INSTITUTE FOR AGRICULTURE AND TRADE POLICY
COMMENTARY

Farm futures need financial reform

MINNEAPOLIS, JUNE 24, 2010 — Over the next few weeks, members of the Senate and House of Representatives will meet to iron out their differences in order to complete a historic financial reform bill. The final bill will cover a wide range of financial services, including credit cards, mortgages, payday loans and investment bank practices that affect all Minnesotans.

But a crucial chapter of the bill affects farmers and ranchers directly. That chapter resulted in part from hearings called by House Committee on Agriculture Chairman Collin Peterson beginning in the spring of 2008. As agriculture representatives ranging from the National Farmers Union to mega cotton trader William Dunevant told the committee, the commodity futures markets were broken for agriculture.

In 2008, futures prices had become so volatile that rural banks could not assess price risks in order to make loans. Some banks were not loaning to country elevators, and some of those elevators therefore could not pay farmers to forward contract their grain and oilseed production. A rural credit and farm cash-flow crisis was imminent. What had gone wrong in the futures markets and how could it be repaired?

As Chairman Peterson's hearings revealed, and subsequently a June 2009 Senate report on wheat speculation confirmed, the Bush administration had exempted favored financial firms from limits on the number of commodity market futures contracts that one entity could hold during a contract period. As a result The Brock Report estimated that Goldman Sachs and Morgan Stanley alone held about 1.5 billion bushels of Chicago Board of Trade corn contracts in March, while commercial hedgers, i.e., commodity users and traders, were limited to holding only 11 million bushels by Commodity Futures Trading Commission (CFTC) rules. This financial speculator "weight of money" greatly amplified the normal price volatility that can be traced to supply and demand related fundamentals.

In a remarkable feat of legislative engineering led by Chairman Peterson, on September 18, 2008, just days after the collapse of Lehman Brothers that triggered the global economic crisis, the House passed the Commodity Markets Transparency and Accountability Act of 2008. The bill set the standard for financial reform in Congress through new rules to make the markets transparent and accountable.

A chief target of the 2008 bill and subsequent financial reform proposals is over-the-counter (OTC) trading. OTC trades are not conducted on regulated exchanges, nor are their prices reported to the CFTC until long after they have influenced the market.

About Steve Suppan

Steve Suppan has been a policy analyst at IATP since 1994. Much of Steve's work is to explain U.S. agriculture, trade and food safety policy to foreign governments and nongovernmental organizations, especially farmer organizations. Steve has also represented IATP at meetings of the Codex Alimentarius Commission, the UN Commission on Sustainable Development, and the UN Food and Agriculture Organization.

About IATP

Institute for Agriculture and Trade Policy works locally and globally at the intersection of policy and practice to ensure fair and sustainable food, farm and trade systems. IATP is headquartered in Minneapolis, Minnesota with offices in Washington D.C. and Geneva.

OTC traders and dealers, such as Goldman Sachs, take advantage of exchange price information without contributing information to price discovery, a legal requirement for exchange traders. The Senate bill would greatly limit the ability of "too big to fail" banks and their corporate clients to trade OTC. Unfortunately, thanks to Finance Chair Barney Frank, the House bill now contains loopholes that would allow about 60 percent of OTC trades to be exempt from regulation, according to CFTC Chairman Gary Gensler.

Perhaps the most notorious OTC trades in commodities are those conducted through the Enron Loophole, which exempts all energy trades from position limits, resulting in extremely volatile energy prices. Gas, oil and diesel prices not only affect agricultural input prices, but agricultural futures prices as well—and therefore, prices paid to farmers. Commodity index funds bundle together futures contracts for energy, agriculture and metals. Most of these funds are heavily weighted toward energy contracts—e.g., the Goldman fund was about 70 percent energy dominant in 2008. So, when energy prices swing up or down, the smaller agricultural component of the index fund follows.

The Obama administration's CFTC has proposed a rule to close the Enron Loophole; but without a ban on OTC trading in agricultural contracts, the effect on agricultural prices will be minimal.

Why has it taken Congress so long to repair the commodity markets? More than a thousand financial services industry lobbyists—many of them former members of Congress or congressional staff—have fought for new loopholes to keep the gravy train running. Secondly, the House and Senate banking and agricultural committees both have responsibility over trading practices used in both the financial and commodity markets. These jurisdictional conflicts, together with the opposition of the banks and their major corporate clients, have delayed passage of a reform bill.

Minnesota's farmers have Representative Peterson to thank for standing up to Wall Street and reforming commodity, and financial, markets. As a member of the House-Senate conference committee, we urge him to keep fighting to prevent Wall Street and its congressional allies from watering down the final bill and creating unfair markets that damage farmers, ranchers and rural communities.

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