The world food crisis and the capitalist market

Part Two

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9 June 2008

This is the second part of a three-part series of articles on the world food crisis. Part one was posted June 7. Part three was posted June 10.

The central problem underlying the current food crisis is not a physical lack of food, but rather its unaffordability for masses of people due to rapidly increasing prices. Among the immediate factors driving the rapid worsening of the food crisis, a major role is played by the explosion of speculative investment in basic commodities such as oil and grain, itself bound up with the difficulties facing US and world financial markets and the decline in the US dollar. Rampant speculation by hedge funds and other big market players has increased costs, encouraging private firms to further bid up prices in a competitive drive to amass as much profit as possible.

Official statistics disprove the assertion that there is not enough food for everyone. According to 2008 US Department of Agriculture figures, the average per capita consumption is 2,618 calories per day in developing countries and 3,348 in developed countries, compared with a recommended minimum of 2,100 calories. However, profound disparities in access to this food, stemming from poverty and social inequality, condemn many millions to hunger.

Time magazine quoted United Nations World Food Program official Josette Sheeran as saying, "We are seeing food on the shelves but people being unable to afford it."

Commodity speculation

World market prices for agricultural commodities have surged precisely as big investors have pulled out of traditional investment and credit markets, largely as a result of the bursting of the US housing and credit bubbles in 2007. Speculative capital has gone in search of other profitable investments.

A major avenue for such speculative capital is commodity futures. This essentially involves financial bets that prices of basic goods such as oil, grains and metals will continue to rise. Since these futures are used as benchmarks for actual trading in the physical commodities, their heady rise has helped sharply pull up market prices for the commodities themselves.

Recent congressional testimony by a US hedge fund manager, Michael Masters, sheds an interesting light on commodity futures speculation. He told Congress:

"In the early part of this decade, some institutional investors who suffered as a result of the severe equity bear market of 2000-2002 began to look to the commodity futures market as a potential new 'asset class' suitable for institutional investment. While the commodities markets have always had some speculators, never before had major investment institutions seriously considered the commodities futures markets as viable for larger-scale investment programs. Commodities looked attractive because they have historically been 'uncorrelated,' meaning they trade inversely to fixed income and equity portfolios [i.e., they do not necessarily fall, and instead tend to rise, when the bond or stock markets decline]."

Masters continued: "Mainline financial industry consultants, who advised large institutions on portfolio allocations, suggested for the first time that investors could 'buy and hold' commodities futures, just like investors previously had done with stocks and bonds."

A commodity futures contract is an agreement between a buyer and seller to trade a given quantity of the commodity at a specified future time and place. The only negotiated element of the contract is the price at delivery, which varies over time on the market. First developed during the nineteenth century on Chicago grain exchanges, commodity futures were initially designed to allow farmers or other producers to lock in costs, avoiding financial losses from sudden swings in prices for key goods.

There is a long history of futures speculation. An investor correctly guessing that corn prices will rise can enter into a futures contract as a buyer, then pocket the difference between the price agreed on at the earlier date and the higher value of corn on the delivery date. Similarly, an investor believing that corn prices will fall can enter into a futures contract as a seller. This is called selling "short."

To prevent mass speculation in futures from driving prices, the US Commodity Futures Trading Commission (CFTC) places limits on the amount of futures contracts an individual speculator can hold. However, according to 2007 congressional testimony by CFTC Director of Market Oversight Don Heitman, the CFTC has been making an exception to these regulations for Wall Street banks since at least the early 1990s. Now, hedge funds, pension funds or other major investors simply enter into swap agreements with these Wall Street banks to evade CFTC restrictions.

This speculation has taken on grotesque forms. According to the Chicago Board of Trade, less than 10 percent of their grain futures contracts are held by parties actually intending to trade grain. Big investors routinely seek to profit simply from buying futures contracts and, shortly before the due date of the contracts, exchanging or "rolling" them for futures contracts expiring later. This type of speculation is built on the premise that prices will rise, and gives big investors a powerful financial interest in higher commodity prices.

