

Casino of Hunger

**How Wall Street Speculators
Fueled the Global Food Crisis**

food&waterwatch





About Food & Water Watch

Food & Water Watch is a non-profit organization working with grassroots organizations around the world to create an economically and environmentally viable future. Through research, public and policymaker education, media and lobbying, we advocate policies that guarantee safe, wholesome food produced in a humane and sustainable manner and public, rather than private, control of water resources including oceans, rivers and groundwater. For more information, visit www.foodandwaterwatch.org.

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Executive Summary

During 2008, rising food prices — accelerated by an unprecedented run-up of prices on the commodities futures markets — created a food crisis that increased global hunger, sparked civil unrest and hurt farmers in America and worldwide. The global food crisis is an overlooked symptom of the broader global economic crisis. The food crisis shares many characteristics of the financial meltdown — it was exacerbated by the deregulation of the commodity markets (including agriculture) that encouraged a tidal wave of Wall Street speculation — leading to further increases in already rising food and energy prices.

The commodity futures market provides a vital link between farmers and the buyers of agricultural products like meatpackers, flour mills and food manufacturers. On the most basic level, the commodity futures market is a way for farmers to avoid having to sell their crops at harvest times, when the supply is high and the price is low. Instead, farmers can market their crops before they are harvested through a futures contract to lock in a price they hope will be better, or at least more predictable, than what they would get at harvest time. On the flip side, the buyers of agricultural products can ensure they have a steady supply of crops like corn or wheat at a certain price. The commodity futures market allows both the seller (farmer) and buyer (food manufacturer) to reduce their risk from volatile prices and uncertain supplies — allowing both to hedge their bets.

Over the past two decades, the safeguards that prevented excessive speculation from distorting the futures markets were eroded or eliminated. The commodity markets that provided an arena for producers of raw commodities like corn, wheat, oil and metals to find buyers were largely transformed into markets that traded new financial products. The New Deal-era regulations that were supposed to prevent excess speculation on food commodities were weakened to allow more Wall Street investment houses to pour money onto the commodity exchanges and new, unregulated or self-regulated electronic markets cropped up outside the authority of government oversight. As the housing and stock markets stalled in 2007 and 2008, more money migrated into the commodities markets.

This flood of new speculative investments from Wall Street drove up demand on paper for agricultural and energy commodities, creating a bidding war that pitted food processors and agricultural companies against investment firms that had no intention of ever taking delivery of a load of corn, beans or wheat. The result was that food prices (and gasoline prices that were caught in the same speculative trends) rose dramatically. Commodity Futures Trading Commission Chairman Gary Gensler told the U.S. Senate in 2009, “I believe that increased speculation in energy and agricultural products has hurt farmers and consumers.”¹

The 2008 food price explosion created a humanitarian crisis in the developing world. The stark escalation in food prices arose from tight agricultural supplies and steadily rising demand for food and feed. This price escalation became superheated with the addition of hundreds of billions of speculative dollars in commodity markets. This excess speculation can and should be squeezed out of the marketplace. This issue brief discusses the role of commodities markets in setting food prices, how sensible safeguards were dismantled and eroded, how giant new investors drove the rise in food global food prices, and the common-sense reforms needed to stop Wall Street from gambling on hunger.



Food Crisis of 2007-2008

During 2008, real food prices reached near-record highs. The commodity price escalation between 2002 and 2008 was the steepest, most pronounced commodity price surge in decades — prices were higher for more commodities and for a longer period of time.² The international price of corn, wheat and rice skyrocketed between January 2005 and the spring of 2008.³ The export price of U.S. corn tripled from \$94 a metric tonne at the start of 2005 to \$281 per tonne in May 2008. U.S. hard winter wheat prices more than tripled from \$154 per metric tonne in January 2005 to \$482 per tonne in February 2008. Thai broken rice prices also topped out in May at \$397 per metric tonne, nearly tripling from a \$143 per metric tonne in January 2005.

The 2008 food price increases closely followed record-breaking prices in the commodity futures markets. In February, wheat futures prices on the major Chicago commodity exchange reached a record \$13 per bushel; in April, rice futures hit a record \$24.46 per bushel; in June, Chicago corn futures rose to \$7.625 per bushel; and in July, soybeans and oats hit a record \$16.60 and \$4.55 per bushel, respectively.⁴ The 2008 price run-up was accompanied by price volatility on commodity markets that was higher than any time on record.⁵ In early 2008, wheat and soybean volatility was triple the historical levels and corn price volatility was twice as high.⁶

These commodity market price increases did not stay confined to financial markets. Food processing companies, like breakfast cereal manufacturers, ended up competing against giant investment firms on inflated commodities auctions to buy corn and wheat contracts, which drove up grocery prices for consumers. Higher food prices in America hurt families struggling to make ends meet, especially during the economic crisis. U.S. grocery store food prices rose by 6.6 percent in 2008, the biggest increase since 1980, and cereal and bakery prices rose by 11.7 percent.⁷

