Rising Global Food Prices: The Need for Re-regulating Commodity Futures

Megan S. Chapman
Rising Global Food Prices: The Need for Re-regulating Commodity Futures

Megan S. Chapman

Follow this and additional works at: http://digitalcommons.wcl.american.edu/sdlp
Part of the Agriculture Law Commons, Food and Drug Law Commons, and the International Law Commons

Recommended Citation
Chapman, Megan S. “Rising Global Food Prices: The Need for Re-regulating Commodity Futures.” Sustainable Development Law & Policy, Fall 2008, 43-44.
RISING GLOBAL FOOD PRICES:
THE NEED FOR RE-REGULATING COMMODITY FUTURES

by Megan S. Chapman*

The sharp rise in the price of basic foodstuffs in the last year has impacted consumers around the globe, but the ill effects are disproportionately felt in developing countries. The UN Food and Agriculture Organization (“FAO”) reports seventy-five million more people living below the hunger line in 2007, raising the number of undernourished to 923 million worldwide; these numbers are likely to increase even more sharply in 2008.1 Food prices for staples such as flour, corn, and rice have risen fifty-two percent on average from 2007 to 2008.2 In developing countries, where families may spend as much as fifty to seventy percent of their daily budget on food, these price increases translate into poorer nutrition and loss of purchase power; in other words, these families must make devastating trade-offs: paying for food instead of essential utilities, education, or basic health care.3 Food prices have triggered protests in thirty-six countries, twelve of them violent.4

Economists and food policy experts cite a variety of factors that have most likely contributed to the price rise of commodities. Demand-side fundamentals include the increased demand for commodities due to new investment in biofuels, which now for example use one third of U.S. corn production,5 and the changing diet of the world’s growing middle class, requiring more land- and water-intensive production of meat, dairy, fruits, and vegetables.6 Supply-side fundamentals include weather and natural disasters affecting crop yields, such as Cyclone Nargis in Burma, droughts in Java, stem rust disease affecting wheat crops in East Africa;7 food and water shortages effecting agricultural production; and generally lagging agricultural productivity that fails to keep up with worldwide population and economic growth.8

Many experts agree, however, that the fundamentals alone to do not explain the dramatic rise in commodity prices. Outside of the fundamentals, there are old culprits: inefficient trade policies, such as tariffs, subsidies, and export restrictions, some of which have been raised or reinstated as countries attempt to protect their domestic food supplies. And there is a relatively new culprit: the direct and indirect impacts of speculative investment in commodity futures. Within this market, as the International Food Policy Research Institute (“IFPRI”) reports, “rising expectations, speculation, hoarding, and hysteria are among the additional factors that have played a role in the increasing level and volatility of food prices.”9

Investment in the commodity futures market has increased from roughly $13 billion in 2003 to $250 billion this year.10 Much of the increase has come through the introduction of new investors, index funds, and other noncommercial traders who seek profits through speculation, using largely unregulated over-the-counter swaps.11 Commodity futures were originally designed to protect farmers and commercial investors, for example grain elevators, with some physical interest in the underlying commodity market.12 Until the 1990s, the distinction between these commercial hedges and non-commercial speculators was clear—and both were regulated. In the United States, the Commodity Futures Trade Commission (“CFTC”) regulates the activities of the commercial hedges, for example, by imposing position limits and capital stock requirements.13 Beginning in 1991, recognizing that non-commercial swaps dealers were playing an important role in providing liquidity in the market, the CFTC granted them exemptions from these limits. With deregulatory legislation of the late 1990s, additional regulatory loopholes were deliberately left for commodity swaps, which allowed for more speculation by commercial hedges and the entrance of more noncommercial speculators into the market.14

Speculation in commodities futures involves both benefit (liquidity) and risk (price destabilization). There is little doubt that speculation is tied to rising food prices, whether as a cause, a symptom, or both.15 The causal effects are both direct, as a flood of investment further drives up already rising prices, and indirect, since the price of oil, a non-food commodity, invariably affects the prices of other commodities through transportation and fertilizer inputs.16

By spring 2008, international organizations, think tanks, and politicians began to call for regulatory reform in the commodity futures market. The CFTC called for “a resilience package” of policy measures, the first of which was to “calm markets with the use of market-oriented regulation of speculations” in May.17 On July 10, 2008, Senators Joe Lieberman, Susan Collins, and Maria Cantwell introduced in the Senate the Commodity Speculation Reform Act (“S. 3248”).18 The bill was referred to the Senate Committee on Agriculture, Nutrition, and Forestry, where it has languished ever since.19

Meanwhile, political pressure and charges that the Commission was neglecting its regulatory duties spurred a response from the CFTC. In September 2008 it published the preliminary results of a broad survey of all U.S. swap dealers and index funds. In the introduction to the preliminary report the CFTC

---

* Megan S. Chapman is a JD candidate, May 2011, at American University Washington College of Law.
wrote, “this type of a compelled survey relating to off-exchange activity is unprecedented, but the growth and evolution in futures market participation and growing public concern regarding off-exchange activity supported the need for this extraordinary regulatory inquiry.”20 The recommendations mostly called for further investigation. For example, a review was recommended as to whether “swap dealers would maintain their exemptions in exchange for them to report when their clients reach certain position levels and provide ‘certification’ that none of their speculative clients exceed position limits.”21 One of the four CFTC commissioners, Bart Chilton, said the recommendations did not go far enough. As he colorfully put it, “We need a sheriff in the saddle, to make sure these markets are honest.”22

Regulation is also being addressed internationally. On October 1, 2008 the CFTC announced that it will co-chair the International Organization of Securities Commissions’ newly-created Task Force on Commodity Markets (“TFCM”), alongside the United Kingdom Financial Services Authority, with the participation of both developed and developing member countries. The TFCM is charged with “examining the current supervisory approaches for overseeing commodity markets worldwide” given the “profound changes” these markets have recently undergone.23

If not for the latest wave of the financial crisis, including the near failure of American International Group, the prospect of legislative change in the United States on these issues may have died with S. 3248. Instead, in mid-October various committees of the both the House and the Senate have held hearings on credit-derivatives and credit-default swaps. As these committees debate whether the CFTC, the Security Exchange Commission, or private sector clearinghouses are better suited to regulate credit swaps,24 the hope is that whatever the legislative outcome may be, it does not allow the gaping loopholes in commodity futures regulation to persist.

Endnotes:


2 See id.


5 VON BRAUN, supra note 3, at 3 (compared to 5% a decade ago).

6 Id. at 4.


8 VON BRAUN, supra note 3, at 4.

9 Id. at 5-6.


13 CFTC, supra note 11, at 1.


16 VON BRAUN, supra note 3, at 5; see also Interview with Egon Guttman, Professor Emeritus, American University Washington College of Law, in Washington, D.C. (Oct. 17, 2008).

17 Id. at 9.


20 CFTC, supra note 11, at 1.


22 Id.
