

The Hunger-Makers: How Deutsche Bank, Goldman Sachs and Other Financial Institutions Are speculating With Food at the Expense of the Poorest

A Observations

1) High food prices make people go hungry

If people have to spend 80 percent of their income on food – not just 10 to 20 percent as in wealthy industrialized countries – then an increase in the price of grains, bread and other staples poses an existential threat. In 2011, global average prices for wheat, corn and rice were 150 percent higher (after adjustment for inflation) than they had been in 2000. In 2010 alone, higher prices for foodstuffs caused 40 million people to go hungry and live in abject poverty. Speculation on commodity exchanges with food products such as corn, soybeans and wheat is strongly suspected to contribute to poverty and hunger. This concerns us all. If we are paying into a pension fund or life insurance plan, then we may be financing our retirement by speculating on rising food prices. Even though banks and insurance companies reject accusations of wrongdoing, there is growing evidence that investments on markets for raw materials and food are making people go hungry.

2) Commodity trading as a capital investment strategy

Since the beginning of the last decade, the commodity markets – for metals, crude oil, wheat, corn and soybeans, among others – have been a favored target of investors. Financial institutions promise in their advertising that a growing global population and economic expansion will create steady demand for commodities and therefore turn the purchase of raw materials into a profitable business. At any rate, this is what is said, and investors have this expectation. As a consequence, pension funds, insurance companies, foundations and a large number of individual investors have invested more than 600 billion dollars at commodity exchanges.

3) Exchanges need speculators

These investments are not being made however to participate in the production of commodities or in farming operations. Instead, investors buy futures that are traded on commodity exchanges. Futures are contracts for raw material purchases or sales which are transacted on a date in the future. These contracts originally served to hedge prices in future business transactions by the producers and processors of commodities. In this way, the parties concerned could reliably calculate the cost of raw materials otherwise subject to sharp price fluctuations. A baked goods manufacturer, for example, could reserve a supply of wheat six months in advance at a fixed

price and therefore didn't need to be concerned about losses in bread production. To make sure that buyers and sellers always find their counterpart for these future transactions, there have to be enough market participants present who trade only with these futures, looking to earn money in this way. This activity has nothing to do with the actual physical business. It is the traditional role of speculators who, in a certain number, are indispensable for the functioning of commodity exchanges.

4) From useful to excessive speculation

Most investors active on exchanges today differ however from these traditional speculators. Both the volume of their business and their investment strategy have nothing to do with the actual business of commodity producers and processors, or with needed price hedging. These investors invest in futures because they see them as viable long-term investments. This has caused the share of speculative trading in the total market for commodity futures to swell from formerly about 30 percent to some 80 percent today.

5) Legal price rigging

This development became a reality when governments in the United States and Europe deregulated futures trading at the turn of the century and allowed investors driven solely by a financial market strategy to have unrestricted access to commodity exchanges. This had serious consequences. Commodity futures exchanges were originally established to allow producers and processors to hedge against price fluctuations. They were never intended to be instruments for capital investment, and due to the limited volume of physical goods involved they are not suitable for this purpose. Because investors use them for capital investments, their powerful presence on the market creates an apparent additional demand for commodities over longer periods of time, which ultimately leads to commodity prices being higher than they would be without these financial market-driven investments.

6) Prices disconnected from supply and demand

The appearance of capital investors on commodity markets has coupled commodity exchanges with the general development of financial markets. As a result, factors such as interest rates, readiness to take risk, and falling stock prices have had an impact on prices for commodities that is completely independent of supply and demand for physical goods. This doesn't mean that failed harvests, a decline in oil production or the increased consumption of crops to produce biofuels do not also affect commodity prices. But it does mean that the activity of financial investors can greatly prolong and intensify price hikes triggered by these factors and events.

7) Future prices dictate today's prices

Futures prices at the exchanges for physical trade serve as reference prices for buyers and sellers of commodities. It would make no economic sense for a grain producer to sell goods significantly cheaper than the price guaranteed by futures one or two months ahead. Similarly, it makes no sense for a grain processor to buy goods expensively now when he can obtain those more cheaply in the near future. The spot price, the price used in physical trading, therefore parallels relevant futures prices. If prices for futures have been driven by financial market investment strategies to a level higher than they would have been without this influence, then this has an immediate negative impact on the price of food.

8) How betting on commodities drives up the price of bread

Respected economists, among them Nobel laureate Paul Krugman, argue that investments in futures on commodities exchanges are only bets, comparable to a zero-sum game, and that they cannot distort spot prices. This argument does apply to traditional speculators whose trading with futures is based on the actual development of supply and demand for raw materials on the physical markets. It overlooks, however, that financial market-driven investors at commodity exchanges do not behave like traditional speculators and are not influenced by developments in supply and demand but continuously buy over a longer period of time without selling. This artificially raises futures prices and thereby raises spot prices as well. Currently available analyses of exchange data gathered in the United States show that growing capital investment at commodity markets has raised prices for grains, edible oil and gasoline over long periods by up to 25 percent. This has had serious consequences mainly for poor populations in developing countries, whose food and energy supplies depend on imports and global market prices.

