Commodity market deregulation and food prices

The view from the US

STEVE SUPPAN
takes a hard look
at the relationship
between big business
and US Government,
and asks whether
the ‘revolving door’
of American politics
will ever allow
effective regulation of
commodity markets.

The 200 million person increase in global food insecurity since 2006 – over one billion according to UN Food and Agricultural Organization (FAO) – did not result from global production failure or a shortage of supply. Global food production increased on a per capita basis throughout the past decade and 2008 saw a record global cereal harvest.\(^1\) The trigger for food riots in at least 30 net food import dependent developing countries in 2008 was extreme spikes in food and energy prices. A major driver of these price spikes was rather the overwhelming market domination of financial firms over traditional traders in commodity futures markets. In March 2008, US Commodity Futures Trading Commission (CFTC) rules limited commercial users of commodities to owning 11 million bushels of Chicago Board of Trade (CBOT) maize futures contracts, while Goldman Sachs and Morgan Stanley investors, exempted from contract limits, controlled 1.5 billion bushels. Futures contracts provide short term (generally 90 days for agricultural contracts) protection against abrupt price increases for commodity users (such as bakers or cereal manufacturers) and against abrupt price decreases for commodity producers (such as farmers). However, investment bank “weight of money” drove prices up and then down, as they “rolled out” of contracts and bought new ones. CBOT and other US agricultural futures market prices are globally influential, not only because futures and cash contracts are denominated in dollars, but because US prices are used by policy makers in agricultural export and import planning. Futures contracts became ineffective price risk management tools not only for developing country importers, but also for commodity users in developed countries.\(^2\) In orderly and transparent markets, futures contract prices should converge to set a predictable cash price based on supply and demand fundamentals. Explaining what the UN Conference on Trade and Development calls the “financialisation of commodity markets”\(^3\) is a necessary first step in understanding how the deregulation of commodity and financial markets led to a food price crisis. Without strict regulation and enforcement, spikes in food prices could be repeated in the near term.

Disorderly markets: some origins and consequences

Following the global decline in agricultural futures prices from their June 2008 peaks, the FAO Food Index has risen each month since August 2009. FAO notes that agricultural markets remain structurally susceptible to price volatility originating from non-agricultural markets.\(^4\) What do oil and gold prices have to do with agriculture prices?

On June 24, 2009, the US Senate Subcommittee on Investigations published “Excessive Speculation in the Wheat Market.” The report concludes that price volatility in wheat futures contracts in 2007-2008 could not be explained by supply, demand and other fundamental factors. The Senate investigators found that commodity index fund traders had driven up wheat futures prices from US$3/bushel in 2006 to over US$11/bushel in mid-2008, collapsing to US$3.50/bushel by the end of 2008.\(^3\) Investors in commodity index funds, such as those of Goldman Sachs or Morgan Stanley, bet on the price movements of indices bundling up to 24 commodity futures contracts, including energy, agricultural, base metal and precious metal contracts. Bush administration CFTC waivers exempted index traders and other financial institutions from rules governing how many contracts could be held in a given commodity for a given time period. The rules governing contract position limits were designed to prevent any trader or group of traders from inducing price volatility or otherwise manipulating markets. Furthermore, under the “Enron Loophole” successfully defended during the Bush administration, the CFTC exempted financial service energy trades from reporting, so CFTC regulators couldn’t effectively monitor dominant market forces. Most index fund contracts are traded “Over the Counter,” (OTC) in “dark markets” not subject to commodity exchange regulation. As a result, the oil futures dominant Goldman index fund and other index funds induced price spikes in wheat and other agricultural commodities until June 2008, when the investment bubble burst and aggregate commodity prices fell.

What do oil and gold prices have to do with agriculture?
manager, said that OTC commodity and financial derivative trades were at the heart of the financial crisis, and called for their strict regulation. Preventing effective regulation of the OTC derivatives market is crucial to the banks’ power. Some corporate commodity end users have played the role of “useful idiots” in the banks’ strategy. On December 11, the US House of Representatives passed financial services reform legislation that includes provisions to regulate OTC trades. Financial markets analyst Adam White estimates that legislative loopholes will exempt at least 40-45% of OTC trades from clearing on exchanges or other regulated venues. Prominent among these exemptions is one for trades between banks and non-bank derivatives “end-users.” Signatories to a Coalition of Derivatives End User letter in support of the exemption include agribusiness firms such as Bunge, Cargill and John Deere. The exemption would allow banks and non-banks to gain competitive advantage from commodity exchange price information while maintaining their own trades in dark markets and part of their debt in off-balance sheet financing vehicles. Déjà vu - unless the US Senate closes the House loopholes. The coming financial crisis and food security The outlook for a sustainable and transparent financial system to underwrite trade dependent food security is not good. First, the US needs to know why the system failed, in order to fix it. Consonant with the Obama administration’s stated interest in the future, not the past, the budget for the just launched congressional Financial Crisis Inquiry Commission, scheduled to report December 15, is just $8 million. The Wall Street lobbying budget for defeating financial reform legislation is thus far $344 million, a tiny investment for protecting $35 billion revenue from derivatives trades. Given the thus far successful resistance of Wall Street and its revolving door of government allies to reform, Simone Johnson, former chief economic of the International Monetary Fund, predicts another financial crisis within twelve months. If half of all derivatives continue to trade in dark markets, Wall Street self-regulation is unlikely to prevent another US financial crisis, and a consequent repatriation of capital flows from developing countries, leaving their treasuries bare of hard currencies to pay for food imports. Two thirds of all developing countries remain import dependent for a critical margin of their food security. Twenty years ago, Solon Baralachew wrote on how an unstable global monetary system intensified commodity price volatility to the detriment of food security. Since then, new “financial innovations” have only exacerbated this instability. Advocates of yet greater dependency on trade liberalisation for food security can only hope that the global financial services industry is regulated before it destroys what remains of the liberalisation project.

5. www.levin.senate.gov/newsroom/PSI.
11. See, above all, the research reports at www.accidentalhuntbrothers.com.
12. Mossvaer-Rahmani et al., 19.
16. www.tradedesobserver.org/library.cfm?refId=106511
19. www.accidentalhuntbrothers.com/psi

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commodities futures markets (price discovery, risk management & the notional link between futures prices and the supply & demand fundamentals of underlying commodity – downstream component? commodities prices bears negative consequences for commercial actors; - But Buyuksahin and Robe (2011), IEA, conclude that the increased co-movement between commodities prices has not been proven to be either beneficial or harmful to the market and its actors; - Reserve Bank of Australia concludes that synchronization of price cycles across asset classes is not uncommon it tends to happen when the. Studies about the 2008 food crisis generally attribute the price spikes and supply shortages that year to some combination of Get live commodity market prices, Get commodity analysis and mcx, ncdex and nmce exchange price, Current market price. Technically Copper market is under short covering as market has witnessed drop in open interest by 4.23% to settled at 3853 while prices up 0.45 ... More >. 2020-06-19. MCX Natural Gas under short covering; Support seen at 124. Technically Natural Gas market is under short covering as market has witnessed drop in open interest by 11.82% to settled at 16577 while prices u... More >. 2020-06-19. MCX Crude Oil under short covering; Support seen at 2878. Technically Crude Oil market is under short covering as market has witnessed drop in open interest by 24.34% to settled at 1470 while