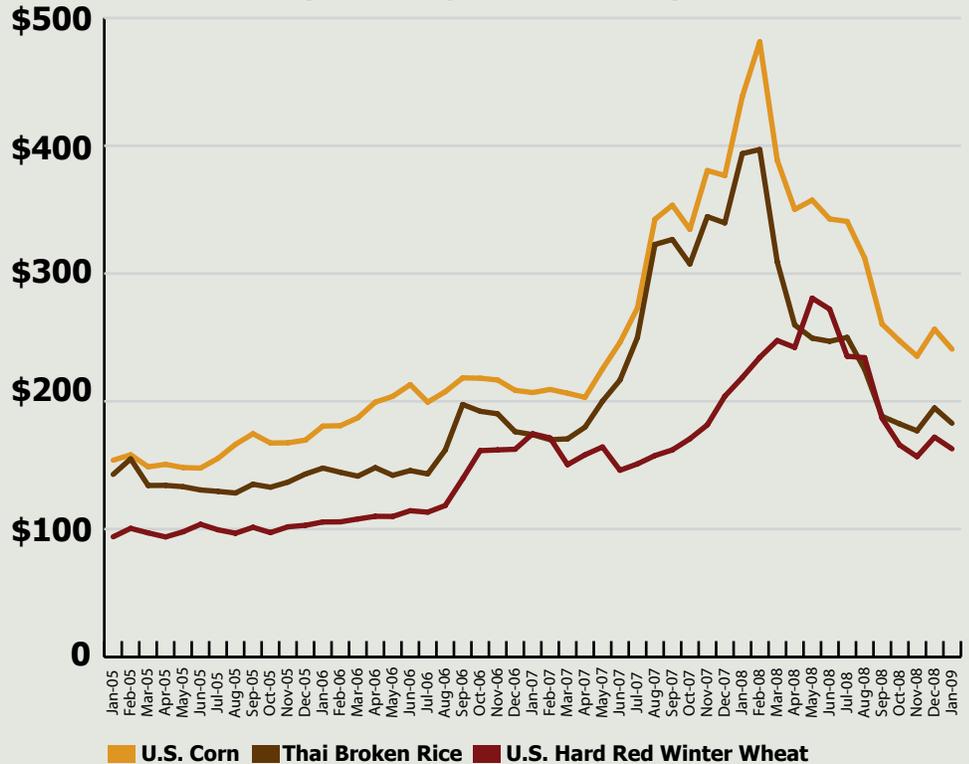
In the developing world, rising food prices can be calamitous because many families spend more than half their income on food; the poorest families spend nearly three quarters of their income on food.⁸ According to the International Food Policy Research Institute, commodity speculation can fuel “unwanted price fluctuations that can harm the poor and result in long-term, irreversible nutritional damage, especially among children.”⁹ During 2008, the United Nations Food and Agriculture Organization estimated that the high price of food made an additional 130 million people worldwide malnourished.¹⁰ Skyrocketing food prices fueled civil unrest and riots from Bolivia to Cameroon to Indonesia that threatened the stability of 33 countries.¹¹ In April 2008, the Haitian government collapsed after more than a week of rioting over high food prices.¹²

By late 2008, agricultural prices declined more suddenly than they had risen — but settled at higher levels than before the gambling began.¹³ Even when global export prices began to moderate in late 2008, the prices for consumers in the developing world remained high or only moderated very slightly, while in many places retail prices continued to rise long after world export prices fell.¹⁴

Commodity Speculation Worsened Market Factors Causing Price Rise

Speculation alone did not cause rising food prices, but rampant commodity speculation helped drive surging prices during 2007 to 2008. Increased inflows of Wall Street investment dollars exacerbated the underlying market trends and already-rising prices. Several years of poor weather conditions around the world flattened harvests and created supply disruptions going into 2008.¹⁵ Higher demand from biofuel refineries in industrialized countries as well as the increasing buying

Commodity Export Prices
(in Dollars per Metric Tonne)



Source: UN FAO

power of consumers in rapidly expanding economies drove up demand.¹⁶ These market forces provided the foundation for food price increases. The surge in speculative agricultural commodity investments accelerated the trend.

During the first half of 2008, before the seriousness of the global economic slowdown was appreciated, investors and regulators disputed that speculation pushed commodity prices higher. In April 2008, Bush appointees at the Commodity Futures Trading Commission largely denied that excessive speculation was occurring in the commodities markets and downplayed the impact of speculative investment surges on the price of commodities.¹⁷ In October 2008, the International Monetary Fund reported “there is little concrete evidence that rising speculation or increased investor interest in commodities as alternative assets had a systemic or lasting impact on prices.”¹⁸ A task force created by international commodity and stock market regulators commented in 2009 that “economic

fundamentals [such as changes in supply and demand], rather than speculative activity, are a plausible explanation for recent price changes.”¹⁹

