Rising Food Prices and the Egyptian Tinderbox: How Banks and Investors Are Starving the Third World

By Ellen Brown
Global Research, February 04, 2011
4 February 2011

Region: Middle East & North Africa
Theme: Global Economy, Poverty & Social Inequality

"What for a poor man is a crust, for a rich man is a securitized asset class." –Futures trader Ann Berg, quoted in the UK Guardian

Underlying the sudden, volatile uprising in Egypt and Tunisia is a growing global crisis sparked by soaring food prices and unemployment. The Associated Press reports that roughly 40 percent of Egyptians struggle along at the World Bank-set poverty level of under $2 per day. Analysts estimate that food price inflation in Egypt is currently at an unsustainable 17 percent yearly. In poorer countries, as much as 60 to 80 percent of people's incomes go for food, compared to just 10 to 20 percent in industrial countries. An increase of a dollar or so in the cost of a gallon of milk or a loaf of bread for Americans can mean starvation for people in Egypt and other poor countries.

Follow the Money

The cause of the recent jump in global food prices remains a matter of debate. Some analysts blame the Federal Reserve's "quantitative easing" program (increasing the money supply with credit created with accounting entries), which they warn is sparking hyperinflation. Too much money chasing too few goods is the classic explanation for rising prices.

The problem with that theory is that the global money supply has actually shrunk since 2006, when food prices began their dramatic rise. Virtually all money today is created on the books of banks as "credit" or "debt," and overall lending has shrunk. This has occurred in an accelerating process of deleveraging (paying down or writing off loans and not making new ones), as the subprime housing market has collapsed and bank capital requirements have been raised. Although it seems counterintuitive, the more debt there is, the more money there is in the system. As debt shrinks, the money supply shrinks in tandem.

That is why government debt today is not actually the bugaboo it is being made out to be by the deficit terrorists. The flipside of debt is credit, and businesses run on it. When credit collapses, trade collapses. When private debt shrinks, public debt must therefore step in to replace it. The "good" credit or debt is the kind used for building infrastructure and other productive capacity, increasing the Gross Domestic Product and wages; and this is the kind governments are in a position to employ. The parasitic forms of credit or debt are the gamblers' money-making-money schemes, which add nothing to GDP.

Prices *have* been driven up by too much money chasing too few goods, but the money is chasing only certain selected goods. Food and fuel prices are up, but housing prices are down. The net result is that overall price inflation remains low.

While quantitative easing may not be the culprit, Fed action *has* driven the rush into commodities. In response to the banking crisis of 2008, the Federal Reserve dropped the Fed funds rate (the rate at which banks borrow from each other) nearly to zero. This has allowed banks and their customers to borrow in the U.S. at very low rates and invest abroad for higher returns, creating a dollar "carry trade."

Meanwhile, interest rates on federal securities were also driven to very low levels, leaving investors without that safe, stable option for funding their retirements. "Hot money" – investment seeking higher returns – fled from the collapsed housing market into anything but the dollar, which generally meant fleeing into commodities.

New Meaning to the Old Adage "Don't Play with Your Food"

At one time food was considered a poor speculative investment, because it was too perishable to be stored until market conditions were right for resale. But that changed with the development of ETFs (exchange-traded funds) and other financial innovations.

As first devised, speculation in food futures was fairly innocuous, since when the contract expired, somebody actually had to buy the product at the "spot" or cash price. This forced the fanciful futures price and the more realistic spot price into alignment. But that changed in 1991. In a revealing July 2010 report in Harper's Magazine titled "The Food Bubble: How Wall Street Starved Millions and Got Away with It," Frederick Kaufman wrote:

The history of food took an ominous turn in 1991, at a time when no one was paying much attention. That was the year Goldman Sachs decided our daily bread might make an excellent investment. . . .

Robber barons, gold bugs, and financiers of every stripe had long dreamed of controlling all of something everybody needed or desired, then holding back the supply as demand drove up prices.

As Kaufman explained this financial innovation in a July 16 interview on *Democracy Now*:

Goldman . . . came up with this idea of the commodity index fund, which really was a way for them to accumulate huge piles of cash for themselves. . . . Instead of a buy-and-sell order, like everybody does in these markets, they just started buying. It's called "going long." They started going long on wheat futures. . . . And every time one of these contracts came due, they would do something called "rolling it over" into the next contract. . . . And they kept on buying and buying and buying and buying and accumulating this historically unprecedented pile of long-only wheat futures. And this accumulation created a very odd phenomenon in the market. It's called a "demand shock." Usually prices go up because supply is low . . . . In this case, Goldman and the other banks had introduced this completely unnatural and artificial demand to buy wheat, and that then set the price up. . . . [H]ard red wheat generally trades between $3 and $6 per sixty-pound bushel. It went up to $12, then $15, then $18. Then it broke $20. And on February 25th, 2008, hard red spring futures settled at $25 per bushel. . . . [T]he irony here is that in 2008, it was the greatest wheat-producing year in world history.

. . . [T]he other outrage . . . is that at the time that Goldman and these other banks are completely messing up the structure of this market, they've protected themselves outside the market, through this really almost diabolical idea called "replication" . . . . Let's say, . . . you want me to invest for you in the wheat market. You give me a hundred bucks . . . . [W]hat I should be doing is putting a hundred bucks in the wheat markets. But I don't have to do that. All I have to do is put $5 in. . . . And with that $5, I can hold your hundred-dollar position. Well, now I've got ninety-five of your dollars. . . . [W]hat Goldman did with hundreds of billions of dollars, and what all these banks did with hundreds of billions of dollars, is they put them in the most conservative investments conceivable. They put it in T-bills. . . . [N]ow that you have hundreds of billions of dollars in T-bills, you can leverage that into trillions of dollars. . . . And then they take that trillion dollars, they give it to their day traders, and they say, "Go at it, guys. Do whatever is most lucrative today." And so, as billions of people starve, they use that money to make billions of dollars for themselves.

