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Preparation for Seoul and getting ready for France

Broadening of G20 agenda is continuing

A summary report by Sandro Gianella

The G20 governments and sherpas are currently in the process of preparing the summit in Seoul in November. A series of meetings on both ministerial-levels (finance and central bank deputies meeting) and among the development working group that was initiated in Toronto, indicated that the G20 is certain of its role and is therefore creating high expectations for their next summit. In a recent presentation the Korean presidential committee for the G20 summit outlined the agenda for the event, making clear that they saw the Toronto Summit as providing a basket of policy options whereas Seoul will be the place for making concrete policy recommendations. The main points in the agenda are: reform of international financial institutions, financial regulatory reform, and global financial safety nets (to better deal with volatilities in global capital flows) and development. The Korean government believes, that development falls in line with the G20s broad mandate and expertise. However, it takes a rather narrow view of development, with recommendations focusing mainly on growth, investment in infrastructure, trade and human resource development (the next edition of the newsletter will take a detailed look at the development agenda of the G20).

These developments, and the seriousness with which the Korean G20 committee is tackling the preparatory meetings shows that they are determined to host a successful summit and are ready to create expectations that they believe will be met. At the same time, pundits are discussing the possibility of a divide not between developed and developing countries, but along geographical lines. While these fears have yet to be substantiated, the continued widening of the G20s agenda and the uneven recovery from the financial crisis will not make it easy to reach conclusions.

Simultaneously, the French government under president Sarkozy has stepped up and outlined its ideas for the G20, once they take over the presidency from Korea right after the Seoul Summit. In a yearly high-profile speech to ambassadors, he argued that rather than finishing what is left from the Korean summit, France will show “action and ambition” trying to “shake up global governance, notably by setting up a G20 secretariat with a role in development and climate measures.” In addition, three main topics are on the top of the agenda: the reform of the international monetary system and stabilization of exchange rates, the regulation of raw material prices and excessive commodity speculation and the reform of world governance. International media is skeptical of the scope for spectacular success during the French G20 presidency, given the opposition in other capitals to some of their most cherished plans, such as exchange rate reform or a proposed international tax on financial transactions. In addition, the ambitious agenda is also viewed in regards to the upcoming presidential election in France in 2012. This newsletter will take a closer look at a particular point in Franes G20 presidency: commodity speculation and food security. The strengthening of the oversight of global commodity markets was raised by Sarkozy, by saying:

“Why should we only regulate derivative markets in the financial sphere? Extending regulations to raw materials and agricultural markets is possible and desirable. That way we will limit speculation.” (WSJ - Sarkozy outlines priorities for French G-20 leadership)

In addition, he said the G-20 needs to review the transparency of agricultural markets and study stocking policies, as well as the creation of insurance instruments by international financial institutions to allow importing countries to shield themselves against price volatility. France’s economy, energy and agriculture ministers sent a letter to three European commissioners, arguing that “at a time when commodity markets are more and more financial, the European regulation of commodity derivatives markets appear insufficient to us.”

In short, both the Korean and the French presidency of the G20 confirm the thesis that the group is trying to gain legitimacy in the sphere of global governance by taking on issues such as development and food security in addition to their original target of financial and economic governance. Besides, it is becoming clear that the approach of the G20 in these issues is rather conservative and most of the times purely growth oriented. This calls for additional pressure by civil society groups to push their principles and agenda on the table and hold national governments accountable for the positions and decisions they take at the G20 level.
The great hunger lottery - How banking speculation causes food crises by World Development Movement

By Tim Jones


The World Development Movement (WDM) describes the subject of their report as “the highest stakes, riskiest economic behavior ever devised, married to the most fundamental basic need of humankind.” Derivatives trading has been one of the most lucrative parts of the financial industry, but it is the increasingly complex, opaque and disconnected nature of these and similar products that ultimately triggered the collapse of the banks and the worst financial crisis in human history. While betting on the value of sub-prime mortgages undoubtedly leads to disastrous consequences, there is another area where the speculative behavior of the world’s largest banks and hedge funds represents a threat to the very survival of people: food commodities.

In this report, the WDM has compiled extensive evidence establishing the role of food commodity derivatives in destabilizing and driving up food prices around the world. Furthermore, it shows how this was fueled by the behavior of financial speculators, and describes the terrible immediate impacts on vulnerable families around the world, as well as the long term damage to the fight against global poverty. The report further describes how the current situation came to pass, the risks of another speculation induced food crisis, and what specifically can be done by policymakers in the US and the EU to tackle the problem.

