



Summary of the discussions (12-01-15)

Agricultural commodity trade, food prices and regulation: International debate and relevance for Switzerland

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Marc Chesney - University of Zurich, Vice Director of Department of Banking and Finance

Maximo Torero - International Food Policy Research Institute, Washington, Director of the Markets, Trade, and Institutions Division

Martin Hess - Swiss Bankers' Association, Head of Economic Policy

Introduction by **Manuel Sager**, Director-General of the SDC

Moderator: **Markus Mugglin**, Former Chief Editor Echo der Zeit, DRS (Today SRF)

The subject of the event was agricultural commodity trade, food prices, volatility, and regulation, with a focus on the impact of speculation on food prices. In addition possibly adequate policy responses to the negative impacts of food speculation on the world's poorest were discussed¹. The event was introduced by the Director-General of SDC Ambassador Manuel Sager, who situated the discussion in the current Swiss political context.

This subject was addressed against the backdrop of new legislation currently under discussion in Switzerland, in particular the financial markets infrastructure law and a popular initiative launched by the young socialists entitled "No Speculation on Food Commodities". The former intends to adapt the regulation of financial markets to the lately quickly changing reality in this sector. Among other issues it regulates certain actors and the trade with derivatives, touching therefore also upon food speculation. The popular initiative specifically targets food speculation with the aim to strongly regulate and reduce it. It also proposes international engagement to minimize food speculation. At the international level the most relevant developments are that the European Union and the United States have implemented and are implementing regulations related to increase transparency in general as well as to limit high frequency trading and positions held in commodity future markets. These issues are partly also addressed in draft legislation on the financial market infrastructure, currently submitted to the Swiss parliament.

The experts presented a wide spectrum of positions on the issue. It reached from the position that there is evidence that food speculation matters for strong rises in food prices to the position that there is very little or no evidence for this claim. Equally the experts' positions differed on what kind of and how much regulation of speculation is needed.

The experts and audience largely agreed that food speculation only addresses a part of the global food security problem. Rising food prices increase the part of an already big portion of people not having access to food because they do not have the necessary means to buy food on markets while they also cannot produce enough to sustain themselves. Rising food prices also lead to higher income and are welfare enhancing given comparative competitiveness of less developed countries in the agricultural sector. The speed of price changes determines which effect will prevail.

Is there evidence and what are the implications for action?

On the one hand, the position was supported that speculation is highly relevant for exacerbating the peaks in food prices and hence needs to be regulated. However one of the experts differentiated that first, it was not so much high prices, which had a very negative impact in 2007-2008, and that those prices were not historically unprecedented in real terms, but that it is the volatility of prices, which was exceptionally high and unprecedented²; and second, while changes in supply and demand fundamentals could not fully explain the drastic increase in food prices during 2007-2008 and while speculation is relevant for exacerbation of the rise in prices, it was wrong policy reactions which made matters worse and provoked even higher rises. As an example, export restrictions and bans by certain countries were named. It may be rather the exception than the rule that speculative activity is damaging and is more a matter of degree during periods where there is a high risk of exacerbating prices. Nevertheless, spot market and future market

¹ For an overview: Lein, B; de Roquefeuil, Q; van Seters, J. 2014. Strengthening policy coherence for development in Switzerland: The case of food security (Discussion Paper 166). Maastricht: ECDPM.

http://www.sdc-devpol.ch/en/Home/Documents/A_P_Publications/PCD_for_Switzerland_Food_Security

² See Food Prices: Riding the Rollercoaster. 2012. In: 2011 Global Food Policy Report. IFPRI. Washington DC. <http://www.ifpri.org/publication/2011-global-food-policy-report>.

prices correlate and move alongside and there is even evidence showing that futures markets have generally dominated spot markets in the past years³.

Moreover the same expert pointed out that the historically unprecedented levels of excessive volatility generates the possibility of larger potentially speculative trading as it could be observed during 2007-08. Part of the exacerbating volatility could only be explained by speculation. Speculation hence affected consumers and especially the poor.

Important in this context is that the capital invested in food speculation increased very significantly in the last decade and new actors joined the scene. There is a difference between commercial and non-commercial actors, hence actors which are directly linked to the physical commodity trade and actors which are solely involved in financial trading. Hedge funds are main actors on these markets (noncommercial). The point was made that on the contrary it should be producers and consumers instead (commercial).

On the other side of the spectrum of opinions it was mentioned that, while nearly one billion of hungry people are unacceptable, still there is little evidence for the impact of speculation on food prices. It was furthermore criticized that many studies lack methodological quality. By providing liquidity, speculators contribute to well-functioning markets. Only when accurate market prices serve their function as an indicator of scarcity and, hence, lead to the investments needed in agriculture. Sufficient capital also benefits producers to cheaply insure against volatility, which would hamper effective production otherwise.

A contribution from the audience stressed the obligation to act due to international public law. A prominent example is the right-to-food approach. Even if there is a claim of lack of evidence there is a need for action based on the Precautionary Principle. This was disputed with the argument that evidence should be considered as the base for designing sound policy measures. At the same time it was also a claim in discussion that the impact of food speculation is controversial for the same reason the evidence for climate change is controversial, because it challenges powerful interests.

It was a general consensus that more transparency is necessary. It was added that better definition of what are commercial and noncommercial transactions in the futures market are necessary, that there is a data availability problem, and that knowledge is concentrated mainly within the hands of the big players.

Should food speculation be regulated? And if so how?

Concerning the question on if and how to regulate food speculation the positions reached from the claim that a much stronger regulation is necessary to the claim that regulative interventions may be acceptable, but only if these future regulations are not more restrictive than those of other countries, leaving Switzerland with a competitive disadvantage. Regulations need to be very targeted and linked to specific preconditions (i.e. market situations, prices and significant levels of price volatility). In that sense a proposal was raised to trigger regulatory mechanism during periods of excessive volatility. The regulative mechanism would be restricted to those periods when there is a possibility of larger net returns in the short term, which then may lead to increased (potentially speculative) trading. This again may exacerbate prices even more and as a result affects consumers and producers. The triggering of the regulatory mechanism would be based on the model developed by the International Food Policy Institute (IFPRI).

There was consensus that Switzerland should align with international regulatory standards in order not to attract more speculative activities by serving as a regulatory island. At the same time it was argued that simultaneous international regulation is very unlikely although some progress between the European Union and the United States has started since the Paris G20 meeting in 2011. Some countries need to step ahead and create exemplary laws for other countries to follow. However, as the European Union and the United States are currently ahead of Switzerland concerning the regulative situation, the main concern should rather be the regulation differences.

Repeatedly it was voiced that, if Switzerland does not align with the regulation of the United States and the European Union, it may attract more speculative activities and that may be welcomed by certain interest groups. It is also worth noting that while banks are the best regulated players, it would be important to regulate all relevant players, for example big trade companies. The four biggest agricultural commodity trading companies (Archer Daniels Midland, Bunge, Cargill and Louis Dreyfus) have a very important market share. Their engagement in speculative activity is seemingly expanding. Here the differentiation between commercial and non-commercial actors becomes increasingly blurred.

On a general note it was invoked that policies to regulate speculation are not to be neglected, it still is of crucial importance to design policy measures carefully. One of the reasons for this is that some experience showed that wrongly designed policies may worsen the situation. A consensus between all positions existed, that Switzerland should not create major regulation differences with the European and United States legislation.

³ For details see: M Hernandez and M. Torero. 2010. "Examining the dynamic relationship between spot and futures prices of agricultural commodities", *Commodity Market Review*, 2009-2010, pp.47-87