Other researchers have concurred in this explanation of the food crisis. In a July 2010 article called "How Goldman Sachs Gambled on Starving the World's Poor – And Won," journalist Johann Hari observed:

Beginning in late 2006, world food prices began rising. A year later, wheat price had gone up 80 percent, maize by 90 percent and rice by 320 percent. Food riots broke out in more than 30 countries, and 200 million people faced malnutrition and starvation. Suddenly, in the spring of 2008, food prices fell to previous levels, as if by magic. Jean Ziegler, the UN Special Rapporteur on the Right to Food, has called this "a silent mass murder", entirely due to "man-made actions."

Some economists said the hikes were caused by increased demand by Chinese and Indian middle class population booms and the growing use of corn for ethanol. But according to Professor Jayati Ghosh of the Centre for Economic Studies in New Delhi, demand from those countries actually *fell* by 3 percent over the period; and the International Grain Council stated that global production of wheat had *increased* during the price spike.

According to a study by the now-defunct Lehman Brothers, index fund speculation jumped from $13 billion to $260 billion from 2003 to 2008. Not surprisingly, food prices rose in tandem, beginning in 2003. Hedge fund manager Michael Masters estimated that on the regulated exchanges in the U.S., 64 percent of all wheat contracts were held by speculators with no interest whatever in real wheat. They owned it solely in anticipation of price inflation and resale. George Soros said it was "just like secretly hoarding food during a hunger crisis in order to make profits from increasing prices."

An August 2009 paper by Jayati Ghosh, professor at the Centre for Economic Studies and Planning at Jawaharlal Nehru University in New Dehli, compared food staples traded on futures markets with staples that were not. He found that the price of food staples not traded on futures markets, such as millet, cassava and potatoes, rose only a fraction as much as staples subject to speculation, such as wheat.

Nomi Prins, writing in *Mother Jones* in 2008, also blamed the price hikes on speculation. She observed that agricultural futures and energy futures were being packaged and sold just like CDOs (collateralized debt obligations), but in this case they were called CCOs (collateralized commodity obligations). The higher the price of food, the more CCO investors profited. She warned:

[W]ithout strong regulation of electronic exchanges and the derivatives products that enable speculators to move huge proportions of the futures markets underlying commodities, putting a bit of regulation into the London-based exchanges will not alleviate anything. Unless that's addressed, this bubble is going to take more than homes with it. It's going to take lives.

What Can Be Done?

According to Kaufman, the food bubble has now increased the ranks of the world's hungry by 250 million. On July 21, 2010, President Obama signed a Wall Street reform bill that would close many of the regulatory loopholes allowing big financial institutions to play in agriculture commodity futures markets, but Kaufman says the bill's solutions are not likely to work. Wall Street innovators can devise new ways to speculate that easily dance around cumbersome, slow-to-pass legislation. Attempts to ban all food speculation are also unlikely to work, he says, since firms can pick up the phone and do their trades through London, or arrange over-the-counter (private) swaps.

As an alternative, Kaufman suggests a worldwide or national grain reserve, so that regulators can bring wheat into the market when needed to stabilize prices. He notes that we actually kept a large grain reserve in the Clinton era, before the mania for deregulation. President Franklin Roosevelt pledged to maintain a large grain reserve in his second Agricultural Adjustment Act in 1938.

Chris Cook, former director of a global energy exchange, maintains:

The only long term solution is to completely re-architect markets. Firstly, cutting out middlemen — which is a process already under way. Secondly, a new settlement between producer and consumer nations — a Bretton Woods II.

Speculative markets today are driven more by fear, says Cook, than by greed. Investors are looking for something safe that will give them an adequate return, which means something they can live on in retirement. They need these investments because their employers and the government do not provide an adequate safety net.

At one time, federal securities were a safe and adequate investment for retirees. Then federal interest rates plunged, and investors moved into municipal bonds. Now that market too is collapsing, due to threats of bankruptcy among bond issuers. Cities, counties and states floundering from the credit crisis have been denied access to the quantitative easing tools used to bail out the banks — although it was the banks, not local governments, that caused the crisis. See "The Fed Has Spoken: No Bailout for Main Street."

Meanwhile, pensions are being slashed and social security is under attack. Arguably, along with the grain reserves institutionalized under Franklin Roosevelt, we need an Economic Bill of Rights of the sort he envisioned, one that would guarantee citizens at least a bare minimum standard of living. This could be done through job guarantees when people were able to work and social security when they were not. The program could be funded with government-created credit or government-bank-created credit, and this could be done *without* causing hyperinflation. To support that contention would take more space than is left here, but the subject has been tackled in my book Web of Debt. In the meantime, the credit needed to get local economies up and running again can be furnished through publicly-owned banks. For more on that possibility, see http://PublicBankingInstitute.org.

Niko Kyriakou contributed to this article.

Ellen Brown *is an attorney and the author of eleven books, including Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free. Her websites are http://WebOfDebt.com, http://EllenBrown.com and http://PublicBankingInstitute.org.*

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: **Ellen Brown**