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The G-20's Opportunity on Commodities Exchange Regulation

By Steve Suppan

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When the Group of 20 heads of state meet later this week in London to discuss responses to the global financial crisis, one item directly affecting global food and energy security will be missing from the agenda: the regulation of commodity exchanges.

While a stated goal of the G-20 financial ministers and central bank governors is to ensure that "all systemically important financial institutions, markets and instruments are subject to an appropriate degree of regulation and oversight," the G-20's "Washington Action Plan" neglects commodity exchanges.

Governments, led by the United States, exempted from regulation Over-the-Counter (OTC) commodities derivatives, estimated by the Bank of International Settlements to be worth US$13 trillion in 2008 in notional (contracted) value. Price volatility, and resulting food and energy insecurity associated with riots in at least 60 countries, was caused in part by the OTC "weight of money" that overwhelmed the supply/demand price signals of regulated exchanges. This certainly should have been enough to put commodity exchange regulation on the G-20 agenda.

To understand how important commodity exchanges are to the global financial collapse, heads of state should put the UN Conference on Trade and Development's "The Global Economic Crisis: Systematic Failures and Multilateral Remedies," published in March, at the top of their reading list. One key message is unambiguous: "The growing role and weight of large-scale financial investors on commodities futures markets have affected commodity prices and their volatility." The analysis in support of this message is compelling. As financial investors rush in and out of commodities, price volatility can make price risk management instruments in commodity exchanges too expensive for commodity processors and traders, particularly in developing countries, to use.

UNCTAD spares no government nor discriminates against any particular asset class in its analysis of the global economic crisis: "It is the failure of Governments to deliver effective global governance that is to blame foremost for the global economic predicament." Such global governance is hinted at in UNCTAD's call for a "broad international agreement" on speculative investment instruments across asset classes to prevent the creation and bursting of bubbles, as investors chase a safe harbor in one asset class or another, while economies collapse and unemployment soars. Another submission to the G-20 worth noting comes from the International Organization of Securities Commissions (IOSCO) at which financial institution regulators

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from most governments are represented. The IOSCO's Task Force on Commodity Futures Markets, co-chaired by the United States and the United Kingdom, reviews reports by the U.S. Commodities Futures Trading Commission, the UK's Financial Services Authority and the International Monetary Fund, among other regulatory bodies. The Task Force concluded that "economic fundamentals, rather than speculative activity, are a plausible explanation for recent price changes in commodities." This conclusion is not surprising, since to admit the role of speculation would be to acknowledge that the exemption of OTC trading from regulation and other deregulatory measures led to the price boom and bust. Nevertheless, the IOSCO report contains valuable recommendations, some of which should be publicly welcomed by the heads of state in their April 2 meeting.

The recommendations cover four issues: transparency of commodity market information; transparency and surveillance of derivative contracts based on that information; enforcing market rules and "lack of ability to investigate non-regulated entities"; and "the institutionalization of commodities futures regulator cooperation" among IOSCO member governments. The leitmotif of the Task Force recommendations is "should encourage." Any greater regulatory control over commodity exchanges to fulfill public purposes, such as ensuring food and energy security, is apparently unthinkable.

According to James K. Galbraith's *The Predator State*, the ideology of "free markets" is so pervasive in government and universities that neither more regulatory cooperation nor public outrage at the massive taxpayer bailouts of free market failures will begin to transform the financial markets to support public purposes. Regulatory standards will have to be agreed by all those affected by financial markets, not just by the G-20 regulators and their financial services industry allies. The United Nations high-level meeting on international financial reform, to be held June 1-4 at UN headquarters in New York City, promises to be a forum for a more inclusive and fundamental discussion of regulatory standards. There, the G-192, as UN General Assembly President Miguel d'Escoto calls the UN's members, will try to come to agreement on better global financial governance. The G-20 could get a head start in London by getting serious about commodities exchange regulation.

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