Institute for Agriculture and Trade Policy

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Thank you for inviting me to speak with you today. The United Nations High Level Meeting on the economic crisis and development, and the Commission of Experts advising the HLM, rightly focused on the role of financial services deregulation in triggering the crisis. However, a major category of financial services institutions has been overlooked by the HLM outcome document and the Commission of Experts, namely, commodities futures markets. Since only about 10 percent of futures contracts result in the delivery of a commodity, they are primarily a financial instrument. Commodity futures prices are a crucial link in the price transmission of food security, energy security and in the use of base and precious metals. Commodity exchanges have a structural economic importance far greater than the value of futures contracts, to say nothing of how their operations affect the everyday lives of people around the world. Futures prices have global consequences and hence, I will argue, require global economic governance under United Nations aegis.

Futures prices are benchmarks for cash prices that affect export revenues, prices for essential food and energy imports, and investments that are particularly important for commodity dependent exporting countries. In 2007 and 2008, extreme price volatility in the futures markets made it exceedingly difficult to use traditional futures contracts to manage price risks. For example, huge jumps in the price of oil—$25 dollars a barrel in one day!—were inexplicable in supply and demand terms. Similarly inexplicable was the doubling of wheat futures prices in less than two months on the Minneapolis exchange. Recognizing the economic damage caused by deregulated and de-supervised derivatives trading, the U.S. House of Representatives has drafted legislation to prevent excessive speculation in U.S. commodity markets. The bill also has measures to discourage regulatory arbitrage, i.e. evasion of trading rules by traders exploiting weaker regulatory jurisdictions. However, the bill and the Obama administration's proposed rules are strongly opposed by a financial services industry that has grown rich by creating and exploiting regulatory loopholes.

Of the reasons that an intergovernmental agreement on commodity exchange regulation is needed, one stands out to me. Even if the United States successfully implements limits on the number of futures contracts held by one trader to minimize the "weight of money" effect on futures prices, this U.S. limit can be evaded. Traders can obey the futures contract position limits in each regulatory jurisdiction, but by aggregating contracts across markets and jurisdictions, they can continue to create extreme price volatility that they can exploit to the detriment of development. The communiqué of the just concluded meeting of G-8

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finance ministers expressed concern about the sharp increase in the price of oil over the past month. Hence, there must be an intergovernmental agreement on commodity exchange regulation, if only to harmonize national exchange rules. The HLM outcome document should authorize a working group towards preparation of such an agreement.

However, a harmonization agreement alone will not suffice to regulate the massive intra-day trading that is a main driver of commodity price volatility. Professor Stephan Schulmeister has proposed a .01 percent Financial Transactions Tax to reduce the frequency of both financial and commodities derivatives trading. The tax would have little effect on commodities buyers and sellers trading a contract a few times a month, but would dampen the automated trading of contracts dozens of times a day. According to our calculations, based on 2007 notional values of commodity futures contracts reported to the Bank for International Settlements, such a tax would raise about $10 billion. The tax, readily collected by national exchange authorities and discounting for an administrative fee paid to those authorities, could be put in a UN endowment for development projects.[1] To those who oppose any international taxation, we would respond in the words of U.S. Supreme Court Justice Oliver Wendell Holmes: "Taxes are the price we pay for civilization."

1. Steve Suppan, "Regulating commodities speculation: normative and fiscal means," Institute for Agriculture and Trade Policy, May 2009. http://www.tradeobservatory.org/library.cfm?refID=105922