While changes in agricultural supply and demand explain some of the conditions that would make food prices rise, the rapid rise in prices across all farm commodities cannot be explained by market fundamentals alone. The chaotic market conditions between 2007 and 2009 make it difficult to untangle the factors that contributed to skyrocketing commodity prices. But as the market-oriented International Food Policy Research Institute noted, “Changes in supply and demand fundamentals cannot fully explain the recent drastic increase in food prices.”²⁰

The biggest change from normal conditions in earlier years was the addition of hundreds of billions of dollars in investment money into the commodity futures markets. The United Nations Conference on Trade and Development noted, “a major new element in commodity trading over the past few years is the greater weight on commodity futures exchanges of financial investors that consider commodities an asset class.”²¹ The additional excess speculation has magnified the volatility in food-staple prices that has contributed to the global food crisis and increased poverty.²²



The Role of Commodity Futures Markets

The commodity futures market provides two basic functions to the agricultural economy: risk management and price discovery. A futures contract is an agreement to buy or sell a physical commodity for delivery in the future.²³ Although these contracts are for future delivery of a commodity (5,000 bushels of wheat, for example), most contracts are not bought with the intention of actually taking delivery of the commodity (by a bakery company, perhaps). Instead they are exchanged for other contracts or sold.²⁴

Agricultural futures markets developed over a century ago to help sellers (farmers) and buyers (food manufacturers) ensure long-term access to markets (for farmers) and needed inputs (for food companies) at mutually acceptable prices. The futures market allows two parties — say a farmer-owned grain elevator and flour-milling factory — to agree to buy and sell a specified product for delivery in the future at a fixed price. Since crop prices are low at harvest time when supplies are greatest but higher the rest of the year when supplies dwindle, futures contracts can mitigate these seasonal ups and downs by allowing farmer sellers and food industry buyers to lock in prices well in advance of the time of sale.²⁵ The futures market provides a venue for farmers and food companies to manage (or hedge) their business risks.

For example, a food processing company might agree to buy 500 railroad cars full of corn in six months at a fixed price to guarantee a supply of a needed input (especially if the company thinks that the price will rise by the time it eventually needs the corn) and a grain elevator would agree to sell corn in the future to ensure it can eventually move its inventory (especially if it thought the price of corn would fall). By locking in a price, farmers, grain elevators, flour mills and bakery companies manage risks, investments and budgets and ideally stabilize costs and revenues.²⁶

Many homeowners that use home heating oil effectively enter the futures markets if they choose to lock in their winter heating oil contracts during the previous summer. Because these homeowners are purchasing heating oil well in advance of its delivery, they are locking in a futures price. If home heating oil



A Midwestern grain elevator. Photo by William Schenold/Stock.Xchng.

is more expensive during the winter months (which it often is), the homeowner has hedged their price risk. However, if the price of heating oil falls during the winter, the homeowner might be locked in at a higher price.

The other function of futures markets is supposed to be to discover what price the market will bear. The futures market brings together buyers and sellers that closely monitor current and future market conditions. The market essentially condenses the opinions of these market participants over time and results in a price.²⁷ The classic example of the benefits of this price discovery function is the farmer who can make planting decisions in the spring based on the prevailing futures contract prices (the prices he can expect to receive in the future).²⁸

These vital market functions can only work efficiently for farmers and food manufacturers with strong regulatory safeguards. The New Deal established sensible safeguards to prevent excessive speculation in commodities markets after the commodities market meltdown during the Depression. Well-regulated commodity markets prevent market manipulation and fraud as well as offer transparent price information to buyers and sellers. Regulated exchanges also require

participants to provide collateral or a deposit (called margin accounts) to ensure that buyers and sellers will fulfill their obligations. The agency responsible for policing these futures markets is the Commodity Futures Trading Commission. As CFTC Commissioner Bart Chilton noted, “It’s our sworn job to protect price discovery and to root out any fraud, abuse, manipulation, whether or not it’s speculators or hedgers.”²⁹

Deregulation Allowed Speculation to Bloom

The risk management and price discovery functions of the commodity futures markets worked fairly well when the market primarily traded physical commodities like wheat, oil or copper. But starting in the 1980s, the financial industry began to introduce new products like interest rate and currency futures and other financial derivatives that functioned like physical commodity futures — buyers and sellers took positions based on long-term financial trends for fixed-duration contracts. As the volume of financial futures contracts increased, regulators spent more of their time regulating financial futures and the necessary oversight and safeguards for agricultural commodities fell by the wayside.

