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Bajaj Finserv share price	1,501.8 2.23%
Bajaj Finance share price	7,198.8 0.9%
Asian Paints share price	3,246 0.61%
Kotak Mahindra Bank share price	1,787 0.26%
Tata Motors share price	613 0.35%

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Adani Power share price	323 -1.78%
Bharat Electronics share price	133.95 -0.26%
Tata Steel share price	117.3 -0.8%
State Bank Of India share price	572.35 -0.7%
Zee Entertainment Enterpr...	268.7 -1.32%

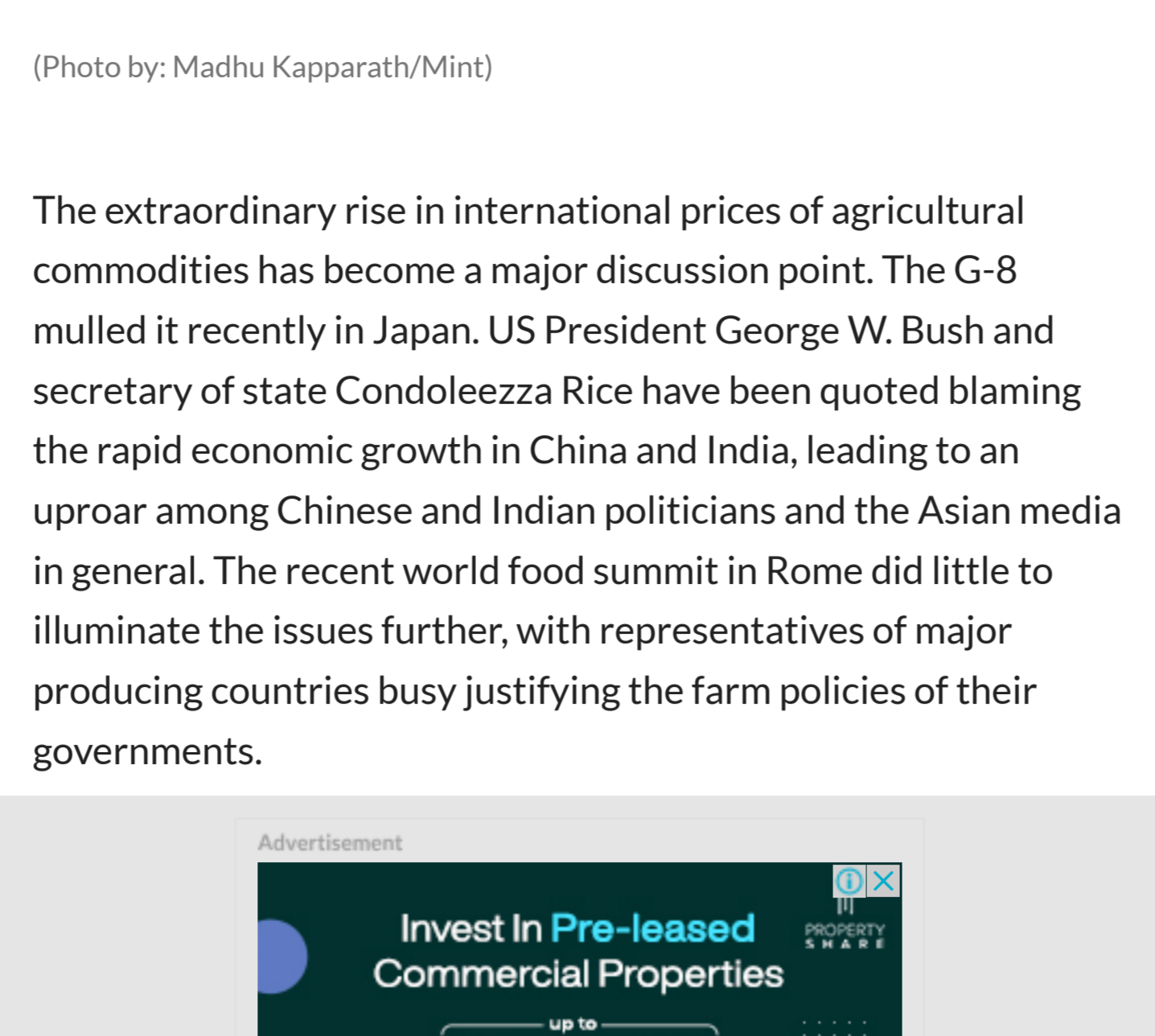
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5 min read • 21 Jul 2008, 12:17 AM IST

**Jikun Huang, Scott Rozelle, Bharat Ramaswami and Uma Lele**

*The real cost of surviving*



(Photo by: Madhu Kapparath/Mint)

The extraordinary rise in international prices of agricultural commodities has become a major discussion point. The G-8 mulled it recently in Japan. US President George W. Bush and secretary of state Condoleezza Rice have been quoted blaming the rapid economic growth in China and India, leading to an uproar among Chinese and Indian politicians and the Asian media in general. The recent world food summit in Rome did little to illuminate the issues further, with representatives of major producing countries busy justifying the farm policies of their governments.

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Since World War II, we have seen a steady rise in food supplies and decline in real world food prices (exceptions include the steep spike in 1974-75). A genetic revolution led developing countries in Asia to expand investments in agricultural research and extension, irrigation and fertilizer use, causing major supply shifts. For most of the past 25 years, China has been a net food exporter. India, too, has joined the ranks. So how could they be causing prices to rise?

Previous spikes in international food prices were the result of major drops in production in exporting countries. In contrast, the Food and Agricultural Organization's data indicate that the current spike was preceded by three near bumper crops, although droughts in Australia did tighten wheat supplies temporarily and recent rice price increases are being blamed on the rice export bans in developing countries.

