MP Briefing

Tackling hunger and protecting consumers

Curbing excessive speculation on food

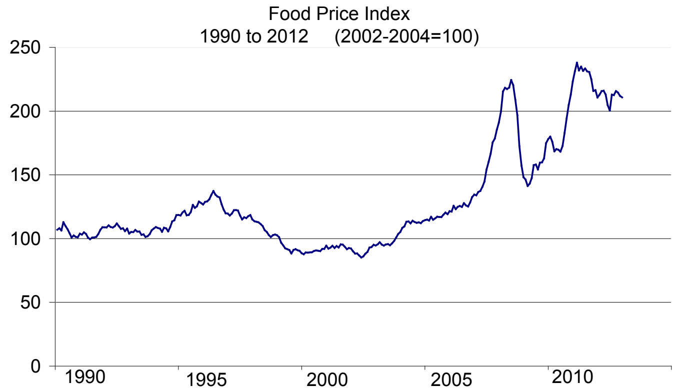
April 2013

World Development Movement
Justice for the world's poor

- Excessive financial speculation in food commodity derivatives has significantly increased price volatility and inflation for staple foods. This has had negative impacts for consumers and businesses in the UK and has contributed to significant increases in hunger and poverty globally.
- This effect was most clearly seen in the food crisis in 2007-2008, when the price of maize rose by 180 per cent. Speculation continues to contribute to food price spikes with food prices reaching record highs during 2011.
- The US has enacted new regulations to curb excessive speculation on food but the implementation is being delayed by legal action from the financial lobby. The EU is in the process of agreeing new regulations. It is vital for the UK government to support effective international legislation rather than promoting failed self-regulation.

High and volatile food prices

In 2008, food prices reached record levels rising 80 per cent in 18 months then declining rapidly. Since 2009 prices have climbed again reaching a new record peak in early 2011 and have been at high levels since.



Such increases have a disastrous effect on low income households everywhere. The 2007-2008 food price crisis pushed the number of hungry people worldwide to over one billion. In the last six months of 2010 alone, 44 million people were pushed into extreme poverty by rising food prices. As a result, over 16 per cent of people in developing countries and one third of the population of sub-Saharan Africa do not have enough food.

The increased price of food also led to households eating less fruit, vegetables, dairy and meat; reducing savings; selling assets or taking out loans and reducing spending on 'luxuries' such as healthcare, education or family planning. Consolata M Kiswili, a farmer from the Makueni district in Kenya, said that when prices rose: *"I had to sell everything I had just to be able to feed myself and my four children. My last remaining cow was so wasted from drought and lack of food, I had to sell it for a mere 300 shillings (c. £2.00)."*

The cause of high volatility – excessive speculation

Between 1996-2011, financial speculators' share of major commodity derivative markets for basic foods such as wheat has risen from 12 to over 60 per cent. Meanwhile, the value of assets held by financial institutions has nearly doubled from US$65 billion to $126 billion between 2006-2011.

Research by the UN Special Rapporteur on the Right to Food, UN Conference on Trade, Aid and Development (UNCTAD), the World Development Movement and others demonstrates the central role of financial speculators in the 2007-2008 food crisis and other recent price spikes. These reports found that the scale of the increase in food prices seen in 2007-2008 was due to financial speculation in commodity markets. Indeed, some academics argue that recent food price volatility is more closely correlated with activity in

"Without any real supply or demand issues we are witness to the fact that most agricultural food commodities are at record highs at once, and coffee is at a 34-year high. Through financial speculation ...the commodities market is in a very unfortunate position."
Howard Schultz,
Chief Executive, Starbucks Coffee Company

"It is deeply alarming that the greatest proportion of activity in the futures markets no longer involves those in the supply chain but is, instead, taken up by speculators. Food commodities are too important to be played about with by day traders and speculators."
Nigel Miller,
President, National Farmers Union, Scotland

financial markets than with agricultural supply and demand.

The influence of financial speculators is not just limited to the 2007-2008 food crisis. In June 2011, a report for the G20 by international organisations including the IMF and the OECD noted that "too much speculation can cause frequent and erratic price changes" in futures markets. A panel of experts for the UN Food and Agriculture Organisation went further, stating that "tighter regulation of speculation is necessary." A 2013 research paper by ETH Zürich and UNCTAD found that "At least 60–70% of commodity price changes are now due to self-generated activities" on financial markets. This further supports the body of evidence that excessive financial speculation is playing a major role in distorting commodity prices.

While there is a role for some speculation in these markets to provide buyers and sellers of food with trading partners to hedge their risk, such levels have been far exceeded and speculation is now fuelling price volatility. Speculation is undermining the basic functions of commodity derivative markets; the hedging of price risk by commercial traders and acting as a benchmark for food prices in the physical markets.

An opportunity to address excessive food speculation

In the US, the Dodd–Frank Act introduced measures intended to address excessive commodity speculation. Provisions include mandatory exchange trading of derivatives that had previously been traded in unregulated bilateral deals (over-the-counter) and position limits across commodity markets. The implementation is being delayed by legal action from the financial lobby but the US regulator is confident that these provisions can be enforced. The EU needs to introduce similarly robust regulation so that Europe does not become an under-regulated venue for commodity speculation.

What can MPs do?

In order to achieve food security for the world's poorest people and to ensure that speculation does not contribute to increasing price inflation and volatility, MPs should ask the chancellor to support regulation through the review of the EU's 'Markets in Financial Instruments Directive' that:

- Requires exchange trading of the vast majority, if not all, commodity derivatives on regulated trading venues, in the same way that shares are traded on the stock market. This will increase market transparency and regulatory oversight.
- Requires position reporting by all commodity derivative traders, so that regulators know how many contracts of what type are held by each market participant at any one time.
- Introduces fixed position limits; caps on the amount of the market that can be held by any individual or group of traders, such as financial speculators. This would effectively prevent financial speculators dominating the futures market and distorting prices. Alternative arrangements such as 'position management' should only be allowed in addition to (not instead of) limits, as alone they would not effectively limit the role of financial speculators.

References:

1 World Development Movement. (2011). Broken Markets. www.wdm.org.uk/broken-markets.

2 World Development Movement. (2010). The Great Hunger Lottery. http://www.wdm.org.uk/food-speculation/great-hunger-lottery

3 De Schutter, O. (2010). Food Commodities Speculation and Food Price Crisis. UN Special Rapporteur on the Right to Food.

4 UNCTAD (2009). Trade and development report 2009. Chapter II: The financialization of commodity markets. UNCTAD.

5 FAO et al. (2011). Price Volatility in Food and Agricultural Markets: Policy Responses. FAO.

6 High Level Panel of Experts on Food Security and Nutrition. (2011). Price volatility and food security. FAO.

7 UNCTAD. (2011). Price formation in financialized commodity markets: The role of information. UNCTAD.

For further information, contact: Heidi Chow | heidi.chow@wdm.org.uk | +44 (0)20 7820 4900
More detailed information and reports are available at www.wdm.org.uk/food

FD BF 170413

World Development Movement

The World Development Movement campaigns against the root causes of poverty. Working in solidarity with activists around the world, we oppose injustice and challenge the policies and institutions which keep people poor.

World Development Movement, 66 Offley Road, London SW9 0LS
t: 020 7820 4900 e: wdm@wdm.org.uk w: www.wdm.org.uk