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C2A Notes

Agriculture and food in question

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THE FINANCIALISATION OF AGRICULTURAL MARKETS: WHAT ARE THE IMPACTS ON GLOBAL FOOD SECURITY?

Food prices are increasingly volatile: a total of three price shocks have had an impact on the planet over the past five years, pushing hundreds of millions of people into absolute poverty, and increasing global food insecurity. Simultaneously, a growing number of actors has been investing heavily in agricultural commodity derivatives markets. What are the impacts of extreme financialisation of food markets on the volatility of prices? When one person in seven continues to suffer from hunger worldwide, how can speculation on agricultural markets be effectively regulated?

In theory, financial markets must secure the correct functioning of food markets

The term 'speculation' means to bet on the future evolution of a financial market in order to gain profit. It takes place, in the main, on the financial markets (futures markets). These markets do not usually tend to lead to a physical transaction of physical material but consist of the purchasing and/or the sale of 'papers'. They thus provide a barrier to physical markets, where physical material is exchanged or its monetary value. Speculation may relate to financial, monetary or commercial assets, and derivatives.

Initially, agricultural commodity derivatives markets were intended to play a positive role within the food markets, whose prices are known to be structurally volatile. Indeed, agricultural activity can be unpredictable and particularly vulnerable to adverse weather conditions and variations in production. Moreover, the overall demand for food is inelastic: food products cannot be substituted by other products. In this context, the financial markets have, in theory, provided an essential role to agricultural commodity trading.

« Financial markets must allow players to cover those risks inherent in agricultural activity. »

- They must however allow players to cover those risks inherent in agricultural activity. They thus enable both contracting parties to anticipate costs and future revenues by guaranteeing the price of agricultural commodities on a fixed date and at a predetermined price.

- They must also facilitate said determination of prices. In effect, the prices of commodities futures contracts represent a reference price for physical trade and serve as an orientation point during the negotiation of sales or purchase prices.

- Finally, they must provide liquidity within the markets. Of course, agricultural markets are subject to significant price fluctuations because purchases and sales of agricultural products are conducted 'wholesale' and take place during harvests (either once or a few times per year). Throughout the year, purchases and sales of derivative products of agricultural commodities would help streamline the liquidity of both the financial markets and physical agricultural markets.

In reality, extreme financialisation of agricultural markets aggravates food insecurity worldwide

Today, the agricultural and food market is dramatically financialised, and the financial markets no longer play their role of securing physical markets.

Investment in agricultural derivatives exploded at the beginning of 2000, because it allowed financial operators to diversify their portfolio of securities with a view to minimising risks. Many institutional investors now integrate agricultural commodity derivatives into their portfolios of shares, while the main investment banks systematically advise their clients to invest 5 to 10% of their portfolio in agricultural commodities.

The importance played by financial operators on the market of agricultural derivatives is therefore largely increasing. At the Chicago Board of Trade, financial speculators make up 65% of the market today, compared to only 12% in 1996. Ultimately, less than 3% of agricultural commodities futures contracts actually lead to the delivery of a commodity. The remaining 97 per cent are resold by speculators before their expiration date.

Accordingly, speculation no longer has any link with the physical markets. This financialisation and excessive speculation have accentuated the volatility of agricultural prices:

- The financial markets no longer fulfil their function: price formation. Financial operators are insensitive to changes in supply and demand of food products on the physical markets. Their positions are independent of the characteristics of physical markets and the reality of stock sizes, adding to the actual demand. High prices can therefore be formed even when food is abundant, which leads to situations of food insecurity in the global South, and the prospect of profits for speculators.

- Financial markets no longer serve to ensure the coverage of risks inherent in agriculture. The higher the prices, the more the guarantee and cost of agricultural commodities futures contracts increases: their amount increased by 300% between 2006 and 2008. In countries of the global South, small farmers are forced to take out loans to cover the risks of farming, which makes them yet further vulnerable to the volatility of prices.

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The emergence of new and particularly dangerous speculative tools:
index-fund investing on the prices of agricultural commodities

Speculation on agricultural commodities is performed increasingly through index funds. In 2011, on a global level, index-fund investing in agricultural commodities reached more than $90 billion compared to less than $10 billion in 2004.

These funds replicate agricultural commodities indexes. These indexes represent the evolution of the price of a basket of futures contracts of various commodities, both agricultural and non-agricultural.

Specifically, these funds allow financial operators to invest both heavily and 'passively' in agricultural commodities, without considering sales. The operators bet in a single direction on a price increase, making the demand increase artificially for agricultural products on the financial markets.

According to the World Bank, 'index funds played a key role in the soaring food prices of 2008.'

Who benefits from the financialisation of agricultural markets?

This extreme financialisation of agricultural markets benefits both financial operators and larger agricultural commodities traders, who speculate on both physical markets and futures markets. By participating in the rise in food prices, they accumulate profits and render the food inaccessible to the poorest. In 2009, Goldman Sachs earned $5 billion through trading in agricultural derivatives. In 2011, Barclays Capital obtained 550 million and JP Morgan forecast earnings of 1.2 billion[1].

French banks also hold their own in speculative markets. In November 2012, the main French banks ran at least 18 funds which speculated on agricultural commodities, almost all of which were index funds[2]. Their value came to a total of 2583 million euros.

