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Speculation a Major Contributor to Global Food Crisis, New Report Financial and Food Crises Linked By Deregulated Markets

Minneapolis – Excessive speculation in agriculture commodity markets has played a major role in the rapid rise and fall in global food prices, contributing to a massive increase in undernourished people and commodity market instability, concludes a new report by the Institute for Agriculture and Trade Policy.

“As President Bush and the G-20 meet this weekend, it is important to recognize that many of the deregulatory measures that brought on the Wall Street collapse also contributed to the food security and agricultural market crises,” said IATP’s Steve Suppan, a contributor to the report. “Only prudential regulation and tough enforcement will repair the damage caused by crony capitalism to these markets and the people markets are supposed to serve.”

The IATP report, “Commodities Market Speculation: the Risk to Food Security and Agriculture” (available at iatp.org), concludes that U.S. government deregulatory steps opened the door for large financial services speculators to make huge “bets” that destabilized the structure of agriculture commodity markets. According to the United Nations, global food prices rose an estimated 85 percent between April 2007 and April 2008. Prices rose for wheat (60 percent), corn (30 percent) and soybeans (40 percent) beyond what could be explained by supply, demand and other fundamental factors, the report found.

Commercial speculation in agriculture has traditionally been used by traders and processors to protect against short-term price volatility, acting as a sort of price insurance while helping to set a benchmark price in the cash market. But the elimination of speculative position limits for financial speculators and the rise of commodity index funds undermined traditional price risk management. These funds create a constant upward pressure on commodity prices, alleviated abruptly only when fund contracts are “rolled over” to take profits.

“The underlying fundamental for these funds is not the supply and demand of physical commodities, but the profit target,” said Suppan. “As long as Wall Street players could hide their government-permitted debt loads, they were free to induce price volatility in excess of what could be explained by fundamental factors, and then profit by betting on the induced price movements.”

As of July 2008, \$317 billion had been invested in commodities index funds, led by major traders Goldman Sachs and American Insurance Group. Commodity index funds bundle futures contracts of up to 24 agricultural and non-

agricultural commodities, including oil, energy, and base and precious metals. The bundling of agricultural commodities with precious and base metal commodities means that the price movements (and the larger trading weight of the metals in the fund) can trigger the sale of a fund contract, regardless of the supply and demand situation in an agricultural commodity, according to the report.

At the global level, there is no multilateral agreement to regulate commodities exchange markets. And there is no multilateral framework to respond to global speculation in food prices. Thus far, the UN's Global Task Force on the Food Crisis has yet to analyze the role of speculation in fomenting the crisis.

The report makes a series of recommendations including: creating an independent global commodities exchange regulatory agency, establishing commodity-specific speculative position limits and requiring comprehensive and transparent reporting for all types of futures and options trades executed in the United States. On September 18, the U.S. House of Representatives passed the Commodity Markets Transparency and Accountability Act of 2008, which would take some of these initial steps. The bill will likely be reintroduced in 2009.

"The U.S. House of Representatives has begun to defend U.S. agricultural markets from predatory deregulation and excessive speculation," said Suppan. "The Obama administration and the Senate should not only support and improve the House bill, but help jumpstart multilateral negotiations so that excessive speculation in non-U.S. markets cannot further exacerbate global food insecurity."

The full report can be read at: www.iatp.org

IATP works locally and globally at the intersection of policy and practice to ensure fair and sustainable food, farm and trade systems.