The hands-off regulatory approach blurred the distinction between the physical hedgers (like farmers or flour mills) in the agricultural commodities futures markets and the speculators that dominated the financial futures markets. The CFTC effectively removed the position limits on large speculators in agricultural markets (see more on position limits in the next section), and allowed some futures exchanges to become self-regulated or even unregulated. Even while the rules were being weakened and the volume of contracts was growing, the CFTC pulled cops off the regulatory beat. The number of CFTC employees fell by nearly a fifth, from about 550 staff members in 1999 to 458 staff members in 2007, while the volume of contracts traded on CFTC regulated markets grew five-fold from 1998 to 2007.³⁰

Blurring the Distinction Between Physical Hedgers and Wall Street Money Managers

Before the mid-1980s, commodity traders were divided between commercial traders that had a physical interaction with the commodity they were trading — baking companies buying wheat or farmers selling it — or non-commercial traders that had no interest in the physical commodity but provided liquidity by taking the opposite position to the commercial traders — buying grain futures from elevators and selling contracts to food processors, for example.³¹ Most of these non-commercial speculators in commodity markets were once smaller agricultural futures traders that had knowledge of agriculture and the grain marketplace.³²

Non-commercial traders were subject to limits on the number of contract positions they could legally take on the regulated futures markets. Position limits set a cap on the number of agricultural futures contracts (either a buy or a sell position) a commodities trader can take. These limits were designed to keep investors without an interest in the physical commodity from dominating the marketplace, without limiting necessary trading by grain elevators, food processors and meatpackers. Speculative position limits were first established in 1936 to prevent excess speculation from creating extreme volatility in agricultural prices.³³ Position limits are applied to corn, wheat, oats, cotton, soybeans, soybean oil and soybean meal.³⁴

Between the early 1990s and the 2008 food crisis, the CFTC blurred the distinction between those with a physical interest in the commodity and those with financial interest in the commodity, treating large, purely speculative investment banks and money managers the same as farmers, grain elevators and food processors. The regulations provided expanded exemptions to speculative position limits beyond just farmers and grain-milling companies to include many managed money firms and commodity swaps dealers that were managing their financial risks.³⁵ By 2006, the non-traditional hedgers that were granted position limits exemptions represented a significant share of the long-term futures contracts.³⁶

Even while the rules were being weakened and the volume of contracts was growing, the CFTC pulled cops off the regulatory beat.

At the same time, the more complex financial derivatives — involving interest rate or currency swaps — became more common. The CFTC began to view agricultural futures contracts as just another financial instrument, and effectively dismantled the safeguards that prevented excess speculation in agricultural commodities. In 1987, the CFTC decided that many of the financial companies that were operating in the futures markets — especially in financial futures contracts — were effectively hedgers, just like grain-milling companies or grain elevators, and should be considered commercial traders.³⁷ In 1991, the CFTC exempted commodity-based swaps dealers that used real commodity contracts to sell commodity index funds on the over-the-counter (OTC) swaps markets.³⁸ These changes effectively exempted many financial firms that traded on the commodity futures markets from any position limits and allowed large financial speculators to dominate agricultural and food commodity markets.

Financial Terms

Commodity index funds: Index funds track a basket of commodity prices, much like a mutual fund tracks a basket of stocks.

Commodity futures contract: A futures contract is an agreement to buy or sell a physical commodity for delivery in the future.³⁹ Although these contracts are for future delivery of a commodity (5,000 bushels of wheat, for example), most contracts are not bought with the intention of actually taking delivery (by a bakery company, perhaps). Instead they are exchanged or sold for other contracts.⁴⁰ Futures contracts are most commonly for terms of two years or less.⁴¹

Derivatives: Investment instruments including futures, options and swaps that are based (or derived) on the performance of an underlying asset. For example, corn futures contracts are based on the value or anticipated value of a future delivery of actual corn.⁴²

Financial derivatives and swaps: Non-exchange traded contracts that trade different currencies or interest rate positions between parties. One party, for example, might swap U.S. Treasury Bill interest rates for the London Interbank Offer Rate interest rate over a certain period. These swaps derive value from parties that assume the relative interest rates of the two underlying metrics will converge or diverge over the life of the contract, say 90 days or six months or as long as 10 years.⁴³ These swaps are managed by swaps dealers, most often giant banks that accept the credit risks for the parties negotiating the swaps contract. These are essentially bets on which direction specific financial instruments or measurements (like interest rates) will take.

Open interest: The number of outstanding contracts held by investors, which is a measurement of demand for commodity contracts.⁴⁵

Spot market: Cash markets where physical commodities are bought and sold for immediate delivery, like livestock salesbarns where the actual cash price is determined.⁴⁶



Photo of the Chicago Mercantile Exchange by Liz Noise.

Unregulated Over-the-Counter Market Swamps Commodities Markets

Prior to 2000, the CFTC generally required commodity futures trading to occur on fully regulated exchanges.⁴⁷ These exchanges, like the Chicago Mercantile Exchange and the Chicago Board of Trade (now both the CME Group), operate under established rules and regulations. The exchange itself acts as a financial intermediary between buyers and sellers, sets margin requirements (collateral deposits that ensure buyers and sellers can fulfill their contracts) and reports real time trading data to the CFTC.