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This figure is relatively low when compared, for instance, with the total value of index funds managed by German banks, which amounted to 11,385 million euros, however, the trend remains worrying. In effect, the very large majority of these funds were created following the 2008 food crisis, with the clear objective being to speculate to an even greater extent on agricultural commodities and to make yet more profits on agricultural markets.

With regard to multinationals in agricultural commodities, the four main players are Archer Daniels Midland, Bunge, Cargill and Louis Dreyfus. They are all able to take advantage of this situation because they have exemptions in position limits on the financial markets by virtue of their position as 'commercial players' on the physical markets. This position on the physical markets gives them access to information that most financial actors do not have.

Their speculative activities have been skyrocketing, with traders openly admitting that they derive financial benefits from this additional information. They have thus created investment funds addressed to speculators: in 2010 Black River Asset Management at Cargill managed $4.5 billion worth of financial assets, and Louis Dreyfus Commodities Alpha Fund managed $2 billion worth of financial assets, with a return on investment of 17.3%[3].

Can farmers significantly gain from high food prices?

With the rise in food prices, one might think that the farmers themselves benefit from higher incomes and significantly gain from a situation which would ordinarily only affect the urban poor. In reality, the situation is much more complex than it initially seems.

Small farmers often experience difficulties when attempting to take advantage of rapid increases in prices, because they do not enjoy sufficient access to credit and land, nor to the inputs required to expand production. In addition, the increase in food prices is not always reflected in the prices paid to producers.

Furthermore, after several decades of structural adjustment policies and the liberalisation of markets, a large number of farmers are finding themselves, de facto, in the same position as net consumers on food markets.

Finally, such volatility prevents poorer farmers from investing because they are not able to take on the risk of a future collapse in prices.

1. Wall Street Journal, "Big Banks Cash In Commodities", Carolyn Cui and Dan Fitzpatrick, June 2011 ; Financial Times, "Volatile oil markets lift profits on Wall Street", Gregory Meyer and Javier Blas, May 2011 ; Goldman Sachs, Annual Report, 2009; quoted in SOMO, *Feeding the Financial Hype, How excessive financial investments impact agricultural derivatives markets*, December 2011
2. Banking reform: banks that speculate on hunger, Oxfam France, February, 2013.
3. Oxfam Research Reports, *Cereal secrets, The world's largest grain traders and global agriculture*, August 2012

How can agricultural markets be effectively regulated?

Position limits are a particularly effective tool in regulating derivatives markets. They allow you to impose upon financial actors a ceiling on the number of contracts on a raw material at a given time, and are used to regulate the derivatives markets in most of the world's largest countries (Japan, China, Australia, South Africa, etc.). In the United States, they were used throughout the majority of the twentieth century. Their abolition in the 1990s coincided with a hyper financialisation of derivatives markets and resulted in a significant distortion of prices within agricultural markets. They were reintroduced in 2010 when President Obama ratified the 'Dodd-Frank Wall Street Reform and Consumer Protection Act'[4].

« A regulation of physical markets would help strengthen family-based farming to ensure food security for both present and future generation. »

In Europe, reform of the Markets in Financial Instruments Directive (MIFID) is currently in negotiations and should allow for the establishment of position limits for speculative activities in agricultural commodity derivatives. The debates have been rendered difficult by the positioning of certain Member States such as the UK. However, France has made a considerable step forward, which will probably strengthen its negotiating position in Brussels. At the outset of 2013, three essential elements were added by parliamentarians on the initial project of banking reform proposed by the government:

- From 1 July 2015, the Financial Markets Authority (FMA) will impose position limits on financial instruments and the agricultural raw material that a person is permitted to hold.
- Upon the official adoption of the law, any person holding financial instruments for which the underlying asset is an agricultural raw material will have to communicate its daily positions to the FMA.
- The FMA will publish a weekly report showing the aggregate positions of different categories of persons holding financial instruments whose underlying asset is an agricultural raw material.

A regulation of physical markets that would enable the countries of the global South to protect their agricultural markets is also required to help strengthen family-based farming and rural farmers to ensure food security for both present and future generations.

4. Position limits adopted by the American regulator (TCRC) on the basis of the Dodd-Frank act were the subject of legal action in the U.S. courts. The TCRC appealed this decision and applied 'historical' position limits in the meantime, i.e. those in force before deregulation.

As part of its mission to support the collective advocacy of its members, Coordination SUD has set up working committees. The Agriculture and Food Commission (C2A) brings together 20 international solidarity NGOs that act to realize the right to food and increase support for smallholder farming in policies that impact world food security: 4D, ACF, aGter, Artisans du Monde, AVSF, CARI, CCFD–Terre Solidaire, CFSI, CIDR, Crid, Gret, Interaide, Iram, Oxfam France, Peuples Solidaires in association with ActionAid, Réseau Foi et jusitce Europe, Secours Catholique, Secours Islamique, Union nationale des Maisons Familales Rurales and 1 guest : Inter-réseaux.
The Commission aims to coordinate the work conducted by its participants and facilitate consultation among its members for their advocacy work with social actors and international policy makers. The members of the Commission reach agreements on the representation provided in the name of Coordination SUD in a range of arenas (Concord in Europe, FAO, WTO, UNCTAD) and share information on current international stakes. The Commission is mandated by Coordination SUD to formulate the positions taken by the group during the main institutional meetings on the subject of agriculture and food.

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