Funds worth tens or hundreds of billions of dollars each have been generating returns of more than 30 percent, as big investors control and profit from owning claims to ever-larger portions of the world's food supply. The value of the two largest commodity indexes—the Standard & Poor's/Goldman Sachs Commodity Index and the Dow Jones-American International Group Index—went from about $20 billion in 2002 to $110 billion in 2006, then to $170 billion in 2007 and $240 billion in March 2008.

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As investment in commodity futures took off, the rise in food prices over the years 2000-2006 accelerated sharply. The International Food Policy Research Institute, a Washington, D.C., think tank, writes: “In 2007, the international food price index rose by nearly 40 percent, compared with 9 percent in 2006, and in the first three months of 2008 prices increased further, by about 50 percent.”

Bloomberg News wrote on April 28: “Commodity index funds control a record 4.51 billion bushels of corn, wheat and soybeans through Chicago Board of Trade futures.... Investments in grain and livestock futures have more than doubled to about $65 billion from $25 billion in November, according to consultant AgResource Co. in Chicago. The buying of crop futures alone is about half the combined value of the corn, soybeans and wheat grown in the US, the world’s largest exporter of all three commodities. The US Department of Agriculture valued the 2007 harvest at a record $92.5 billion.”

According to a June 6 report in the *New York Times*, wealthy investors are pouring billions of dollars into the acquisition of physical property—farmland, fertilizer, grain elevators and shipping equipment. Brad Cole, president of Cole Partners Asset Management, told the *Times*: “There is considerable interest in what we call ‘owning structure’—like United States farmland, Argentine farmland, English farmland—wherever the profit picture is improving.”

The *Times* matter-of-factly explained the investors’ strategy of deliberately holding back grain from the market in order to reap higher profits from shortage and famine: “When crop prices are climbing, holding inventory for future sale can yield higher profits than selling to meet current demand, for example. Or if prices diverge in different parts of the world, inventory can be shipped to the more profitable market.”

The *Times* also quoted a commodities broker, Jeffrey Hainline, who pointed out the dangers of a catastrophic price collapse if speculative investors ultimately decide to pull out their money and sell off the assets they have acquired. Hainline said: “Farmland can be a bubble just like Florida real estate. The cycle of getting in and out would be very volatile and disruptive.” This type of outcome threatens not only farmland, but also the agricultural goods being acquired or traded on the futures markets.

Energy prices and biofuels

Rising energy prices, caused to a significant extent by futures speculation, are massively boosting costs for basic farm inputs. The International Food Policy Research Institute (IFPRI) notes: “Energy prices always affected agricultural prices through inputs, i.e., price of fertilizer, pesticides, irrigation and transport. Now, energy prices also affect agricultural output prices strongly via biofuel-land competition.”

Fertilizer prices have exploded, because the production of nitrogen fertilizers requires large amounts of natural gas, the price of which has been carried upward along with oil prices. According to a University of Illinois study, from 2000 to 2008, Illinois farmers’ fertilizer costs roughly doubled—from approximately $55 to $115 per acre of corn. Rising grain prices also result in rising costs for seed, which has roughly doubled from 2000 to 2008. Together, the two account for approximately two thirds of farmers’ input costs.

Transport cost increases, driven by soaring fuel prices, have particularly affected grains, which make up a large portion of world solid bulk shipping. According to the London-based International Grains Council, average shipping prices for a ton of heavy grains sent from the US Gulf Coast to Europe have gone from $44 to $83 over the last year; for the Gulf Coast to Japan, the jump was $65 to $165.

US support for the development of biofuels, largely driven by agribusiness interests, is further dragging food prices upwards. In a measure ostensibly aimed at reducing US energy imports, the Bush administration has mandated the use of corn-based ethanol as a fuel substitute, subsidizing it at the rate of $0.51/gallon. In 2007, ethanol production consumed 20 percent of the US corn crop—roughly 53 megatons (Mt) of corn, enough to feed 150 million people on a US-style, corn-intensive diet.

Projects to triple US corn-based ethanol production to 35 billion gallons by 2017 would further eat into world food supplies. These projects are going forward despite corn-based ethanol’s at best negligible energy and ecological benefits.

