

## Parliamentary briefing

# How financial speculation causes food crises

### Summary

- Excessive financial speculation in food commodity derivatives has significantly increased volatility in the prices of staple foods, exacerbating UK inflation, global hunger and poverty.
- This effect was clearly seen in the food crisis in 2007-2008, when for example the price of maize rose by 180% before falling sharply. In February 2011, world food prices again reached new record highs.
- The US is enacting important new regulations and proposals from the European commission are due to be published in autumn 2011. It is vital for the UK government to support effective international regulation.

### The 2007-2008 food crisis

Between the start of 2006 and mid-2008, the price of maize rose by 180 per cent and wheat rose by 110%.<sup>1</sup> Comparing price volatility between 2002-2006 and 2007-2008, maize price volatility increased by over one third and wheat price volatility increased by around 50 per cent.<sup>2</sup>

This increase in the price of food had a disastrous effect for people across the world. In 2007 and 2008 there were a further 115 million hungry people.<sup>3</sup> The United Nations Food and Agriculture Organisation (FAO) estimated that in June 2009 over 1 billion people were chronically malnourished.<sup>4</sup>

In addition to the direct impact on hunger and malnutrition, the 2007-2008 food crisis resulted in the number of people in extreme poverty increasing by 20 million.<sup>5</sup> The increased price of food also led to households eating less fruit, vegetables, dairy and meat; reducing savings, selling assets or taking out loans and reducing spending on 'luxuries' such as healthcare, education or family planning.<sup>6</sup>

### The 2010-2011 food price spike

Between June and September 2010, wheat prices rose by 70 per cent.<sup>7</sup> Media reports pointed to crop fires and subsequent export ban in Russia as the cause, but in fact, globally, the wheat harvest was the third highest on record.<sup>8</sup> This indicates that the spike was caused by speculators driving a wildly disproportionate response to events in Russia, a view supported by an international committee of the UN Food and Agriculture Organisation.<sup>9</sup> Food price rises in the last six months of 2010 alone pushed an additional 44 million people into extreme poverty, according to the World Bank.<sup>10</sup> They reached new record levels in February 2011 and have remained almost as high in the months since.<sup>11</sup>

### The cause of high volatility – excessive speculation

Research by the World Bank<sup>12</sup>, the UN Special Rapporteur on the Right to Food<sup>13</sup>, UN Conference on Trade, Aid and Development<sup>14</sup> and others demonstrates the central role of financial speculators in these price increases. International organisations recently advised the G20 that "too much speculation can cause frequent and erratic price changes."<sup>14</sup> As outlined by these reports, it is evident that the scale of the increase in food prices since 2007 is due to financial speculation in commodity markets.

Indeed, some academics argue that recent food price volatility is more closely correlated with activity in financial markets than agricultural supply and demand. According to Professor Jayati Ghosh, Chair of the Centre for Economic Studies and Planning, Jawaharlal University:

*"It is important to recognise that the global food crisis is not something that can be treated as discrete and separate from the global financial crisis. On the contrary it has been intimately connected with it, particularly through the impact of financial speculation on world trade prices of food. [...] It is clear that the recent volatility in world trade prices of important food items simply cannot be explained by real demand and supply factors ... FAO data show very clearly that there was scarcely any change in global supply and utilisation [from 2007- Sep 2010]."*<sup>15</sup>

In order to achieve food security for the world's poorest people, food commodity derivative markets must be regulated to prevent financial speculation leading to excessive and volatile food prices.

## International consensus for regulation

A wave of recent reforms and discussion in the US and EU have reshaped the future of the regulation of commodities. The Dodd–Frank Wall Street Reform and Consumer Protection Act in the US re-introduced measures that had existed prior to 2000 for regulating agricultural commodities, including measures to improve the transparency of the markets and limits on the share of the market held by financial speculators. However, effective implementation of the Act is dependent upon countries like our own similarly reforming regulation so as not to create a system of arbitrage in which Europe is used as an under-regulated offshore haven.

The European Commission is addressing the regulation of commodity speculation through the review of the Markets in Financial Instruments Directive (MIFID). It is essential that the UK government supports strong measures through these regulatory instruments to create greater transparency and efficiency in these markets, and apply effective limits to prevent financial institutions from distorting the price of commodities such as food.

In order to achieve this, the UK government should support European regulation:

- Introducing well-defined and strict **position limits** on financial speculative participants in agricultural commodity derivative markets and a strict definition for end-users who are hedging for their business;
- Mandatory **exchange trading** of commodity derivatives, preferably centrally cleared, which would provide much more information about all commodity derivatives trading not only to regulators but also to the wider public.

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<sup>1</sup> World Development Movement (2010). *The Great Hunger Lottery*.

<http://www.wdm.org.uk/food-speculation/great-hunger-lottery>

<sup>2</sup> UNCTAD (2011) Price formation in financialized commodity markets: the role of information and (2009) *Trade and development report 2009. Chapter II: The financialization of commodity markets* United Nations. New York and Geneva.

<sup>3</sup> World Food Programme <http://www.wfp.org/hunger/stats>

<sup>4</sup> FAO (2009). *One sixth of humanity undernourished - more than ever before*. FAO. 19 June 2009.

<sup>5</sup> World Bank (2009). *Global Economic Prospects. Commodities at the Crossroads*. World Bank. p96.

<sup>6</sup> World Development Movement (2010). (*op. cit.*)

<sup>7</sup> Index Mundi (2010) <http://www.indexmundi.com/commodities/?commodity=wheat> (Accessed November 2010)

<sup>8</sup> FAO (2010) *Wheat sends food prices up: FAO Food Price Index climbs five percent in August*. FAO. 01 September 2010.

<sup>9</sup> FAO (2010) *Final Report of the Committee on Commodity Problems Extraordinary Joint Intersessional Meeting of the Intergovernmental Group (IGG) on Grains and the Intergovernmental Group on Rice, Sep 24*.

[http://www.fao.org/fileadmin/templates/est/COMM\\_MARKETS\\_MONITORING/Grains/Documents/FINAL\\_REPORT.pdf](http://www.fao.org/fileadmin/templates/est/COMM_MARKETS_MONITORING/Grains/Documents/FINAL_REPORT.pdf)

<sup>10</sup> World Bank (2011) *Food price watch*. World Bank. 15 February 2011.

<sup>11</sup> FAO (2011) *Food price index*. <http://www.fao.org/worldfoodsituation/wfs-home/foodpricesindex/en/>

<sup>12</sup> Baffes & Haniotis (2010) *Placing the 2006/08 Commodity Price Boom into Perspective*. World Bank.

<sup>13</sup> De Schutter, Olivier (2010). *Food Commodities Speculation and Food Price Crisis*. UN Special Rapporteur on the Right to Food.

<sup>14</sup> UNCTAD (2009). *Trade and development report 2009*. Chapter II: The financialization of commodity markets.

<sup>14</sup> FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTf (2011) *Price Volatility in Food and Agricultural Markets: Policy Responses*. [http://www.unctad.org/en/docs/2011\\_G20\\_FoodPriceVolatility\\_en.pdf](http://www.unctad.org/en/docs/2011_G20_FoodPriceVolatility_en.pdf)

<sup>15</sup> Ghosh, J. (2010). *Commodity Speculation and the Food Crisis*. World Development Movement <http://www.wdm.org.uk/sites/default/files/Commodity%20speculation%20and%20food%20crisis.pdf>