At its heart, it carries a very straightforward message: allowing gambling on hunger in financial markets is dangerous, immoral and indefensible.

Financing Food - Financialization and Financial Actors in Agriculture Commodity Markets by SOMO

By Thijs Kerckhoffs, Roos van Os and Myriam Vander Stichele


Financing Food focuses on how derivative markets work and on speculation in food and agricultural products. This study demonstrates how the futures market for agricultural products, in particular, has changed and is being disrupted by new speculators, growing index funds and commodities funds. This can have an influence on food prices, which can rise as a result, making food too expensive for the poor inhabitants of developing countries.

The study also shows how a number of large banks and investment banks, such as Goldman Sachs, Bank of America and Deutsche Bank, control a wide range of functions in the derivatives trade and are a driving force behind the financial speculation. These banks made huge profits and paid huge bonuses in 2009, partly as a result of the trade in derivatives, of which food derivatives formed a part.

SOMO closes the report with several proposals for reforms within the financial markets for agricultural products, in order to prevent excessive speculation. Up to now, the derivatives trade has remained largely unregulated. Legislation is being drawn up in the US, the subject has long been on the agenda for the G-20, and the EU is preparing new laws.

SOMO’s website has many more interesting articles and documents on the subject of food and agriculture. Here is the link to the respective page: [http://somo.nl/dossiers-en/sectors/food-agriculture/food-agriculture](http://somo.nl/dossiers-en/sectors/food-agriculture/food-agriculture)

New rules to curb Wall Street’s influence over food and farming by the Institute for Agriculture and Trade Policy (IATP)


This comment on the recent Wall Street reform bill argues that the new law will severely restrict excessive speculation on agricultural commodity futures markets. Commodity expert Steve Suppan argues that “this landmark bill is a first step toward preventing the excessive speculation by big Wall Street banks that has created enormous price volatility in agriculture and energy markets and is an important win for farmers and rural communities whose economic futures are so tightly linked to agriculture and energy.”

This landmark bill is going to play a crucial role in the discussion of the G20 members and it is expected that the French presidency will most likely have a close look at how the Obama administration dealt with the issue of excessive commodity speculation. Although the bill has yet to be implemented, it makes clear that it is possible and imperative to combine the discussion on food security with the increasing financialization of commodity speculation in order to create coherent and effective policies. The bill requires the Commodity Futures Trading Commission (CFTC) to set per-commodity limits across all markets on the number of derivatives contracts that can be controlled by any one entity and its affiliates during a trading contract period. In addition, it also requires that most derivatives presently traded over the counter will be traded on public and regulated exchanges. The report concludes by arguing that greater transparency in the U.S. will also benefit many developing countries, which will benefit from greater price predictability and stability as they forward contract sales.

Follow IATP on Twitter: [http://twitter.com/iatp](http://twitter.com/iatp)
The outbreak of the financial crisis in 2008 has led to a remarkable rebirth of the Group of 20, turning the club into the self-declared premier forum for global economic coordination. At the same time, the world was shocked by a global food crisis with food-prices skyrocketing at times up to 100 (corn) or 140 percent (wheat). These drastic changes have had tremendous consequences in developing countries, where millions were no longer able to buy their daily food. In some countries like Haiti, the Philippines or Egypt this even lead to widespread riots.

Consequently, the G8 and the G20 too, could no longer look away and included food security on their agenda, most prominently at the 2009 G8 summit in L’Aquila, Italy. The heads of state agreed to raise a total of 20 billion US dollars for the fight against hunger. Moreover, in the final communiqué of the G20 Pittsburgh Summit, they committed to continuously invest in the promotion of food security. The World Bank was commissioned to set up a trust fund for these investments and in April 2010 the so-called Global Agriculture and Food Security Program (GAFSP) was started. Responding to recommendations from the G20, it focuses mostly on the increase of agricultural productivity and the improvement of access to new technologies in developing countries. The fact that OECD countries are now paying attention to the agricultural sector is to be welcomed.

However, the way in which this problem is being dealt with leads to several problems. Putting increasing agricultural production in the spotlight means that the G20 is missing a big part of the picture. Aspects such as the relations in the international trade system or the vulnerability of developing countries to price fluctuations in commodity markets are left out of the debate. The recent rise in wheat-prices after the fires in Russia - even though experts agreed that global supply is sufficient - shows the problematic role that speculators play on agricultural commodity markets. The lack of coherence in the policies of the G20 is especially regrettable because sustainable measures need a more wide-ranging definition of food security. The discussion is stuck in intellectual silos instead of tackling the topic of food security in synchronization with the rest of the economic agenda of the G20 and in order to find a development-friendly trade reform and a way to curb excessive speculation on commodity markets.

