

Comment by the World Development Movement to the Commodity Futures Trading Commission on the proposed rule for Position Limits for Derivatives

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About WDM

The World Development Movement (WDM) campaigns to tackle the root causes of poverty. We lobby governments and companies to change policies and practices that keep people poor. WDM is a democratic membership organisation of 15,000 individuals and 60 local groups based in the UK.

Comment

1. The World Development Movement welcomes the Commission's work in drawing up rules for the implementation of the Dodd-Frank Wall Street Reform Act, in particular efforts to reduce excessive speculation on food commodities.
2. In 2007 and 2008, there was a huge increase in the price of food and energy. The IMF's food price index increased by more than 80 per cent between the start of 2007 and the middle of 2008. Combined with lower incomes due to the global economic slowdown, high food prices led to the number of chronically malnourished people increasing by 75 million in 2007 and a further 40 million in 2008.¹ This risk to consumers in the developing world remains; the FAO Food Price Index has reached record levels for the last 8 consecutive months, surpassing those of 2008.²
3. While a range of factors has contributed to these food price rises financial speculation on agricultural commodity derivatives has had a significant impact. According to Barclays Capital, about \$320bn of institutional and retail money is now invested in commodities (not including hedge funds) compared with only \$6bn a decade ago. Speculation rides on the back of underlying changes in supply and demand, amplifying their impact on price. **This speculation continues to impact on price, and as long as it remains unregulated, there is a danger it will contribute to a huge price spike in the future.**
4. The impact of this financial speculation has been recognised by a wide range of institutions and academics including the UN Special Rapporteur on the Right to Food³, UN Conference on Trade Aid and Development (UNCTAD)^{4,5}, the Director-General of the U.N.'s Food and Agriculture Organisation (FAO), Jacques Diouf⁶, the World Development Movement⁷ and many others.^{8,9,10}
5. According to an analysis of CFTC reports and other data, from 1998 to 2008, *"physical hedger positions have risen 90%. During this same time, speculator positions have grown by more than 1300%."*¹¹ These traders frequently make trading decisions based on portfolio concerns, such as trends in stocks or currencies, rather than on information regarding the fundamentals of the underlying asset. The effect of these market participants is to decrease the correlation between derivative prices and physical market fundamentals, and to increase volatility through momentum trading and certain forms of technical analysis.¹²

6. WDM believes that introducing aggregate position limits in commodity derivative markets is the most effective way to reduce the negative impacts of excessive commodity speculation. Aggregate position limits can reduce the impact of financial players in the price discovery functions of these markets and help to reduce excessive volatility. **WDM strongly urges the Commission to implement the proposed rules regarding aggregate speculative position limits.**
7. The Dodd-Frank Act included provision for exemptions from the proposed aggregate position limits for “bona fide hedgers” and it is vital that the Commission defines this in the strictest possible sense. **Bona fide hedging should only include activities by commercial businesses that deal with physical commodities that use derivative markets to hedge commercial risks in those commodities.** The rule should also aim to prevent firms who hedge commercial risk using the exemption to take part in excessive speculative trading; such exemptions should be examined on a case by case basis and justified against specific criteria.
8. **Financial speculators such as banks, hedge funds, mutual funds, private equity firms and other passive financial investors in commodities must not be allowed exemptions as bona fide hedgers.** Institutions seeking to hedge exposure to commodity markets through investment vehicles such as ETFs, ETNs or commodity index swaps must also not be allowed exemptions as bona fide hedgers.
9. It is vital that the Commission takes strong action in introducing effective aggregate position limits to reduce the risk of regulatory arbitrage between the US and the EU. Earlier this year the European Commission undertook a consultation on the review of the Markets in Financial Instruments Directive (MiFID) which included provisions for introducing position limits in commodity derivative markets.¹³ In order to avoid opportunities for regulatory arbitrage, or decisions made in the US pre-judging proposals for regulation in Europe, it is vital that the Commission introduces the proposed aggregate position limits.
10. Finally, we would encourage the Commission to engage with its counterparts in other large and emerging financial and commodity markets, particularly those within the G20, to encourage the harmonisation of effective regulatory regimes on commodity derivatives at the global level.

References

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 - ⁴ UNCTAD (2009) *Trade and Development Report, 2009: Chapter II The Financialization of Commodity Markets*. United Nations. http://www.unctad.org/en/docs/tdr2009ch2_en.pdf
 - ⁵ UNCTAD (2009) *The Global Economic Crisis: Systemic Failures and Multilateral Remedies: Report by the UNCTAD Secretariat Task Force on Systemic Issues and Economic Cooperation*. http://www.unctad.org/en/docs/gds20091_en.pdf
 - ⁶ Kubota, Y. (2011) *FAO wants price curbs and warns of food crisis: report*. Reuters. 25/01/11. <http://www.reuters.com/article/2011/01/25/us-fao-food-inflation-idUSTRE700AJ20110125>

⁷ World Development Movement (2010) *The Great Hunger Lottery*

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⁸ FAO (2010) *Final Report of the Committee on Commodity Problems Extraordinary Joint Intersessional Meeting of the Intergovernmental Group (IGG) on Grains and the Intergovernmental Group on Rice*. 24/09/10.

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⁹ United States Senate, Permanent Subcommittee on Investigations (2009): *Excessive Speculation in the Wheat Market*.

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¹¹ Michael Masters and Adam White, *How Institutional Investors Are Driving Up Food and Energy Prices*,. The Accidental Hunt Brothers. 31/07/08.

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¹² UNCTAD (2009) *Trade and Development Report, 2009: Chapter II The Financialization of Commodity Markets*. United Nations. http://www.unctad.org/en/docs/trd2009ch2_en.pdf

¹³ European Commission (2010) *Public consultation: Review of the Markets in Financial Instruments Directive (MiFID)*

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