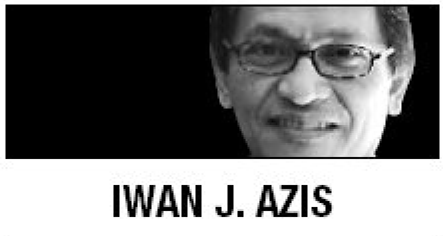
[Iwan J. Azis] Better get used to high food prices

2011-10-28 20:03

Catastrophic flooding and crop losses in Thailand, the world's leading rice exporter, are raising concerns that another food crisis may be in the offing. Further disquieting is the possibility that the world may have already entered a new era where persistently high food prices are the "New Normal."



At a time when policymakers are grappling with a host of thorny economic issues, the possibility may be unwelcome, but must not be ignored.

Although volatility in commodity markets is nothing new, there are worrying signs that food price fluctuations are now taking place within a much higher bandwith than ever before. Even when prices dip they remain high by historic standards, and when prices rise it's enough to put a serious dent in families' budgets.

For Asia's poor, who already spend 60 percent of their household budget on food, even the smallest fluctuation in food prices forces unenviable choices on where best to devote their scant resources. More money for food means less for health care, education, or other important expenditures. It also means that those striving to escape poverty are less likely to do so, while millions more risk falling below the $1.25 a day poverty line.

The Asian Development Bank estimates that a 10 percent rise in domestic food prices in developing Asia threatens to push an additional 64 million people in to poverty. With food price inflation in many emerging Asian economies averaging 11 percent in the first half of 2011 alone, the growing numbers of families facing the scourge of dire poverty is staggering.

Much of the sharp increase in the region's food prices is due to production shortfalls caused by extreme weather events — such as droughts and floods — and subsequent export bans by some food producing countries. Growing appetites for grains, oil, seeds, sugar, and livestock in emerging economies like the People's Republic of China and India are exerting further upward pressure on supply.

There has also been a growing trend over the past decade to "financialize" commodities, turning food into an important tradable asset class, just like stocks, bonds, currencies, or real estate. As a result, movement in one major asset — say, real estate prices in the United States — can drive food prices in other parts of the world to levels well above what real supply and demand might dictate. The current super-easy money policy in industrial countries may have also driven the financialization of commodities.

And then of course there's the weakness of the U.S. dollar, in which most food commodities are denominated, as well as high oil prices, which raise costs at almost every step of the food supply chain, from fertilizer and animal feed, to fuel for bringing food from the farm to kitchen table.

With a "New Normal" of persistently high and volatile food prices here to stay, what are policymakers to do?

There are no easy solutions, but when faced with bouts of soaring food prices, governments must be both pragmatic and flexible.

Tightening monetary policy — like raising interest rates — is a standard tool to combat inflation and cool economic overheating. It is a fairly ineffective tool if the inflationary pressure is supply-side, however, and relatively blunt if price movements are volatile. Rate hikes take months to show results, and if overblown can tighten the economic leash until it chokes growth, especially for small and medium businesses.