policy pennings

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Collateral Damage And Response To The Food Crisis It Wasnt Supposed To Be This Way

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Looking at current crop market trends, it seems clear that the impact of the events of the last two years is still hanging over the market. The first effect on crop prices was in response to an anticipated demand for corn by the rapidly growing – and at that time very profitable – corn based ethanol industry.

In the absence of stabilizing stocks, the markets, which had seen a futures price as low as a $1.875 close on November 30, 2005 and had made modest gains to an August 31, 2006 close of $2.32 began to march upward as the fall 2006 crop was being harvested.

By February 28, 2007 the corn futures price reached a high of $4.37, more than double the price 15 months earlier. Farmers responded with the largest US corn planted acreage in history by planting 93.6 million acres of corn. With the assurance of an adequate crop, the price leveled off in the $3.50 range.

Concern then shifted to soybeans which had lost acreage to corn and in the presence of ever rising crude oil prices, both commodities began to respond. A combination of factors, including spring floods, then led to a price rally that reached a high of $7.62 during June 2008, and a monthly close of $7.2475, nearly 4 times its close 30 months earlier.

It would be an understatement to say that such a price increase got everyone's attention. The price spike exceeded that of the 1970s when over a 27 month period, corn prices increased three-fold from $1.2675 on July 31, 1972 to a monthly close of $3.91 on September 30, 1974.

The rapid price increase in the recent time period had a number of consequences beyond the balance sheets of crop farmers. Meat animal producers were put in a price squeeze. For years they had enjoyed feed inputs at less than the cost of production and suddenly corn and soybean prices were well above the cost of production. As a result of higher feed prices and some untimely management decisions one poultry integrator, Pilgrim's Pride went bankrupt.

The increase in corn prices put pressure on ethanol producers and a number of plans for additional ethanol plants were put on the shelf as margins began to get squeezed. Fearing even higher prices, some ethanol plants forward contracted corn at what turned out to be near record high prices. When commodity prices fell – oil included – some ethanol operations, like VeraSun found themselves in a bind and filed for bankruptcy protection as they sold off their assets.

The consequences of higher crop prices were not limited to the US. Food riots took place in more than 25 countries around the world as the poor who struggled to feed themselves when prices were low were virtually shut out of the market as prices quadrupled. The riots and in many cases the fear of unrest resulted in various measures being taken by countries around the world. The United Nations Food and Agricultural Organization (FAO) has documented policy responses to high prices by 102 countries (ftp://ftp.fao.org/docrep/fao/meeting/016/k4742e.pdf).

FAO reports that "policy responses can be grouped into three main categories

i) "Consumer-oriented policies which provide direct support to consumers and vulnerable groups, including tax reductions, distribution of public stocks, price subsidies, sector salary increases, and a variety of social safety nets.

ii) "Trade and market-oriented policies to reduce price of importables and increase domestic supplies, including reduction of tariffs and export restrictions and bans.

iii) "Producer-oriented policies intended to support farmers to increase output, including reductions of taxes on production, agricultural input subsidies, and free distributions as well as support prices."

The another kind of response is documented by the International Food Policy Research Institute (IFPRI) in its policy brief titled "'Land Grabbing' by Foreign Investors in Developing Countries: Risks and Opportunities" (http://www. ifpri.org/pubs/bp/bp013.asp). In that report they document some 54 projects where countries with the financial resources are trying to outsource some of their food needs by purchasing or leasing land in developing countries. The plans vary, but it is clear that many countries want more control over their food supply that the market currently offers.

But lest we forget, let's remind ourselves that it wasn't supposed to be this way. Trade liberalization and the reduction of government involvement in food markets were supposed to make food supplies more reliable. Instead, FAO documents interventions by 102 countries to ensure stable food supplies while IFPRI documents 54 projects in which food-importing countries are positioning themselves so they are not at the mercy of the market when food supplies are short.

Over the next several weeks we want to take an in depth look at why current policies have been inadequate to deal with the current crisis. Δ