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No. 11/2011 dated 2 February 2011

Food Price Spiral: Causes and Consequences

By Paul P.S. Teng

Synopsis

Food prices have been trending upwards. Unchecked increases have social and political repercussions. Speculation on food as a commodity has contributed to the spiral. "Market panic" and "herd mentality" must be checked to avoid volatility.

Commentary

THE LOCAL and international media have reported almost everyday on the global food price spiral since the beginning of 2011. This reflects concern that price increases of common food items may lead to serious effects on the poor and middle class and indeed destabilise societies. In January 2011, the riots in Tunisia, and the shortage of chillies in Indonesia are but two recent manifestations of the phenomenon. There are serious consequences from unchecked price spirals and the real causes of the increases must be addressed.

The Spiral and Its Consequences

Current global prices of grains are already about 50-70% higher than mid-2010, according to United Nations agencies such as the Food and Agriculture Organisation (FAO) and the World Food Programme (WFP). Private sector investment and trade groups confirm these. Food price increases impact directly on the twin spectres of hunger and poverty. Domestic food prices are dictated by commodity prices such as wheat, corn, rice and soybean. FAO data show an upward trend in prices in 2010 which continues into 2011. Food prices have increased in Asia up to 20%, with countries like India and Indonesia showing double digit price increases, but much less for countries like Taiwan and Korea.

Food is an important component of the Consumer Price Index (CPI), which has also shown double digit increases in some countries such as the Philippines and Vietnam because food is a big part of the CPI. In the ASEAN region, the prices of some food items are particularly sensitive to production shortfalls -- such as wheat in Australia, and rice in Thailand and Vietnam due to flooding.

In 2007-2008, rising prices put basic food items beyond the reach of the poor and middle class, precipitating civil disobedience in at least 43 countries. According to the FAO, urban households were among the hardest hit, especially the lower income groups which spend a higher proportion of their earnings on food than the richer class. By some estimates, up to 50% of a poor family's income may be spent on food (such as in the Philippines), compared to less than 25% of a family's income in more economically well-endowed countries such as Singapore and Taiwan. During the same period, stocks of the major traded grains were at a record low

and the perception that there would be supply shortages triggered action by several governments to stop exports.

The subsequent spillover effects led to market panic. So far in the new year, food-related civil unrest has occurred in several countries in northern Africa, not only Tunisia, Egypt and Algeria. The latest reports from the WFP show that in 24 countries, the overall cost of the basic food basket is more than 20% above the five-year average! Food fears have precipitated countries like China, South Korea, Vietnam, Indonesia, India and Russia to take pre-emptive action such as reducing tariffs on some imported food items, fixing prices and encouraging people to grow food.

Reality Check on Causes

Food price spirals result from shortages caused by interruptions in supply, or through speculation. In the short term, governments can avoid disruptions in supply caused by over-reaction that result in a freeze on exports. Extreme weather events and biosecurity factors (insect pests, diseases) which reduce the surplus production necessary for export are difficult to deal with. Speculation on food commodities is nothing new but in this globalised world with instant access to news, it is easy for some to profit from shortfalls.

Many of the underlying problems which produced the sharp increases in food prices and increased the number of hungry over the past decade have not gone away. Some of these longer term factors need to be addressed, such as competition for land use and diversion from food production; climate change; falling water availability; rising energy costs; use of food/feed biomaterial for biofuel; and resource scarcity (including declining arable land).

A reality check must also include a hard look at the production levels of grain and the surplus entering the world market. On the average, only 11-12% of total corn (maize) production is traded yearly. Similar figures are: rice 3-7% traded; wheat 18-20% traded; and soybean 22-23% traded. Wheat prices started their rise when Russia embargoed wheat exports in June 2010 due to domestic shortage caused by adverse weather. China recently announced that over two million hectares of wheat have been affected by drought. The effects of floods and droughts in various parts of the world are also being closely watched.

Looking Ahead

Reports indicate that on balance, the current supply of key grains are still acceptable. Current food prices remain higher than their pre-spiral levels and may still go up. Looking ahead, some analysts have forecast grain commodity price rises of 10-15%, resulting in a 8-9% rise in food prices in Asia.

Barring any sudden decision by exporting countries to turn off the export flow of grains, and any further extreme weather conditions, most experts agree that there need not be a repeat of the 2007-08 crises. There appears to be enough buffer for several months in "powder keg" countries which rely on imported grains. At least nine countries worldwide have taken some steps to ease price rises. More may be expected to do so in the coming months.

However, because of the link between poverty, hunger and food insecurity, several countries are on a tinderbox and any further price rise or supply shortage may lead to civil unrest.

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