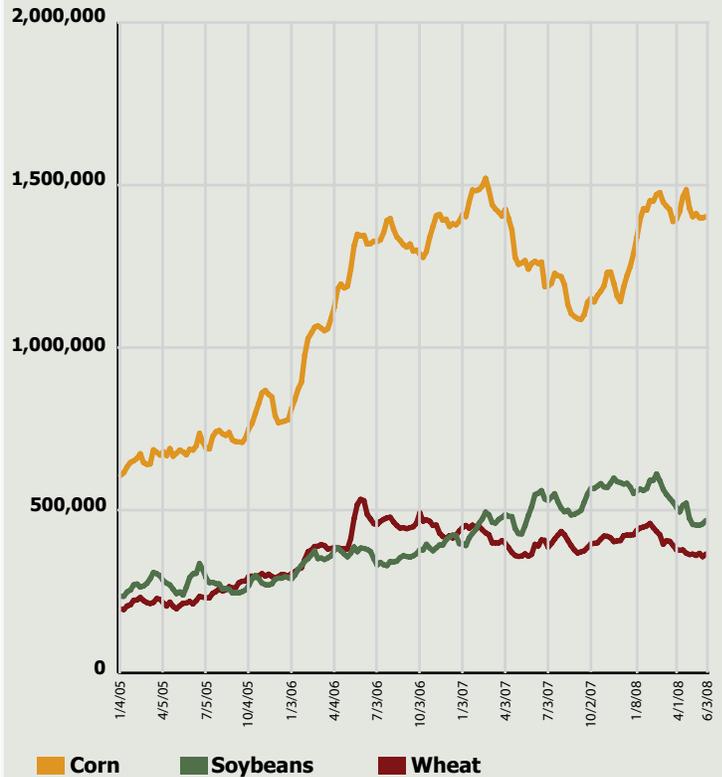
The growth of the financial derivatives market was largely outside these regulated exchanges — most of these derivatives contracts were between investors and large investment banks. These “over-the-counter” trades are essentially private contracts between sellers and buyers of these derivatives contracts. These contracts do not require collateral or margin and are not required to report to the CFTC.⁴⁸ The two sides of these trades generally occur on self-regulated electronic markets or between the two parties over the telephone.

The Commodity Futures Modernization Act of 2000 explicitly permitted off-exchange, self-regulated futures trading in certain electronic and foreign exchanges as well as completely unregulated over-the-counter (OTC) trading.⁴⁹ The 2000 legislation was intended to foster innovation in the futures and derivatives markets and to encourage new types of financial instruments to be traded commercially.⁵⁰

The over-the-counter market is enormous. In June 2008, outstanding OTC contracts amounted to \$684 trillion.⁵¹ The share of commodity trading in the OTC market is small (about one in 50 contracts) but it has more than tripled from 1998 to 2006.⁵² Even this small share amounts to significant activity on the OTC market can have a large impact on the relatively small agricultural commodity markets. The total value of OTC commodity contracts (including metals, energy and agricultural commodities) was \$13 trillion in mid-2008, compared to \$835 billion in outstanding commodities contracts on the U.S. regulated exchanges.⁵³

Blurring the distinction between physical hedgers and financial investors as well as allowing an unregulated swaps market to thrive encouraged more investors to enter the commodities market. Managed money funds could and did trade and invest in both the regulated exchanges and the OTC market. Investment banks were hedging their investments in financial derivatives with agricultural futures contracts. The weakening of position limits allowed more Wall Street firms to trade and hold large pools of agricultural commodity futures contracts. Both of these deregulatory factors allowed a tidal wave of new investors and funds into the agricultural commodity markets which significantly increased demand — artificial demand — for physical commodities, which led to inflationary price pressures.⁵⁴

Weekly Futures Open Interest: Number of Contracts per Week



Source: CFTC CoT reports



Increase in Futures Investment

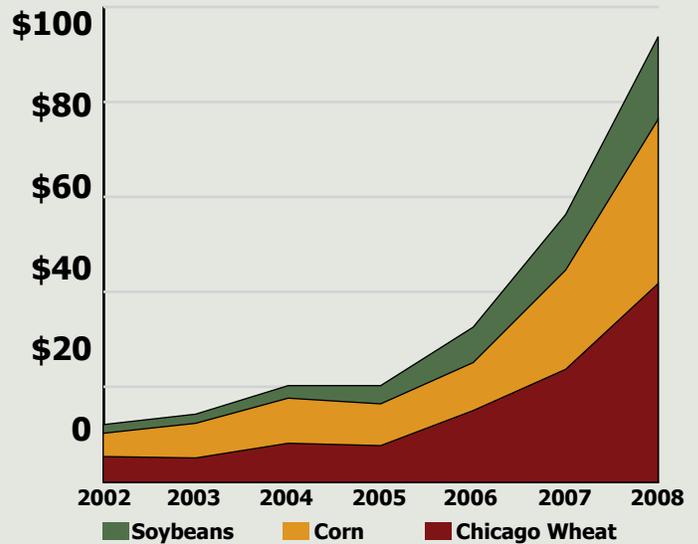
Over the past decade, the total volume of commodity futures trading increased more than five-fold.⁵⁵ The number of futures and futures options contracts for all commodities (including oil and metals) traded on regulated exchanges grew from 630 million contracts in 1998 to 3.75 billion contracts in July 2008.⁵⁶

Agricultural commodities have seen a significant increase in both the volume of trading (the number of contracts that are sold back and forth) and the total number of contracts that are held by hedgers and investors (known as open interest). Between 1998 and 2007, the number of large futures trading companies that trade in wheat and corn on the Chicago exchange grew by 116 and 43 percent, respectively.⁵⁷ Prior to 2005, the volume of agricultural commodity trading and the number of open-interest contracts were fairly steady, in part because these futures contracts were mostly used by agricultural commercial traders with a physical interest in the contracts. Starting in 2006, both the volume of trading and the level of open interest began to rise significantly for agricultural commodities.

