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FOOD PRICES UP AGAIN:

**Why, how and what?**

**Food prices are once again on the rise. Daily News Business spoke to Institute of Policy Studies Executive Director Dr Saman Kelegama to obtain a broader picture of the emerging scenario. Excerpts of the interview.**

**Q: Why are food prices increasing in the world?**



Dr Saman Kelegama

**A:** Food prices are rising once again due to a combination of factors: (1) increase in demand for food with increase in income and increase in population in developing countries, (2) increase in demand due to changes in food habits, (3) surging oil prices and the resulting diversion of food products for bio-fuel production, (4) market speculation, and (5) natural disasters and climate change. Let me elaborate on each one of them:

It is worth noting that two developing countries, China and India account for 1/3rd of the global population. Their incomes and living standards have increased with recent growth and development. Thus, the demand for food has also increased in these two countries. This is the case with all other developing countries which are growing rapidly and showing higher living standards in recent years.

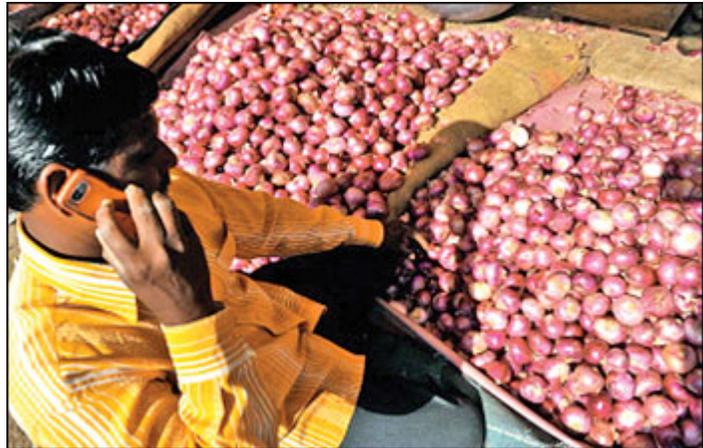
The meat consumption in China has increased significantly with enhancement of living standards and rapid urbanization. It has increased in India as well but not that much as in China. So, demand for animal feed has increased by a significant margin due to meaty diet styles in these two countries. And a large portion of the global cereal output now goes for animal feeding, reducing the amount for direct human consumption. Moreover, with the growing middle class in these two countries, the demand for motor vehicles has gone up and thus the demand for oil has increased. This has led to increase in oil prices and therefore increase in food prices.

It has been shown by the FAO that one-third of cereal production in the world goes to animal feed and a large share of it also goes for agro-fuel production.

The 2007 and 2008 food crisis clearly demonstrated the correlation between oil and food prices. High oil prices make agro fuels more profitable and thus push more food crops into ethanol and bio-fuel production.

Always when there is a bad harvest in a major agriculture exporting country it brings pressure on the market and sends signals to the speculators, who then start to buy to accumulate stocks, which leads to further price increases.

Climate change will have a significant impact on agriculture. The Intergovernmental Panel on Climate Change has predicted that rain-dependent agriculture will be cut by half in 2020, thereby adversely affecting food security. Natural disasters such as floods, droughts that adversely affect agricultural output are largely a result of climate change.



An Indian vendor uses his mobile phone as he selects onions at a street market in Hyderabad on January 18, 2011. India's annual inflation rate accelerated in December 2010 to 8.43 percent, led by rises in the cost of food, fuel and commodities. AFP

It is difficult to say that one of these explanatory factors is more influential than the other, suffice is to say that all these factors have in some way or another contributed to the current scenario of escalating food prices.

**Q: There was a food price escalation in 2007 and 2008 but it diminished. Why did food prices suddenly increase this time around?**

**A:** After the 2008 price hike, the higher price induced cultivations and the consequent good harvest helped prices to fall back. But natural disasters, US Dollar depreciation due to US Quantitative Easing Policy, and the rapid growth in India and China in 2010, have created a situation a bit worse than in 2008.

As stated, natural disasters are most often an outcome of climate change. During 2009 and 2010, we saw droughts and fires devastating harvests of wheat and other grains in Russia, flooding adversely impacting planting seasons of wheat in Canada, and sugar in Australia. It is estimated that global wheat production will be around 646 million tons in 2010 and 2011 compared to 683 million tons in 2009 and 2010. In short, adverse

weather conditions have affected the large food exporting countries of the world and reduced supplies.

Dollar depreciation has encouraged speculators to look for alternative sources of investment like commodity markets where you find food and oil. Speculators have made the situation worse. For instance, the recent floods in the fourth largest wheat producer in the world, Australia, is likely to hamper its wheat production. Speculators will react to this and push prices further up.

Production has failed to keep up with growing demand because food is not going to where it is needed as explained earlier.

**Q: How will this food price hike manifest around the world?**

**A:** We have already seen the food prices related protests in Algeria, Tunisia and India. India is a net food exporting country, yet it faced an Onion shortage due to adverse weather conditions and prices escalated, which was one of the reasons for the protest in India.

The invisible hand of the market will not come into play in such situations and the government intervention in terms of strengthening the public distribution systems, improving storage capacity to accommodate buffer stocks, possible imposition of price controls, will be seen more often around the world.

Selective import liberalization, ensuring effective competition in the food market by breaking monopoly, cartels, and other such market powers, will be seen in the coming days.

Bangladesh has already taken steps to import 900,000 tonnes of rice to boost its stocks. Some countries have imposed price controls.

Let us not forget that rising food prices can bring down popular governments. Recently, Bolivian popular leader, Eva Morales had a tough time in cutting consumer subsidies (due to fiscal problems) because of mass uprising. So any government will do whatever it could with the available resources to minimize the adverse impact on the masses.