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A shift in global demand for energy and derived demand for agricultural crops explains the price hikes and that shift is unlikely to be temporary. With rising energy prices and use of crops as feedstock for biofuels, crop prices will continue their steep rise. Spot and future prices reflect the difference in expectations. Future trading prices for 1976 were considerably lower than spot prices in 1974, as were future prices in 1997 relative to spot prices in 1995. In contrast, future commodity prices in 2010 and 2011 are considerably higher than spot prices in 2008.

There has been no abrupt increase in China's domestic food demand in recent years. And researchers have established unequivocally that the rising demand for most food commodities has been met mainly by higher domestic production. Moreover, its rise in food imports is matched by a rise in exports.

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Indian demand does not fit the picture either. Although production growth of staples such as rice and wheat has slowed in the last decade, so has demand. Numerous studies have shown a sustained decline in its per capita calorie consumption over the last 25 years, mainly because of lower cereal consumption. The counter-intuitively, while the decline has been the largest among the richer households—perhaps due to consumption of more milk, fruit and vegetables, and more fats—lower calorie consumption has been noted for all income groups. There has been neither a decline in real incomes nor any rise in the real price of food over the last 25 years in India—until recently. Experts hypothesize that the caloric decline may be explained by the decline in manual work and improvements in health indicators. This does not mean Indians are adequately nourished — anthropometric indicators of nutritional status of both adults and children are among the worst in the world. If its growth gets more broad-based and contributes to food price increases, it would be a measure of success of India's economic policies.

In both countries, greater pressure on state supplies to control domestic inflationary pressures, together with tightening of global supplies, has set off policy responses such as export bans. But they reflect marginal shortfalls. Indeed, as importers of soya and palm oil, India and China are victims of the oil fuel boom.

Contrary to some studies, biofuels are not only driving the rise in prices of crops used as feedstock in fuel production but of other crops that compete for land and other resources. The US and Brazil produce more than 90% of the world's ethanol and have more than 90% of that market. Future plans are ambitious. In 2007, 20% of US corn went into ethanol, which equals half the global trade in 2000. By 2015, up to half of the US corn crop will be used for biofuels.

Brazil's largely soya-based ethanol feeds a huge domestic energy market. Its soya bean production has grown mainly thanks to accelerated deforestation in the Amazon, setting off international alarm bells on global warming. Other countries, such as Indonesia and Malaysia, are getting into the act, as profitability of biofuels is related directly to the price of energy. The rise in food prices is thus closely tied to that in oil prices—an unprecedented, fundamental, deepening linkage between the forces affecting supply and demand for agricultural commodities through energy markets.

Meanwhile, investment in food and farming in developing countries, including external aid for agriculture, dropped dramatically. It has picked up since 2004, but is nowhere near the required level. And farms' greater use of fertilizers, electricity, water and transport to global markets adds to energy dependence.

The good news is that developing countries may focus on food and agriculture. Donors, and hopefully countries, will invest more, not just in international agricultural research, but in national research, extension, soil and water management—in ways that involve the poor.

Elimination of agricultural subsidies by the US and OECD countries for food and energy production is long overdue, but is unlikely to happen soon. The least the latter can do is to increase assistance to developing countries in science and technology so that not just large corporations but the world's small farmers can participate in the agricultural boom.

Edited excerpts. This article was first published by the Far Eastern Economic Review on its website (Feer.com) on 7 July. Reprinted with permission of Feer and Dow Jones and Co.

Jikun Huang is director of the Center for Chinese Agricultural Policy. Scott Rozelle is a professor of international studies at Stanford University. Bharat Ramaswami is a professor at the Indian Statistical Institute. Uma Lele is a former senior adviser at the World Bank and a visiting professor at the University of Maryland. Comment at theirview@livemint.com

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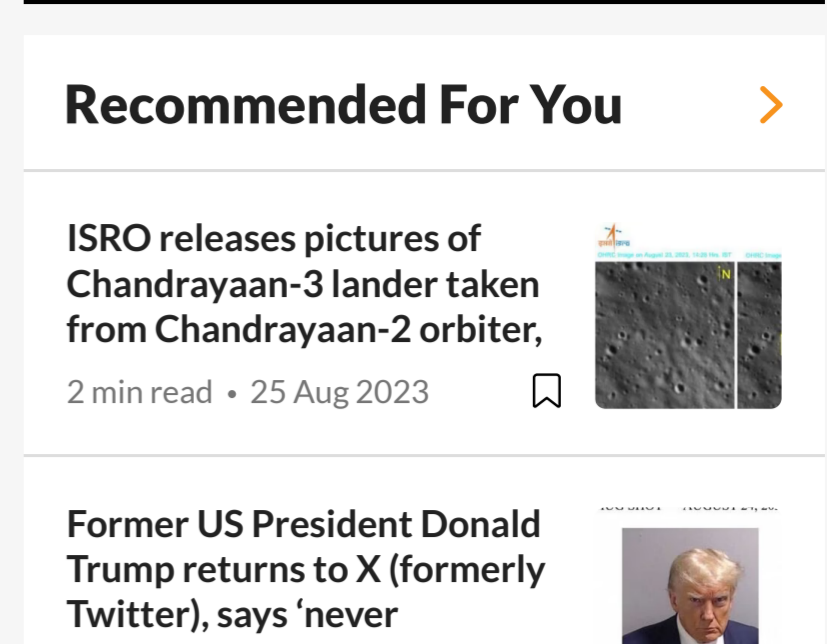
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