Cracking Down On Speculation – a Safe Bet For Tackling Hunger

Even when markets are functioning well, food moves not to where needs are greatest, but to where purchasing power is highest. What hope then, for the world’s poorest, when food prices soar on the back of speculative bubbles, taking basic foodstuffs further out of their reach?

Food commodity speculation is a major threat to food price stability, and thus to food security and the realization of the right to food across the developing world. Speculation occurs in various forms and with diverging impacts on food prices and food security.

On the physical markets a form of speculation occurs when traders hoard food by delaying sales or accelerating buying, thus creating an artificial scarcity. This can lead to significant price increases under certain conditions – particularly where the food distribution channels are dominated by a small number of actors, or where a particular commodity is produced by only a handful of countries. The interests of this type of speculation are to cloud the market and benefit from the ensuing uncertainty. But the actors are primarily commercial operators from the agri-food sector.

Another type of speculation occurs on the markets for derivatives, where financial products are traded: futures, swaps, options. The nature of these markets has changed significantly over the past ten years, as a result of the deregulation of 2000, when the Commodities Futures Modernization Act was adopted. But also, because institutional investors such as pension funds or hedge funds have decided to invest in commodity markets as a hedge against inflation at a time where stock markets are not offering good returns, and in order to spread the risks in a portfolio strategy.

Speculation on physical and financial markets has combined and interplayed to create havoc for those depending on fair and stable prices in order to make a living or to put enough food on the table.

Financialisation of commodity markets
Speculation by grain traders on physical markets is not, alone, so problematic. It can
be counteracted by the transparent provision of information about grain stocks, weather, and harvest forecasts. This type of bubble can be burst by reassuring traders that there is in fact no scarcity, and future demand can be met.

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However, the sheer weight of the financial interests now betting on agricultural derivatives poses a novel and severe threat. Annually, financial speculators trade around 46 times the volume of global wheat production and 24 times the volume of global maize production.

These new financial investors are purely interested in the short-term monetary gain and are not generally interested in the physical item: they never actually buy the ton of wheat or maize; they only buy a promise to buy or to sell. The result of this financialisation of the commodities market is that the prices of the products respond increasingly to a purely speculative logic. This is why over very short periods prices spike or bubbles explode, because prices are less and less determined by the real match between supply and demand.

The arrival of commodity index funds is of particular concern. Here investors bet on agricultural commodities as part of a basket of commodities. Speculators thrive on uncertainty, and benefit from volatile prices and from any movement of prices that correspond to their expectations. In general, however, commodity index funds tend to take "long" positions – promising to buy in the future at prices that are higher than current "spot market" prices –, and they regularly renew such positions before the delivery time. In order terms, they speculate on constant price increases, and this in turn may cause the prices to move upwards, leading their predictions to be self-fulfilling prophecies.

Apart from cases of manipulation of prices by one actor (whose financial weight may be such on these thin markets that its predictions shall cause price shifts), another important danger is the herding effect of multiple investors taking up similar positions and obscuring the fundamentals. Non-agricultural actors can trigger and exacerbate price swings through their own behaviour, for example by snapping up cereals futures in the wake of a drought. This can create market scarcity and drive up prices, allowing them to sell on their contracts at a higher price.

This kind of speculation distorts underlying prices, and therefore has detrimental effects on the food security of vulnerable populations. The world’s poorest citizens are already vulnerable to the price increases that come with a bad harvest, but additional price bubbles driven by speculation are catastrophic for poor consumers who typically spend more than 60 per cent of their household budget on food. What’s more, many of the world’s poorest countries are highly reliant on food imports. And the more countries import food from international markets, the more they are vulnerable to price swings amplified by speculation.

A fair and sustainable food system
For the right to food to be realised in the world’s poorest countries, citizens must be able to produce or procure adequate food at all times. In many countries much remains to be done before this becomes reality. Small farmers must be secured on the land and helped to access markets; poor urban populations must be ensured a living wage that allows them to eat. But for any of this to be achieved, food prices must be fair and stable.

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Production decisions in poor regions must not be affected by artificial price signals driven by financiers in Chicago or London, and staple foods must not become suddenly unaffordable for poor consumers because a new bubble has been unleashed by herding investors.

States must be able to tap into international markets that regulate – not distort – supply and demand. This is only the starting point for building a fair and sustainable food system, and putting in place the strategies and policies needed to realise the right to food. But it is a crucial starting point.