

Is a new architecture required for financing food and environmental security?

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A year ago we were all very focused on the issue of sharply rising food prices; it was at the top of the agenda for much of our discussion. At this point, a lot of that discussion has just faded into the background, we pushed it on to the backburner and we don't seem to think it's a terribly important issue anymore. It's been overshadowed as an issue by the global macroeconomic crisis and the financial crisis. There has been a broad sense that it has been a false alarm. But what I argue for a good part is that we are wrong to have turned our attention away from the food crisis so quickly.

Looking back, the sharp rise in prices of basic food stuffs created for a large part of the world extreme difficulty. For many people in the world this represented a depression level, reduction in real income, this was not in terms of dollar or euro values perhaps as large as the current crisis but it arguably affected even more people more severely than the macro crisis has so far because those who were most affected by the sharply rising food prices are those who spend a larger share of their income on food, which is the poor. So the global food crisis had an extraordinary human impact, arguably a larger adverse human impact than the global financial crisis so far. One indication of how severe it was is the remarkable amount of civil unrest and political instability that was seen last year. e.g. Ethiopia, Egypt, Mexico and Thailand – very large number of countries were severely disrupted politically as people were unable to afford basic nutrition.

There were also some extraordinary political responses. Much of the world's system of trade in foodstuffs broke down temporarily as food exporting countries moved to limit, or in some cases completely ban exports in an attempt to provide some protection to their domestic consumers. There was widespread discussion about whether in fact the world had started to fulfil the prophecies of Malthus, whether we had in fact entered into a neo-Malthusian era of the world, and much discussion of the pressure of a growing world population and economic growth as well as some problematic policies on the world's food resources. All of that moved into the background rather abruptly in late 2008 as we went from the world of Malthus to the world of Keynes. We went to a severe economic slump striking the whole world. It is an extraordinary world downturn and quite clearly the worst downturn since the great depression. Global GDP will decline this year for the first time since WW2. There were expectations of a decoupling of the emerging markets; this has not happened; it became coupling with a vengeance. No part of the world economy is spared. It started with the US, but Europe and Japan will suffer as deep or even deeper recessions with no real end in sight. All of this has taken the attention away from the food crisis. The macro crisis has led to many people to write off the food and more broadly the commodity price crisis of 2008 as not fundamental. There is widespread belief that all that really happened was a speculative bubble and too many people were trading commodities driving commodity prices to unsustainable levels, and that all the concerns about ultimate supplies of food were misplaced.

But I argue against this view. International trade in commodities futures has expanded enormously and food prices went up very sharply, commodity prices went up very sharply and then fell a great deal. A lot of people took this as vindication that it was a speculative bubble. But this is not right. Firstly, the rise and fall of commodity prices affected not only commodities with large futures but those without e.g. iron ore. Trading commodity futures only affects the price to the extent that speculation leads to withdrawal of real supplies which leads to hoarding. That was not the case as food stocks were at record lows. With an economic slump, the real price of commodities always falls and vice versa. The great depression showed a spectacular collapse of agricultural prices. Therefore the current fall in prices is expected. It is a global recession so global prices should fall.

The crisis will eventually end and when it does, we'll discover that neo-Malthusians were not wrong. Resource constraints plus bad policies are creating a major problem for the supply of food in the world.

Despite the sharp fall in food prices since their peak in early 2008, prices of basic foodstuffs are still higher than the beginning of this decade.

Aside from the level of food prices still on an upward trend, the volatility is a clear problem. People do not eat in the long run, they eat every day. Should high prices from 2008 re-occur, it would be a very serious problem. We are very vulnerable to such high prices for example when a country imposes an export ban – the global economy is affected even if the domestic consumers are protected.

The poor have no access to ways of diversifying risk and they have no protection against high food prices. The bottom line is that the system we evolved which relied on faith that world markets in physical food stuffs plus world financial markets for diversifying risks would provide a reasonable protection against volatility did not work and we do face a secular upward trend on food prices. Fundamentally we are moving towards a world where Malthusian type pressures are increasing and it's a problem.

So what do we do at this point? One thing is to invest in future food production and this is both physical and R&D. We tend to think of agriculture as being an economics one on one market – producers and consumers getting the market right. This is true but only up to a point. Ag production and progress in production depends heavily on public goods, especially R&D. So thinking about why we got through the Malthusian warnings of the 1960's and the green revolution – a critical role was investment in basic research by international organizations. There has been much less emphasis on this research and physical infrastructure for agriculture in recent years largely because people thought it was solved problems. But at this point it looks like we have seriously underinvested and need to play catch up.

There are some policies that are major aggravating factors. Biofuels is not really discussed at the moment because of the decline in oil prices which reduced the demand and at the same time food prices have gone down. But it will come back as an issue and it's clear that there was a significant increase in the pressure on global food supplies that was the result of badly conceived biofuels policies. I need to know more, but this was a serious mistake. It is pushed to the background because of the current economic crisis, but it will be a problem that will come back to haunt us.

Beyond the long run policies, what about stability? There was scrambling to provide financial aid to countries that were suffering severely from high food prices. Aid did help but it was very difficult to come up with the money. Looking back at history, aid that kept a lot of people in Africa was because of the Saudi's helping. With the current oil prices this may not happen again anytime soon.

We should have a reserve system in place for emergency support and the ad-hoc response shows a better system for financial aid is needed.

It does look that we went too far from the policy of maintaining food stocks within countries as a protection against crisis. Yes, with an individually country's harvest failure, global markets work quite well. But a systemic hike in food prices leads to the global market break down. Food is different to other markets such as steel. Food is fundamental and needed to live on, particularly in poor countries. The effects of a global food price rise are to cause global markets to break down exactly when we need them most.

The environmental resource scarcity issues also still look entirely real. Right now we have a severe slump for everything and in the case of raw materials this means a decline in relative prices. But this will end and when it does we are back in a world that has growing population, growing purchasing power, and growing consumption of foods that are very intensive in the use of cereals, for example meat uses a lot more basic agricultural production than the consumption of grain.

Water is a concern and so too is the use of potential arable land. When arable land is diverted to non-agricultural uses it usually raises world GDP, but it also has the effect of reducing the incomes of those already at the bottom of the earning scale. But last but not least, the environmental issues. To the extent climate changes, most agricultural patterns become disrupted, and again the countries that are the poorest are the ones that are most vulnerable in the face of this.

Specific institutional remedies should be discussed. But there ought to be something.

We had a very serious outbreak of human suffering and political instability resulting from a really quite brief spike in the price of food. It was not an extended period; it was overtaken by events by the broad collapse of economic activity thanks to the financial crisis. Had it gone on any longer, it might have been much worse and all indications are that the food crisis of 2008 was a dress rehearsal for future crises and we better have some mechanisms in place to deal with these.