Moreover, the initiative of the G20 is not integrated into other programs of international “food security governance” but instead creates parallel structures detached from these existing strategies. For example, the “Committee on World Food Security” (CFS) under the auspices of the FAO has been applauded as successfully integrating groups affected by food insecurity into the decision-making process. In how far this newly established body will become a serious actor in part depends on its financial possibilities and the resulting political authority. Rather than bypassing the CFS completely, the G20 should give it the power to coordinate the newly available funds for food security in order to take advantage of the democratic and participative structure of the committee. This is more likely to result in a fair distribution of the funds in the interest of the affected populace.

What’s more, the increasing financialization of commodity markets has led to more severe price-fluctuations that are not directly related to the market fundamentals of supply and demand, as argued in a recent report of the United Nations Conference on Trade and Development. Since the introduction of so-called commodity index funds by institutional investors such as Goldman Sachs, traders are allowed to invest in the price of basic foodstuffs. The number of derivatives and future contracts have shot up. In addition, many of these financial instruments are traded over the counter, and are therefore neither transparent nor regulated. The passage of the Dodd-Frank Wall Street reform bill in the United States has shown, that it is possible to combine the discussion on food security and the reform of financial markets in an effective and coherent manner. (more on the bill in the opinion piece on the next page)

The G20 does have the opportunity to push for global financial reforms that would lead to a fairer and more transparent way of trading commodities. In short, the G20 should realize that food security is a complex problem which is dependent on the support and cooperation of both civil society and local actors. As the premier forum of discussion for global economic cooperation it does have a role to play in solving the recurring food crises, but until now it has only attempted to solve part of the puzzle. It remains to be seen whether the G20 will finally be able to draw conclusions not only in regards to the financial-, but also the food crisis and consequently increase the coherence of their recommendations.
The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States paved the way for real change in global commodities markets. At the time of its passage, Chairman Dodd called for coordinated international effort towards rescuing food and energy markets from their current plight. However, the G20 has been slow out of the blocks, despite the fact that there are few issues as urgent for its member countries as repairing commodity markets. These markets determine the allocation of the essential raw materials of society: food to keep us alive, and fuel to power our industries and homes. In a world ravaged by the effects of a global financial crisis, stabilizing volatile commodity markets is one of the most important preconditions for economic recovery.

That is why the French administration has moved to push commodities regulation towards the top of the G20 agenda. A week ago, President Sarkozy announced that regulating commodity derivatives would be one of the priorities of France’s year-long presidency of the G20, which commences in November. This was followed by a letter from France’s Economics, Energy and Agriculture Ministers, sent to three European commissioners on August 27th, which stressed the inadequacy of the current regulatory structure. The letter called for coordinated action across the EU, and sketched out some possible strategies for reform.

These strategies include the establishment of a European equivalent to the Commodity Futures Trading Commission (CFTC), which in the U.S. regulates all commodities futures (and now, with the passage of the Dodd Frank reform bill, all other commodities derivatives too). Such a proposal was previously championed by French Finance Minister Christine Lagarde. Currently, EC commodity market rules are loosely enforced by national authorities, who are often inconsistent and sometimes even indifferent about implementation and enforcement. As well as proposing a more centralized, and therefore consistent, approach to regulation, the letter also raises other possibilities. These include the creation of U.S.-style position limits to curb excessive speculation, and various measures to improve transparency.

All this begs the question: what exactly is the problem that the G20 is trying to solve by reforming regulation of commodities markets?

Really, there are two separate problems: manipulation, which can potentially show up in any market, and excessive speculation, which is specific to commodities.

Manipulation is a deliberate abuse of market power to influence prices. It occurs when a small group of market participants gains enough power to control prices for a period of time, and uses this power to their own advantage, at the expense of other participants. A notable example came last month, when Anthony Ward of Armajaro Asset Management LLP purchased enough cocoa on the London International Financial Futures and Options Exchange (LIFFE) to make 5.3 billion chocolate bars, pushing up cocoa prices 5% in one...
Opinion

Commodity speculation - continued

day. This was enough to prompt actual users of cocoa to write to NYSE Liffe, the holding company of the Liffe exchange, as well as the UK’s Financial Services Authority demanding the creation of position limits to curb such activities.

Excessive speculation is a less well-understood phenomenon. However, it is potentially far more dangerous. Here, the price distortions are generally not deliberately created. Whereas manipulation refers to an intentional act of sabotage perpetrated by some individual or small group, excessive speculation is a condition of the market that may arise even when every individual participant is acting in good faith.

