

Abstract

Much of recent work has raised the issue that the surge in prices of foodgrains in the last two years cannot be explained satisfactorily in terms of the fundamentals of supply and demand. It has also been suggested that the part that cannot be explained in this way is due largely to speculation. Speculation influences food prices in two distinct ways: one is the huge influx of capital from commodity index funds, hedge funds and pension funds in commodity futures markets or options. Some evidence suggests that expiry prices in commodity futures markets are considerably higher than cash or spot prices, implying that futures markets are not facilitating price discovery. The second form is purchase or hoarding of commodities on the presumption that their prices will continue to rise. The present analysis, based on a rational distributed lag model of global stocks of wheat, maize and rice and their prices over the period 1986-2008, confirms a positive long-run effect of rising prices on stocks. In the case of rice, this effect is considerably stronger. If this finding has any validity, although the need for correcting demand-supply imbalances remains a top priority, careful attention must also be given to limiting speculation. Various suggestions include the imperative of a 'virtual grain reserve' to be established to help calm markets through the futures market. But, above all, there is a strong case for a better functioning trading system-in particular, for trade liberalization in agriculture and to build trust in global food markets and stock management.

Keywords: Foodgrain stocks, Price, Speculation, Hoarding

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