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The Finite World

By PAUL KRUGMAN

Oil is back above $90 a barrel. Copper and cotton have hit record highs. Wheat and corn prices are way up. Over all, world commodity prices have risen by a quarter in the past six months.

So what’s the meaning of this surge?

Is it speculation run amok? Is it the result of excessive money creation, a harbinger of runaway inflation just around the corner? No and no.

What the commodity markets are telling us is that we’re living in a finite world, in which the rapid growth of emerging economies is placing pressure on limited supplies of raw materials, pushing up their prices. And America is, for the most part, just a bystander in this story.

Some background: The last time the prices of oil and other commodities were this high, two and a half years ago, many commentators dismissed the price spike as an aberration driven by speculators. And they claimed vindication when commodity prices plunged in the second half of 2008.

But that price collapse coincided with a severe global recession, which led to a sharp fall in demand for raw materials. The big test would come when the world economy recovered. Would raw materials once again become expensive?

Well, it still feels like a recession in America. But thanks to growth in developing nations, world industrial production recently passed its previous peak — and, sure enough, commodity prices are surging again.

This doesn’t necessarily mean that speculation played no role in 2007-2008. Nor should we reject the notion that speculation is playing some role in current prices; for example, who is that mystery investor who has bought up much of the world’s copper supply? But the fact that world economic recovery has also brought a recovery in commodity prices strongly suggests that recent price fluctuations mainly reflect fundamental factors.

What about commodity prices as a harbinger of inflation? Many commentators on the right have been predicting for years that the Federal Reserve, by printing lots of money — it’s not actually doing that, but that’s the accusation — is setting us up for severe inflation. Stagflation is coming, declared Representative Paul Ryan in February 2009; Glenn Beck has been warning about imminent hyperinflation since 2008.

Yet inflation has remained low. What’s an inflation worrier to do?

One response has been a proliferation of conspiracy theories, of claims that the government is suppressing the truth about rising prices. But lately many on the right have seized on rising commodity prices as proof that they were right all along, as a sign of high overall inflation just around the corner.

You do have to wonder what these people were thinking two years ago, when raw material prices were plunging. If the commodity-price rise of the past six months heralds runaway inflation, why didn’t the 50 percent decline in the second half of 2008 herald runaway deflation?

Inconsistency aside, however, the big problem with those blaming the Fed for rising commodity prices is that they’re suffering from delusions of U.S. economic grandeur. For commodity prices are set globally, and what America does just isn’t that important a factor.

In particular, today, as in 2007-2008, the primary driving force behind rising commodity prices isn’t demand from the United States. It’s demand from China and other emerging economies. As more and more people in formerly poor nations are entering the global middle class, they’re beginning to drive cars and eat meat, placing growing pressure on world oil and food supplies.

And those supplies aren’t keeping pace. Conventional oil production has been flat for four years; in that sense, at least, peak oil has arrived. True, alternative sources, like oil from Canada’s tar sands, have continued to grow. But these alternative sources come at relatively high cost, both monetary and environmental.

Also, over the past year, extreme weather — especially severe heat and drought in some important agricultural regions — played an important role in driving up food prices. And, yes, there’s every reason to believe that climate change is making such weather episodes more common.

So what are the implications of the recent rise in commodity prices? It is, as I said, a sign that we’re living in a finite world, one in which resource constraints are becoming increasingly binding. This won’t bring an end to economic growth, let alone a descent into Mad Max-style collapse. It will require that we gradually change the way we live, adapting our economy and our lifestyles to the reality of more expensive resources.

But that’s for the future. Right now, rising commodity prices are basically the result of global recovery. They have no bearing, one way or another, on U.S. monetary policy. For this is a global story; at a fundamental level, it’s not about us.

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