The recent floods in Eastern province affected paddy cultivation

Meanwhile, the Opposition in all parts of the democratic world will fully exploit the situation to discredit the government and gain some mileage.

The FAO predictions are not at all favourable. They say that the price of a basket of cereal, oil seeds, dairy, meat, and sugar has continued to rise for six consecutive months and it has risen by 32 percent in the second half of 2010 (25 percent increase from December 2009 to December 2010).

With floods in Australia and Latin America, the food prices will remain high in 2011, replicating or going beyond the crisis of 2007 and 2008.

Many countries will now explore various options to face this situation. One way is by having increased government interventions (on which some economists will disagree).

The other is by exploring innovative ways to bring down agriculture prices by increasing agriculture production.

Besides such short-term measures, countries around the world will be looking at increasing food production in the long run to face such situations in the future.

According to the FAO, global food production will have to increase by 70 percent by 2050 to meet the world population which will reach 9.1 billion in 2050 from the current level of 6.8 billion.

**Q: What about introducing Genetically Modified Foods to overcome the food crisis?**

**A:** Yes, Genetically Modified (GM) foods may be cheaper and have the potential to solve many of the world's hunger and malnutrition problems, and to help protect and preserve the environment by increasing yield and reducing reliance upon chemical pesticides and herbicides.

Yet there are many challenges ahead for governments, especially in the areas of safety testing, regulation, international policy and food labeling. EU, for instance, has strict labeling policies for GM food.

The acceptability of GM is driven more by bio-safety and human health considerations rather than the cheaper price. Even if you take a farmer, it will not be possible to adopt GM varieties due to cost of seeds and the prohibition of using saved seeds due to intellectual property rights protection.

On the other hand, for a farmer, conventional plant breeding or organic approaches are more acceptable. Given this politically sensitive situation the GM route for food security has to be ruled out at present.

Sri Lanka banned the import of GM foods in mid-2001 by Genetically Modified Foods (Provisional) Regulations, No. 1 of 2001 but its effective enforcement remains questionable up-to-date.

**Q: How is Sri Lanka impacted by the global food price escalation?**

**A:** Sri Lanka is a net food importing country, thus it is going to feel the impact of global food price escalation. The country imports all its wheat requirements, more than 85 percent of its sugar requirements, more than 80 percent of its milk requirements, and so on. Since the country is 96 percent self-sufficient in rice, it imports only four percent of its rice requirements.



Friends and family members transfer their belongings into a boat from their flooded home after rainwaters the day before inundated the city of Ipswich, some 40 kms southwest of the Queensland city of Brisbane on January 12. Australia's third-biggest city Brisbane was besieged on January 12 by once-in-a-century floods that could hit up to 20,000 homes, as fears grew up to 25 people were killed by raging torrents. AFP

I would say Sri Lanka has received a double blow because in addition to the international price increases, there will be domestic agricultural production shortfalls after the recent floods in the North Central and Eastern provinces.

This means the domestic agricultural items like rice and vegetables, will show a price increase. It was reported on a Sunday (January 16) newspaper that the vegetable supply into the Dambulla Economic Centre has declined by 70 percent and obviously the vegetable prices have increased.

It is difficult to say by how much the domestic rice output will fall due to the floods related devastation, suffice is to say that adequate stocks are available now to meet any shortfalls, but some private traders will cash-in and will hold on to their stocks till

the prices go up further. Thus the Government has to move in swiftly and ensure that prices are stabilized. Already some action has been initiated.

The redeeming features are: (1) the appreciated rupee while unfavourable to exporters, will have a cost lowering cushioning impact on high priced imported food items, and (2) our main food importing countries are India, Pakistan, and Australia. At least in the first two countries, the food is relatively cheap compared to international standards and we are benefitting from this.

**Q: What needs to be done to increase domestic agriculture production?**

**A:** I think we have debated this topic for long years. In my opinion what we need is not additional areas to cultivate but to improve the productivity of the existing cultivations. We cannot be self-sufficient in all the food items because self-sufficiency will come at a huge cost to the economy (in terms of investment on irrigation and deforestation).

It is always good to have some degree of self-sufficiency and import the rest as we presently do. Food imports account for 10 percent of total imports to Sri Lanka.

The food import can be easily be met with the current foreign reserves. We are about 10 percent self-sufficient in sugar and import the rest but if we could improve the productivity of sugar in the existing cultivations and be 30 percent self-sufficient, that is well and good.

In order to improve productivity in the agriculture sector, we have to look at high yielding seeds, improvement in soil conditions, improve support services, storage and refrigeration facilities and minimize post-harvest losses. I think these areas have been discussed extensively and what we need is more action in these areas.

**Q: Why is the increase in food prices not reflected in the Consumer Price Index used to measure inflation?**

**A:** The new Colombo Consumer Price Index (CCPI) with base year 2002 replaced the old Consumer Price Index (CPI) with base year of 1952.

The new index was based on the weights for housing, food and transport, from the Household Income and Expenditure Survey of 2002. Although the base year was updated to accommodate an up-to-date basket of goods, there are a number of shortcomings in the new index.

First, geographical coverage is restricted to the urban households of the Colombo district. Second, the two highest expenditure deciles have been included in the index, thus the food and beverages (non-alcoholic) carries a weight of 46.71 compared to 68.32 in the old CPI.

This is because the food and beverages carry less weight among higher expenditure deciles and it has influenced the overall weight of 46.71. Thus, the volatility in food prices are under-reported in the new index.

Above all, the lower food ratio does not represent the country's population, particularly the non-urban population.

A revised inflation indicator will have to be developed and installed soon to reflect the overall population expenditure patterns.

Once we get a more accurate index, we will surely see the index responding more to food price escalations. Countries like India have revised their inflation estimates to a double digit figure for 2011 due to escalating food prices.