And this week's award for economic idiocy goes to.... [1]

Written by **Tim Worstall** [2] | Saturday 16 March 2013

All those who participated in this little piece of political grandstanding [3] by some MEP or other. They ran a competition to see what would be nominated as the most dangerous financial product so that the MEP could then work to have it banned. Of course, the competition was entirely rigged: my own nomination of the euro was rejected, as was a further nomination of a financial transactions tax. On the grounds that they rather like them so of course no one should be allowed to make fun of them.

But worse than that is the pureblind idiocy shown by those who voted for the winners:

> "Products based on food speculation are dangerous because they cause price increases of basic food stuff."

Which I hope you'll agree is the most gargantuan pile of steaming dingoes' kidneys since the Labour Party election manifestoes of the 1980s. For of course speculation doesn't necessarily increase food prices: even if we want to use physical speculation as our example, those speculating short will be reducing food prices as they do so.

But worse than this is as Adam Smith himself pointed out (start at para 40 here [4]). Assuming that we do start talking about physical speculation, about hoarding and storage, the successful speculator increases food prices in the short term and lowers them in the long. To cut Smith's explanation short.

A wheat merchant purchases wheat just after harvest and stores it. He is speculating that there's not going to be enough wheat to last all the way through to the next harvest. If he's wrong, well, boo hoo, he loses money. Weep for him why not. But if he's correct then something very desirable happens. By his action he has moved some of that wheat from when it was plentiful and cheap to when it is in short supply and expensive. That's how he makes his profit of course. But he's also done something else. He's made wheat a little more expenwsive than it was just after harvest: his buying (depends upon quantity of course) will have moved the price up. This will curb consumption at that point. Similarly, when he sells in that "hungry time" just before the next harvest, he will be lowering the price below what it would have been without his sales. This will enable higher consumption at that time. Note though that total consumption is likely to fall: just what we want if there really is a shortage of wheat before that next harvest. In fact, if there is to be a shortage of wheat then we absolutely want everyone to be more economical in their consumption of it before that next harvest. Better that there's a little more substitution to barley or potatoes all year round (as a result of those higher prices) then that there is no wheat at all for 6 weeks before harvest.

Speculation thus smooths food prices through time: not raises them particularly, even if people are hoarding. But smooths them.

Aren't we lucky to share an economic and political system with elected politicians who are incapable of grasping these basic points. Who would actually ban the very thing that ameliorates food shortages. The trade and speculation in food?

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