To understand the problem of excessive speculation, it is necessary to take a step back and consider the purpose of commodities markets. Physical commodities in their natural state are prone to uncertainty and risk. Bad weather like the droughts in Russia can destroy crop yields, while oil spills like the Deepwater Horizon disaster can knock out millions of barrels of oil supply. Therefore, commodity futures exchanges exist to enable producers and consumers of these products to manage their risks.

On exchanges like Liffe, ICE (Intercontinental Exchange) and CME (Chicago Mercantile Exchange), producers and consumers of everything from metals to coffee to crude oil can come together to enter into and trade contracts for future delivery. For example, a farmer could enter into a grain futures contract with a large baker to lock in a certain price for his crop, and an airline could use oil futures to protect itself from a spike in fuel prices. These commercial participants are joined by speculators, who seek to profit by filling in the gaps where a consumer is temporarily unable to find a producer to trade with, or vice versa.

However, in the absence of adequate regulation, speculation (risk-seeking) by financial traders can come to dominate hedging (risk-avoidance) by commercial end-users. In such scenarios, speculation tends to exacerbate price volatility rather than smooth it. This harms businesses and households as the cost of their inputs becomes unpredictable and unaffordable. This volatility causes unemployment in developed countries, and starvation in emerging nations.

Excessive speculation is greatly facilitated by the existence of unregulated over-the-counter (OTC) derivatives markets. In these markets, there is zero transparency, as financial speculators use swaps and other instruments with no disclosure requirements to bypass position limits. The impact of this speculation is then passed on to regulated futures exchanges by the large banks who act as dealers in the OTC markets when they hedge their exposure on exchanges. Finally, the volatility this creates in futures markets is passed on to consumers and producers, both when they trade futures, and when they actually buy physical product directly, because the prices of many physical commodities are benchmarked against futures prices.

The EC is holding a public hearing on commodity derivatives reform (covering both exchange-traded derivatives like futures and OTC derivatives like swaps) on Tuesday September 21st. The G20 plans to hold a public event in late December or early January, with a follow-up in March of next year. So far, the G20 has committed only to improving the over-the-counter derivatives market rather than radically restructuring it, as has been the case in the US. In part, this is a product of mass lobbying by financial institutions.

“So far, the G20 has committed only to improving the over-the-counter derivatives market rather than radically restructuring it, as has been the case in the US. In part, this is a product of mass lobbying by financial institutions.”

David Frenk

David Frenk is the executive director of Better Markets. He studied Philosophy, Politics and Economics (PPE) at Oxford University, before completing his graduate studies in Philosophy at New York University. At both institutions, he was the recipient of various academic awards and scholarships. Prior to joining Better Markets, David worked in both the private and public sectors on a broad range of business and policy issues. In 2005, he acted as a consultant to the Rwandan government on economic strategy and policy. In 2006 and 2007, he worked at OECD’s Center for Education Research and Innovation as a consultant on education policy across Europe. From 2007-9, David operated as a full-time researcher at Masters Capital Research, coordinating theoretical and empirical analysis of markets.

Since joining Better Markets in 2009, David has coordinated a team of researchers studying the function of commodities markets and capital markets. He has met with representatives of the CFTC, SEC, FERC, and FSA, as well as members of the United States Senate and the United States House of Representatives to discuss these topics. He has also lectured frequently in the United States and his native United Kingdom on market structure and function, and on appropriate regulatory frameworks.

David is an expert in financial markets, and has extensive training in statistical analysis and other formal mathematical techniques.
Commodity Markets

They are markets where raw or primary products are exchanged and traded on regulated commodities exchanges, in which they are bought and sold in standardized contracts

What is a Futures Contract?

A futures contract is an agreement to buy or sell in the future a specific quantity of a commodity at a specific price. Most futures contracts contemplate actual delivery of the commodity can take place to fulfill the contract. However, some futures contracts require cash settlement in lieu of delivery, and most contracts are liquidated before the delivery date. An option on a commodity futures contract gives the buyer of the option the right to convert the option into a futures contract. They allow buyers and sellers of physical commodities to hedge their prices and to determine the market price of the commodities.

Who uses Futures and Options Markets?

Most of the participants in the futures and option markets are commercial or institutional users of the commodities they trade. These users, most of whom are called “hedgers”, want the value of their assets to increase and want to limit, if possible, any loss in value. Hedgers may use the commodity markets to take a position that will reduce the risk of financial loss in their assets due to a change in price. Other participants are “speculators” who hope to profit from changes in the price of the futures or option contract.