The number of investment contracts in corn, wheat and soybeans grew rapidly in the past few years. Between 1998 and mid-March 2008, when prices for most commodities hit near-peak levels, the combined open interest (the contracts held as investments by speculators) in corn, wheat and soybean futures quadrupled. The steepest increase was during the price acceleration that caused the 2008 global food crisis. Between 2006 and mid-March 2008, the open interest in corn, wheat and soybeans doubled from about 1 million contracts to about 2.4 million contracts.⁵⁸ The surging volume of investments artificially increased demand for food on the commodities markets, which pushed food prices higher in the grocery stores and on the international markets.

The value of the open-interest positions grew as more contracts were held and the price of the contracts rose. The value of open-interest positions for corn, wheat and soybeans traded on the Chicago exchange averaged \$17 billion between 2002 and 2005, but between 2006 and 2008 the value of the open-interest positions in these three crops nearly tripled, rising from \$33 billion in 2006 to \$94 billion in 2008.⁵⁹

Value of Open Interest
(in Billions of Dollars)



Source: Accidental Hunt Brothers 2008

The daily volume of trading for these three commodities increased as well — suggesting that more traders were actively selling futures back and forth, potentially increasing the speculative commodities inflation in the market. Prior to 2004, about 100,000 corn and wheat contracts combined were traded on the Chicago exchange.⁶⁰ But between January 2006 and June 2008, the combined average daily volume of corn and wheat contracts nearly tripled from about 175,000 contracts to more than 450,000 contracts.⁶¹ The average daily volume of soybean contracts (for soybeans, soy meal and soy oil combined) also nearly tripled, growing from about 125,000 contracts in January 2006 to just under 325,000 contracts in June 2008.⁶²

New Index Funds Pour Investment Dollars into Agricultural Commodities

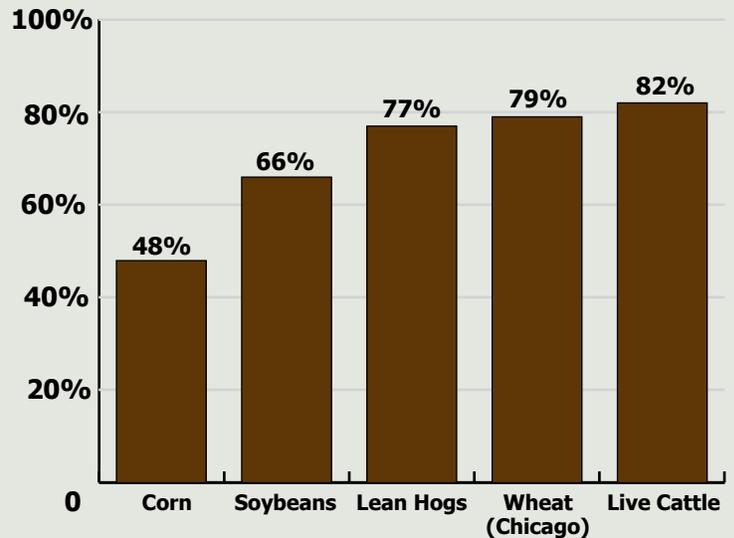
Since the housing market began to implode in 2007, investors began to move into the commodity market to diversify their portfolios, motivated especially by moving into a market that was not evaporating in value. These investors were treating commodities as another type of asset, just like investing in stocks, bonds or real estate.⁶³ The rise in new investors drove up prices for consumers. Dan Basse, president of AgResources research firm, told the *New York Times*

that “The cost from the farm to the grocer is elevated because of the volatility from these [index investment] funds. It will raise the cost for everybody, including the consumer.”⁶⁴

To gain access to the commodity markets’ appreciating value, Wall Street investment banks developed commodity index funds that simulated investing directly in the commodity markets. These index funds track a basket of commodity prices, much like a mutual fund tracks a basket of stocks. Most of the investments in commodity index funds are large pools of money like pension plans, endowments, sovereign wealth funds and hedge funds.⁶⁵

Index fund traders represent institutional investors like pension plans and university endowments that have long-term investment goals, so these funds employ a buy-and-hold strategy commonly used on the stock market.⁶⁶ The long-term index fund investment horizon assumes the value of the commodities contracts will steadily rise over time. As a result, instead of both buying and selling agricultural commodity futures contracts, the funds overwhelmingly buy and hold contracts (taking what are known as long positions). Index funds represent a large portion