As corn fetches higher prices thanks to ethanol subsidies, and the US corn-growing region expands northward due to global warming, corn is increasingly replacing wheat in US farm planting. According to the *Washington Post*, US farmers are expected to plant 64 million acres of wheat this year, down from 88 million acres in 1981.

Speaking of the February 2008 wheat price spike, David Brown, chairman of the American Bakers Association’s commodity task force, told the *Post*: “With low stocks and a weak dollar, things fly off the shelf faster than they used to. There’s just not enough acreage coming back into production to replenish [US] stocks.”

The profit system destabilizes the food supply chain

Amid rapidly increasing inflation, the struggle for profit is disorganizing the entire supply chain, stretching from farm inputs to food sold in grocery stores, as major corporations vie for the lion’s share of the new revenues arising from price inflation.

Fishermen and dairy farmers throughout Europe are currently mounting strikes and protests as rising fuel and input costs lead to massive losses, while the prices paid to them by major food traders stagnate.

Especially for small farmers, the gap between rising seed and fertilizer prices and the market prices for their goods spells financial ruin. In the antiseptic terminology of bourgeois social science, the IFPRI notes that this “hinders production response” to higher prices and increased demand for food. In India, the peasantry has become massively indebted to agribusinesses, and tens of thousands of farmers have committed suicide over the last decade.

With little financial incentive to farm basic grains, farm producers worldwide are collectively planting too little of their harvests. Grain traders must therefore dip into reserve stocks to meet demand.

According to April 2008 figures from the US Department of Agriculture (USDA), from 2004 to 2008, world wheat stocks fell from 151 Mt to 110 Mt; world stocks of coarse grains (corn, oats, rye, barley) fell from 179 Mt to 129 Mt. Rice stocks increased from 74.4 Mt in 2004 to 76.5 Mt in 2005, but since have declined to 75.2 Mt.

The UN Food and Agricultural Organization (FAO) writes: “The ratio of world cereal ending stocks in 2007/08 to the trend of world cereal utilization in the following season is forecast to fall to 18.8 percent, the lowest in 3 decades. In spite of the increase in world cereal production in 2007, supplies are not sufficient to meet demand without a sharp drawdown of stocks.... The ratio for wheat is forecast to fall to 22.9 percent, well under the 34 percent level observed during the first half of the decade. The ratio for coarse grains is put at only 14.5 percent.... The stock-to-use ratio for rice is put at 23.4 percent, also a very low level.”

Large companies controlling key inputs or markets and having wide knowledge of trading conditions are profiting immensely, however.

Key among such companies are big retailers. In a February 2008 conference call with investors, Wal-Mart Chief Financial Officer Tom Schoewe said that Wal-Mart’s record quarterly sales and $4.1 billion profit were partially due to rises in grocery prices, and particularly dairy prices. Schoewe “declined to quantify the impact” of rising food prices, according to *Bloomberg News*.

France’s Carrefour, the world’s second-largest retailer, announced record first-quarter profits of €1.87 billion. Its CEO, José Luis Durán, told analysts that slumping consumer confidence was starting to hurt non-food sales, but this drop was largely offset by a rise in food sales figures.

Agribusiness firm Monsanto, which provides genetically modified seeds

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to farmers in the US and internationally, has also sent seen its net profits increase from $255 million to $993 million from 2005 to 2007. Among seed-producing agribusiness firms, Monsanto is often singled out for its acquisition of Delta and Pine Land Company, which created “Terminator seeds” that grow into plants with sterile grains. This could force farmers to rely exclusively on agribusiness companies for seed supplies. Monsanto claims it will not commercialize the product.

Agribusiness giant Archer Daniels Midland (ADM) reported a 42 percent rise in quarterly profits, to $517 million, for the first quarter of 2008. ADM CEO Patricia Woertz commented: “Volatility in commodity markets presented unprecedented opportunities. Once again, our team leveraged our financial flexibility and global asset base to capture those opportunities to deliver shareholder value”—that is to say, to reap massive profits.

To be continued

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