GTSA

Insight

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Speculation, the cause for high food prices?

Price spikes and riots in 2008 woke the political, economic and civil society's interest in food prices and the futures markets. "Speculation" and the financialisation of the commodity markets have without evidence been blamed for high prices.

On March 24, 2014 the Swiss Federal Chancellery openly backed the Young Socialists' initiative "No speculation with foodstuff", which aims to prohibit investment into financial instruments related to food, either directly or on behalf of clients, by banks, private insurances, hedge funds, private banking relationship managers and others. By limiting Swiss financial operations in the agri-markets, the initiative wants to combat hunger and stabilize prices for farmers and transformers. But does it help to increase global food security and conditions for famers?

Back in 2012, GTSA launched a working group made of agri-markets professionals to look into the matter of speculation and food price mechanisms.

Why food prices are volatile and trending higher

The reason for food price trends is primarily driven by imbalances between demand and supply. Deficit or surplus situations temporarily impact the level of prices, which is why climatic and political conditions play a crucial role in the steady supply of agricultural commodities. Several drivers account for incidents that affect this balance resulting in higher volatility and prices:

- Unpredictable weather patterns;
- Growth of world population to 8.9 billion demanding increased global agri-production;
- Demand pattern related to the economic development of emerging countries;
- Rural-urban migration and changing consumption pattern;
- Farmer shortage as a result of unattractive economic conditions;
- Declining acreage;
- Government intervention and distortion through mandates, stock building etc.
- Lack of investment in farming particularly, in underdeveloped countries;
- Inefficient use of already limited arable land;
- Significant waste in agricultural products.

Less speculation doesn't mean more stable prices. Speculation is the basis of any commercial activity and a necessary attempt to anticipate the best moment for producers to sell and for buyers to buy. Market efficiency plays a crucial role in compensating possible price fluctuations.
Limiting financial markets might affect liquidity and result in an increase of price level and volatility rather than decrease. Both liquidity and transparency are essential for farmers to protect themselves from high prices and volatility. They allow for:

- Proper pricing process and transparency;
- Hedging as a form of insurance against the natural volatility of the agri-markets;
- Liquidity through non-commercial participants.

Recent price fluctuations were caused by climate shocks and structural developments in the real economy and made worse by wrong political response (e.g. protectionism). Introducing entry barriers for futures markets might only worsen the situation.

Investment in agriculture as remedy

Higher prices are necessary to provide incentives for farmers to increase acreage, investment, yields and overall production. It results in an overall increase in the offer bringing down the price through market efficiency. Therefore, today we should focus on investments in rural developments, helping farmers to produce more efficiently and reduce waste of agricultural products. Investments in farming and channeled resources so as to be most effective are beneficial to higher global output, a role that cooperatives and trading houses already undertake.

As Olivier de Schutter stated, "the solution lies in supporting small-scale farmers' knowledge and experimentation, and in raising incomes of smallholders so as to contribute to rural development."

All documents are available to members on the GTSA Intranet, please visit: http://my.gtsa.ch/documents