009 in Italy a meeting of agriculture ministers was also held for the first time. The final declaration, however, remained highly conventional. As mentioned above, though, in the specific context of price volatility the G8 did for the first time mention the problem of speculation. Furthermore, internationally coordinated food storage is also being considered as an instrument to stabilise prices (G8 Agriculture Ministers 2009. Para. 7). This proposal indicates that trust in the market has been dented, even though at the same time the dogma of free trade and the 'successful' conclusion of the Doha Round are being invoked.

The Declaration of the G8 Summit in L'Aquila in July 2009 also addresses the food crisis in depth, and states that '*Agriculture and food security should be placed at the core of the international agenda.*' (G8 2009, Para. 111). Furthermore a *L'Aquila Initiative on Global Food Security* is being launched, according to which 20 billion are being promised, spread over three years (AFSI 2009).

The Leaders' Declaration of the G20 in Pittsburgh in September 2009 calls upon the World Bank to establish a trust fund for this initiative. It also proposes addressing the problem of '*excessive price volatility*' (Pittsburgh Summit 2009, see also Kolmans and Paasch, 2010).

Thus all in all there does appear to be some movement, even if this is for the time being confined to the rhetoric of intention. Because so far (as of the end of 2009), no measures have been taken to stem speculation in food commodities, nor has the general regulation of the financial markets been commenced. One rhetorical swallow does not make a summer of reform.

4. A firewall between financial markets and agricultural trade

Given that the key exchanges for trade in agricultural futures are located in Chicago, New York, Dallas and London, regulation in the USA and the UK would provide key leverage to restrain the influence of the financial markets on agricultural prices. The draft US legislation for financial market reform provides for stronger oversight and the inclusion of trade in over-the-counter trade derivatives. These are steps in the right direction, provided that they are implemented systematically. They do not, however, put a fundamental stop to speculation having an effect on the price formation of agricultural commodities.

Food security is only possible if agricultural trade is decoupled from the dynamics of the financial markets. What is needed is the erection of a kind of firewall between financial markets and agricultural trade. Food prices have a crucial effect on the lives of hundreds of millions of people. They are too important to be left to a *monster*, as Germany's Federal President Horst Köhler is wont to call the financial markets.

The overriding task here is to prevent the *financialisation* of the agricultural sector, i.e. prevent its integration into the logic and dynamics of the financial markets, its subjugation to the system of the financial market casino. The bubble formation effect described above was not an exception, but a reflection of the general trend toward making commodities the object of speculative business models. Growing demand combined within a simultaneous shortening of supply – most clearly illustrated by the commodity oil, extraction of which is about to peak or may already have done so – promises permanently high profits. A similar situation is found with many other commodities. Given a growth of the global population to nine billion by 2050, the demand for food too will rise, even as climate change, especially in the tropics and subtropics, leads to dramatic problems on the supply side.

A realistic and appropriate first political demand for the creation of a firewall between financial markets and agricultural commodities would be a traders' register. Through this instrument only those traders would be allowed onto the commodity exchanges who play a useful role as commercial traders ('good speculators' whose activities are confined to safeguarding producer prices). These commercial traders would be familiar with the markets, and their futures would not be decoupled from the physical market (spot market). Admittedly, a traders' register will only work if the completely unregulated and poorly transparent trade in over-the-counter derivatives is brought under supervision, and if the same rules are applied there to food commodity derivatives as apply for stock exchange dealing.

In the medium term, though, the aim should be to completely withdraw trade in staple foods for developing countries from unregulated market influence, and thus from the unfettered profit principle. Instead, this trade should be regulated politically on the basis of international agreements and in the interest of food security.

This is why food security is incompatible with the free trade ideology of the WTO. The WTO is part of the problem here, not the solution. What should be established in its place, possibly by a reformed and democratised FAO, is a governance system representing the interests of both producers and consumers, especially the vulnerable.

The human right to food is not a commodity. The bankruptcy of the financial market casino is at the same time the bankruptcy of a theory and a praxis according to which the market is always and in every case the entity to organise economic activity optimally. At least as regards the safeguarding of the basic right to food, the crash has once again demonstrated that the market is not capable of doing this. It fails systematically, and if we nevertheless rely on it, millions of people pay with their lives. The crisis is an opportunity to finally try and safeguard food security using other – political and democratic – methods. To achieve this, the development community must become involved in the debate on financial market reform. Because what UNCTAD writes in its report on the financial crisis is true: '*Nothing short of closing down the big casino will provide a lasting solution.*' (UNCTAD 2009b, 60)

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