9) Banks always win by organizing bets on commodities

Using commodity markets for investment has no economic value. Unlike investment activity in stocks and bonds, it does not serve to place capital in businesses or countries for productive purposes. Rather, it is all about betting on the performance of the commodities traded. Indeed, returns to investors are rather modest and the same returns could be achieved through other investment strategies. Diverting investment capital to commodity markets primarily serves the interests of participating financial institutions and exchange groups, who secure profits without risk by charging high fees for transactions. That is why they have the greatest interest in keeping things the way they are.

10) No lack of evidence

Managers in the financial industry argue that there is no evidence that financial investors in commodity markets have more than short-term impact on price levels. This contention is not tenable. The connection between speculation and rising prices is no longer doubted by specialists in the financial industry when it comes to the crude oil market. Because oil prices, reflected in expenditures on fuel and fertilizer, make up about a quarter of the cost of grain production and marketing, the influence of speculation on food prices is thought here to be unquestionably direct. Numerous empirical and econometric studies by experts from prestigious institutions and universities, cited in this report, also provide evidence of speculation influencing the food sector.

11) Regulation saves lives!

foodwatch believes these studies provide enough evidence to see to an end of the abuse of commodity exchanges for capital investment. But even if those responsible in the financial industry and governments do not recognize this evidence as conclusive, they are not absolved of the responsibility to stop the use of these financial products so strongly suspected of doing harm to other human beings and their welfare. The European Union's basic law inherently obliges European policy to be designed to regulate speculation with commodities. The precautionary principle is enshrined in the legal provisions of the Treaty of Lisbon governing the protection of the environment. It prescribes preventive action to protect life and limb if there is sound evidence calling for such a step, even if there is no conclusive scientific clarity about causal relationships. Article 191 explicitly includes the protection of human health. The precautionary principle means that the burden of proof must be reversed when we assess the impact of financial market investments on commodity prices – financial providers and marketers need to prove the harmlessness of their actions. As long as participating financial institutions are not able to prove this, governments and regulators must have the legal power to do everything possible to prevent commodity speculation from causing harm to the life and health of people in poor countries. In plain language, this means that trading in commodity futures must be strictly regulated.

B Calls for Action

1) Impose position limits

The influence of financial investors on price developments in commodities must be thwarted. The absolute number of futures contracts available for speculation must be limited, which means that limits on positions must be defined. When the United States Congress in July 2010 adopted the reform of financial market laws, it mandated the regulatory authority to enforce such position limits. There is no comparable legislature in the European Union however. The forthcoming reform of the EU directive on markets for financial instruments does open the possibility of imposing mandatory limits on positions at European commodity exchanges. foodwatch therefore calls on the German government to join the majority vote already decided by the European Parliament, and to urge the European Commission and governments of other EU states to impose effective position limits for trading with commodity futures.

2) Exclude institutional investors from commodities trading

Whether defining limits on positions is enough to curtail speculation is by no means certain. To use limits effectively, regulatory authorities must be able to reliably distinguish which transactions are subscribed only for speculative purposes, and which serve to hedge prices in trading with physical goods. This distinction has become appreciably more difficult since financial groups like Morgan Stanley, Deutsche Bank and Goldman Sachs have begun trading with physical goods, while oil groups like Shell and BP and major grain trading companies like Cargill, Bunge and ADM have for their part gone into selling the services needed for speculative investment on commodity markets. For this reason, there is also a need to dry up sources of capital for commodity speculation. The largest investments are made by pension funds, insurance companies and the managers of foundation assets. foodwatch therefore urges the EU Commission and the German government to expand existing restrictions on these institutional investors to include a ban on investing in commodity derivatives.

3) Prohibit mutual funds and certificates for commodities

Equally questionable are the mutual funds and countless so called certificates which the financial industry has launched for individual investors, allowing them to participate in commodity speculation. These exchange-traded funds (ETF) and exchange-traded notes (ETN) divert more than 100 billion dollars and euros to commodity markets without being of any economic benefit. Instead, they involve hundreds of thousands of investors in an ethically and legally untenable betting game which has devastating consequences for poor populations in many countries

around the world. foodwatch therefore calls on legislators in Europe to prohibit the issuers of commodity index funds and certificates at least from investing in agricultural and energy commodities.

4) Stop banks from speculating on food

Major banks like Goldman Sachs and Deutsche Bank were key actors in setting up commodity indices, and it is their commodity index funds and other financial products that contribute to harmful price rises at commodity exchanges. foodwatch calls on major financial institutions to do justice to the social responsibility postulated in their own documents: “Our second priority as a good corporate citizen is to earn money in a manner that is both socially and ecologically responsible.” (Deutsche Bank, 2010 CSR Report 2010.) foodwatch calls on major banks to take a first precautionary step by refraining from speculation with food commodities like soybeans, corn and wheat in their financial strategies.