Against The Grain

Law360, New York (February 07, 2011, 2:20 PM ET) -- Gasoline price spikes bring calls for investigations into potential collusion among oil companies with what George Will once called “metronomic regularity.” Those investigations, however, inevitably conclude that supply and demand, not collusive conduct, caused the price increase. The world seems to have reached the conclusion, albeit reluctantly, that demand for oil is greater than supply and that gasoline prices will remain high until demand drops or OPEC dissolves.

The world is facing a similar shortage of another key commodity — grain — and policymakers in the United States and Europe have leveled antitrust and market manipulation allegations against seed manufacturers, agricultural firms and commodity traders. But these actions attack the capillaries, not the jugular.

The core problem is an inability to increase production and there is nothing the antitrust law or a market manipulation investigation can do about that. While there no doubt are market imperfections that should be corrected, the inescapable fact is that the demand for grain is greater than the supply and prices will remain high until more acreage is devoted to grain production or new innovations increase output.

The United Nations Food and Agriculture Organization (UNFAO) predicts that global output of rice, wheat and corn will decrease 1.4 percent this year, while demand will increase 1.8 percent. As the world’s population steams toward the 9 billion mark by 2050, and as people in emerging economies consume more meat and grain, demand for grain is rising at ever-increasing rates. Supply is not keeping pace with demand because insufficient acreage is devoted to grain cultivation, volatile weather patterns have interrupted seasonal production, and some grains are being used to manufacture biofuels. An ominous sign of a perhaps dangerous future is the decision by Russia, traditionally a grain exporter, to ban the export of any grain out of fear of future shortages.

Not surprisingly, grain prices have increased substantially. According to Reuters, prices increased up to 50 percent last year and that has put intense pressure on household budgets, especially in poorer countries, where the UNFAO has found families spend up to 50 percent of their income on food. The most acute problems will be in the countries the United States Department of Agriculture identifies as “food insecure.” But food shortages could also have a serious and adverse effect on wealthier countries like Iran, Brazil and Japan, which are among the world’s top importers of grain.

There have been a flurry of legal efforts in reaction to the seeming squeeze in the grain market. The United States Department of Justice and seven state attorneys general have launched an investigation into Monsanto’s sale and licensing of its patented, genetically modified seeds. Regulators assert that Monsanto’s alleged dominance has increased price. But the seeds, which are resistant to the herbicides that kill weeds, represent what one farmer quoted by The Washington Post called “probably the most revolutionary event in grain crops over the last 30 years.” While farmers decry the price they pay, that is the incentive the patent law uses to encourage breakthrough innovation and there appears to
be no evidence that price has reduced output.

Regulators across the globe have targeted alleged collusion in a number of agricultural markets. Last year, the DOJ and the U.S. Department of Agriculture held five public workshops "to explore competition issues affecting the agricultural sector in the 21st century and the appropriate role for antitrust and regulatory enforcement in that industry." And price-fixing investigations have been launched against, among others, tomato processors, egg suppliers and dairy farmers in the United States, and bread makers in South Africa and Russia. But those investigations relate to prices paid by relatively affluent buyers and will have no effect on the global supply of grain.

One of the remaining targets is a favorite of policymakers who have no one else to blame: commodity traders. Just last month, French President Nicolas Sarkozy blamed grain price increases on hedge funds, speculators and the derivatives market, and vowed to use his position as president of the G-20 to bring the alleged perpetrators to justice. Farm ministers from 48 countries also issued a statement voicing their "concern[] that excessive price volatility and speculation on international agricultural markets might constitute a threat to food security."

But while market manipulation under the commodity laws likely can occur in specialized and short-term situations, the notion that traders have some durable power to drive up the price of grain despite the underlying fundamentals is fanciful. There simply are not the market structures and financial resources to permit traders to raise price over a sustained period regardless of supply and demand.

Concluding that these investigations are likely to be fruitless might cause some to downplay the risk, but it would be a mistake to ignore the fact that the global focus on this shortage will be unprecedented. An oil shortage is disruptive, but a food shortage is destabilizing. In 2009, a headline in Scientific American asked, "Could food shortages bring down civilization?" Alarmist? Perhaps. But as we’ve seen in Tunisia and Egypt, a government that cannot feed its people is in danger of falling.

Governments around the world will be under intense pressure to remedy the situation, and their options are limited. Producers may devote more acreage to grain over time, but there is little that governments can do in the short term to reduce price. They can subsidize prices, but the head of the United Nations World Food Program has said that many governments no longer have the money to do so, and subsidization by those countries that can might exacerbate shortages in countries that cannot.

We therefore can expect more of the same: a flurry of investigations that can do nothing to increase the supply of grain and vituperative attacks against the money-changers who allegedly are driving up price. The wild card in all of this is the globalization of antitrust.

A number of the world’s biggest importers of grain, including Brazil and Japan, and one of the biggest consumers of grain — China — have adopted antitrust laws that have only recently been energized. Whether these countries deem the alleged conduct market manipulation or collusive conduct, the antitrust law is a new weapon available to them as they attempt to discipline global markets.

Unfortunately, we cannot be sure of the analytical methodology these countries will use or the rules they will adopt. We do know that withering scrutiny will be put on grain traders and the financial institutions that employ them, as well as agricultural producers. It would be wise for all of these entities to re-examine their antitrust strategies in proactive ways so they may avoid, or at least minimize, nasty (and unnecessary) problems that could divert their attention from their business.

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