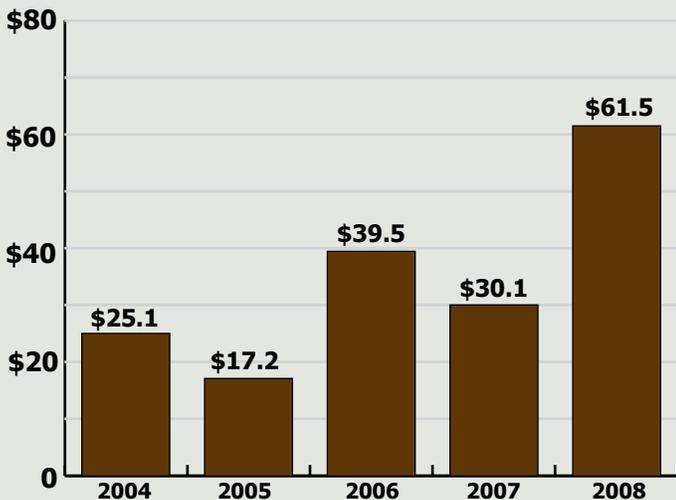
Index Fund Share of Contract Purchases (January 2003 – July 2008)



Source: Accidental Hunt Brothers 2008

of all long positions on the commodity markets. Index funds held about \$200 billion in long commodity positions in March of 2008 — more than a third of the \$568 billion total long positions.⁶⁷

Estimated S&P/Goldman Sachs and Dow Jones/AIG Commodity Index Fund Inflows (in Billions of Dollars)



Source: Accidental Hunt Brothers 2008

Importantly, the long-hold-focused institutional investors can push prices higher because these participants are not interested in selling their contracts for any price.⁶⁸ Having significant portions of the market unavailable for sale puts upward pressure on the remaining contracts, as more bidders are competing for fewer contracts for sale. In essence, these indefinitely long-term investments amount to “virtual hoarding” of agricultural products positions.⁶⁹

Although the number of index fund traders is small, on average they take very large positions in the commodities markets — sometimes 10 times higher than non-index traders.⁷⁰ The four largest financial swaps dealers (Goldman Sachs, Morgan Stanley, JP Morgan and Barclays Bank) controlled an estimated 70 percent of commodity index fund trading in 2008.⁷¹ Commodity index funds investments surged during the past five years. Investments in commodity index funds grew 20-fold from \$13 billion in 2003 to \$260 billion in March 2008.⁷²



Photo by Luiz Baltar/Stock.Xchng.

Two of the most popular indexes are the S&P Goldman Sachs Commodity Index and the Dow Jones-United Bank of Switzerland Commodity Index (formerly Dow Jones AIG Commodity Index).⁷³ These two indexes alone poured \$173 billion new investment dollars into the commodity markets, with annual inflows to these funds doubling from \$25 billion in 2004 to \$62 billion in 2008.⁷⁴ Farm commodities make up more than a quarter (26.3 percent) of these two weighted commodity indexes.⁷⁵

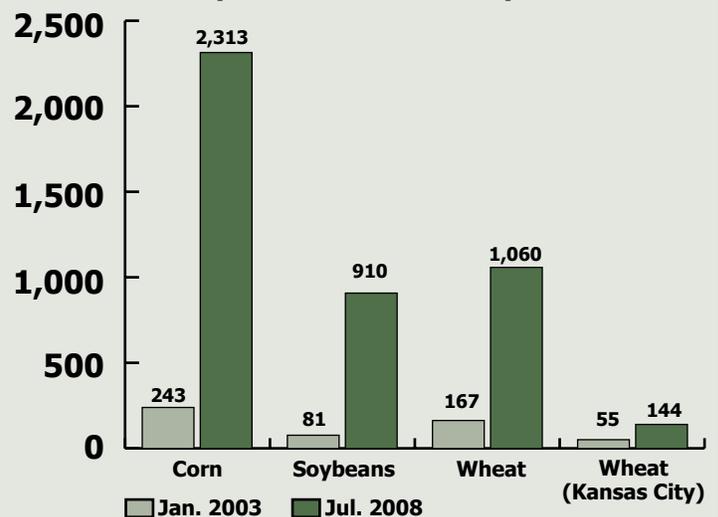
Commodity index fund investment in agricultural commodities rose sharply at the same time world food prices surged. Index fund investments in corn, soybeans, wheat, cattle and hogs has risen nearly five-fold from \$10 billion in 2006 to \$47 billion in 2008.⁷⁶ Index funds or investors can represent a significant chunk of the agricultural futures market. Between January 2007 and March 2008, index investment in all agricultural commodities represented nearly a third of the investments in these commodity futures contracts.⁷⁷ For many food commodity futures contracts, index funds purchases represented more than half the futures contract purchases. Between January 2003 and July 2008, four-fifths of live cattle and wheat contracts (82 percent and 79 percent, respectively), three-quarters of lean hogs contracts (77

percent), two-thirds of soybean contracts (66 percent) and nearly half of corn contracts (48 percent) were purchased by index funds.⁷⁸

