

# Commodities and food – yes or no?

## Too much speculating in the system!

For a long time, speculators only played a minor role on the commodities markets. The vast majority of traders made use of the commodity futures exchange to safeguard themselves against price risks in trading grain in the real world – to hedge their bets. This is precisely what the “Chicago Board of Trade” was founded for by producers, buyers and sellers in the USA in 1848. This was the birth of the largest grain exchange in the world. But things have changed. In the early 1990s, the USA started to liberalise financial regulations. The market underwent a fundamental change. Whereas speculators held only 23 percent of ongoing contracts in 1998, they were in possession of a staggering 69 percent by 2008.

Today, it is the logic of the financial market that governs the grain markets. Experts refer to the “financialisation” of the grain and commodities markets. The result is that the intensity and frequency of price spikes and dips is increasing. Banks and pension and hedge funds are speculating with the world’s bread, and in betting on rising prices, they are accepting the hunger that threatens millions of people who are unable to protect themselves. However, the producers, buyers and sellers of grain are also beginning to feel the downside of the “boom” in the USA. It was not without reason that a re-regulation of trading in commodity derivatives was introduced politically for grain and energy in the USA in the summer of 2010, too.

The “danger” of regulation is bringing all those into the arena who are benefiting from liberalised commodities futures exchanges: the banks, which are forever introducing new finance products to the market and luring investors with good prospects of profits; the institutional investors, who want to diversify their portfolio and benefit from rising food prices; the stock exchanges, whose income increases as more and more futures contracts are traded; and the international grain corporations, which are not only safeguarding themselves on the commodities futures exchanges but are also making considerable profits through financial betting.



The finance industry is making an all-out bid to prevent reasonable

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regulation. It warns of the danger of illiquid markets, despite of regulation in the US always having ensured liquidity on the markets and having restricted excessive speculation for 150 years. With an air of innocence, it refers to the speculators merely being the bearers of bad news or anticipating development trends on the markets and claims that price developments may be traced back solely to fundamental market data. And it suggests that betting on rising prices represents an “investment” in the commodities sector.

As can be expected, the need or the dangers of regulating financial markets is the subject of controversial debate. There will most likely never be unanimous agreement among experts or scientists about the link between speculation and price developments in physical markets. However, whereas some reject any link whatsoever, a growing number of serious surveys conducted by distinguished organisations and experts suggest an urgent need for action because of the negative effects of excessive speculation.

Index funds are viewed especially critically. “Investment” in commodities-related index funds grew from 13 billion US dollars in 2003 to 317 billion US dollars in July 2008. The index funds encompass several commodities (metals, energy sources, agricultural produce, etc.), bet on rising prices and therefore mainly hold long positions in commodities futures. In a well-functioning market, increased demand will result in rising prices. So if more and more futures are bought, the prices of futures should really rise. When fixing their prices, grain traders are guided by this futures price. Correspondingly, higher futures prices result in higher grain prices.

Given the far-reaching, life-threatening consequences of fluctuations in food prices for millions of people, action is needed, even if some economic researchers are of the opinion that the causal links between speculation and price volatility have as yet not been exhaustively demonstrated. For the precautionary principle demands preventive action.

For one thing, action means at least establishing transparency. Speculators must be obliged to report all financial transactions to the responsible authorities, so that what is happening on the markets becomes comprehensible. But this is not enough. In order to curb excessive speculating, upper limits have to be set regarding the number of contracts traded by the speculators. There is no way to avoid regulating the commodities futures exchanges. There is simply too much speculating in the system!