Hedge

A hedge is a bet in the opposite direction from your primary risk. As a farmer wants the price of grain to be high, a hedge is any bet (contract) in the opposite direction, i.e. buying a future that rises in value if grain prices drop. That effectively locks in a price for a future sale, which allows farmers and businesses to plan ahead more easily without having to worry about drastic price swings.

Commodity Index

In a commodity index, an investor’s money is spread among a number of commodities. For example, if an investor buys $1000 of the S&P/Goldman Sachs commodity index, $700 would be invested in energy futures like crude oil and natural gas, $140 in agricultural commodities like wheat, corn and soybeans, $80 in industrial metals like aluminum and copper, and the rest in livestock and precious metals.

Derivative

A financial instrument, traded on or off an exchange, the price of which is directly dependent upon the value of one or more underlying securities. Derivatives involve the trading of rights or obligations based on the underlying product but do not directly transfer that product. Derivatives can also be used to acquire risk, rather than to insure or hedge against risk. Thus, some individuals and institutions will enter into a derivative contract to speculate on the value of the underlying asset, betting that the party seeking insurance will be wrong about the future value of the underlying asset.

Over-the-counter (OTC) derivatives

Are contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. The OTC derivative market is the largest market for derivatives, and is largely unregulated with respect to disclosure of information between the parties, since the market is made up of banks and other highly sophisticated parties, such as hedge funds.

Index Speculator

Index speculators are institutional investors engaged in commodities futures trading strategies that seek to replicate one of the major commodities indices by mechanically following that index’s methodology. They aim to profit from price movements in commodities futures. They are not in the market to hedge an underlying exposure to physical commodities and are not involved in the production or consumption of actual tangible commodities. They are predominantly institutional investors such as corporate and government pension funds, sovereign wealth funds, public and private foundations and life insurance companies.

Chicago Mercantile Exchange

The Chicago Mercantile Exchange (CME) is an American financial and commodity derivative exchange based in Chicago. It trades several types of financial instruments: interest rates, equities, currencies and commodities and has the largest options and futures contracts open interest (number of contracts outstanding) of any futures exchange in the world.

Commodity Futures Trading Commission

The Commodity Futures Trading Commission is an independent agency of the United States government based on the Commodity Exchange Act, which prohibits fraudulent conduct in the trading of futures contracts. In 1974, Congress amended the Act to create a more comprehensive regulatory framework and created the CFTC. It’s mission is to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options.

Sources:
G20 Database & E-Mail Group
Stay informed

Database

If you would like to read more on the G20, recent changes in Global Governance and what it means for specific regions or issues, the G20 Database of the Heinrich Böll Foundation is the right place to go. It is subdivided into the following folders, so you can easily access the analysis and information that is of interest to you:

Folder Structure of the Database

1 - Background
2 - Summits
3 - Issues
   3.1 - Finance
   3.2 - Climate Change
   3.3 - Development
   3.4 - Energy
   3.5 - Trade
4 - Country Specific
5 - Power Dynamics
   5.1 - Within the G20
   5.2 - G20 to non-members
   5.3 - International Organizations
6 - Civil Society

In addition, every folder contains both a Word and PDF document with annotations of the documents included in the folder.

So far, regional Heinrich Böll offices in Washington, Mexico City and Johannesburg and international civil society organizations have asked to access it. More importantly, the database is designed in a way that every member can add documents himself, which are then instantly synchronized so that everyone can access it. This is a great way to share information and build up institutional capacity.

If you would like to know more about the Database or sign up for access please send an Email to Sandro Gianella at gianella@boell.de. To get started right away, here are the 3 easy steps to install the Database on your computer:

1. Install the Programm "Dropbox" from https://www.dropbox.com/install
2. Write to Sandro Gianella, who will send you an Email invite to share the G20 Database folder.
3. Accept the invite and you should be able to access the database through a Dropbox icon on your Desktop.

E-mail Group

In addition, the Heinrich Böll Foundation is part of an international network of NGOs and policy-analysts, which have set up a G20-related E-mail Group.

To subscribe, send email to: alternative-g20+subscribe@googlegroups.com
To unsubscribe, send email to: alternative-g20+unsubscribe@googlegroups.com
To customize your subscription, go to http://groups.google.com/group/alternative-g20 (but you need to create a Google account, if you do not have one)

Replies automatically go the whole group. To minimize email traffic, please do only reply to the whole group if necessary. There is no moderation.

The G20 Database is meant as a way for the Heinrich Böll Foundation and its partners to share and collect information surrounding the G20 and related issues.

Impressum

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