This dominance by index fund purchasers effectively controlled large portions of food staples as global prices were rising. In 2007, index funds effectively purchased more than a third (36.6 percent) of the soybean crop and three-fifths (62.3 percent) of the wheat crop.⁷⁹ In 2008, index funds controlled nearly half (48.2 percent) of the wheat harvest, nearly a third (30.8 percent) of the soybean harvest and one-fifth (19.1 percent) of the corn harvest.⁸⁰ The U.S. Senate Permanent Subcommittee on Investigations reported that index investors in the wheat market rose seven-fold from 30,000 contracts a day in 2004 to 220,000 contracts a day in mid-2008 and this surging investment drove up the cost of wheat.⁸¹

Index funds are almost entirely long in agricultural commodities and represent an especially large share of long agricultural positions. In the corn market, index traders are 96 percent long and the index wheat traders in Chicago are 95 percent long.⁸² In September 2008, index investors represented nearly half of the long-buy positions in the Chicago futures exchanges for hogs, cattle and wheat (45 percent, 46 percent and 47 percent, respectively) and about a quarter of the corn and soybean contracts (22 percent and 28 percent).⁸³

Index Fund Agricultural Holdings (in Millions of Bushels)



Source: Accidental Hunt Brothers 2008

American Farmers Left in Lurch by Excess Speculation

Most farmers do not participate directly in the futures market. Instead they contract to sell their crops to local grain elevators or cooperatives that then sell these future crops on the futures markets. Elevators link farmers to the commodity markets and help growers manage their price risks.⁸⁴

All participants in the regulated commodity exchanges are required to post a margin for the contracts they are selling or buying — essentially a good-faith deposit that ensures that the trading parties will follow through on their contract. These margins are a percentage of the commodity futures price, so as the price changes, the margin requirement changes as well. When prices rise, grain elevators are required to add to their margin deposit account.

In 2008, as prices rose steadily, grain elevators were repeatedly required to replenish their margin deposits. In March 2008, almost a quarter of lenders reported that local grain elevators were having difficulty meeting their higher margin account requirements (known as margin calls), especially in the southern wheat belt of Kansas, Colorado, Oklahoma and New Mexico.⁸⁵ These elevators tapped their credit lines from banks to refill their margin accounts at the exchanges.⁸⁶

Farmers were having difficulty forward contracting with elevators and co-ops (selling their crops on contract in advance of the harvest) because these buyers were running out of credit needed to borrow funds from banks both to pay for future crops and to meet their margin calls on the futures market.⁸⁷ Some elevators and co-ops modified the marketing options they offer to farmers, including eliminating long-term forward sales or hedge contracts to producers.⁸⁸ In 2008, the Federal Reserve Bank of Kansas City found that a third of farmers reported that their regular crop buyer stopped all advance purchasing arrangements.⁸⁹ So as prices have risen, many farmers could not even sell their crops at these higher prices because elevators could not afford to buy the crops or meet margin requirements to sell the crops, and could not access enough credit to participate in the overheated futures market.



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Photo by Lars Sundström/Stock.Xchng.

Conclusions and Recommendations

Curbing excess speculation in agricultural commodity markets can protect consumers and farmers in the United States and worldwide. The 2008 food crisis was not caused by commodity speculation alone, but strong safeguards against commodity price inflation would reduce the wild price volatility that significantly contributed to the 2008 humanitarian crisis. The U.S. Congress has begun to address these issues over the past two years. As Congress takes up financial regulatory reform and commodities futures reform, any measure must prevent excess speculation in commodities markets from increasing global hunger, disadvantaging farmers and driving up grocery prices at U.S. supermarkets by:

Restoring strong aggregate position limits across all markets on financial firms, money managers and index funds to prevent financial speculators from flooding the marketplace and distorting prices. This would allow the CFTC to act when financial firms exceed position limits and create excess speculation in food commodities.⁹⁰ As CFTC Chairman Gary Gensler noted in his confirmation hearing: “Position limits must be applied consistently to all markets and trading platforms and exemptions to them must be limited and well defined.”⁹¹

Closing loopholes and clarifying distinctions between legitimate hedgers and financial speculators. The CFTC has already begun to eliminate position limit waivers for non-commercial traders. The CFTC and Congress should continue to eliminate these waivers and maintain a bright line between legitimate hedgers and financial speculators and close any remaining exemptions and loopholes.

Requiring that all futures contracts, including swaps and derivatives, trade on regulated exchanges. Congress should eliminate the self-regulated and unregulated over-the-counter markets to ensure that all trades are made on CFTC regulated exchanges. Exchange trading creates transparent markets for all participants, provides regulatory scrutiny for all trades and ensures that all trades have the same level of collateralized margin requirements.

Requiring real mandatory reporting of trading data for all exchanges. Regulators need access to real-time trading data across regulated exchanges, self-regulated exchanges and unregulated over-the-counter exchanges. Increased reporting requirements would give regulators the needed information to intervene if excess speculation began to drive commodity price bubbles across all trading platforms.⁹²

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