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How to Protect Developing Countries from Volatile Global Markets

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In the years 2007 and 2008, many developing countries faced an economic *tsunami* as a global wave of food price increases swept over their national markets. The crisis pointed to an impasse in the hitherto dominant, free-market approach to agriculture and food trading. Drawing on this conclusion, this briefing presents four alternative ways to tackle the problem of controlling global food prices for the sake of poor developing countries' food security:

- limiting the connections between the domestic market and the global one;
- creating virtual reserves to counter price volatility in the global markets;
- exploring novel methods of physical supply management, more flexible and less bureaucratic than previous ones;
- reducing the impact of speculation and financial INVESTMENT on price-setting.

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Executive Summary

1. Diversified and protected local food markets

Developing countries suffer since decades from swift changes in prices for commodity exports, on which most of them rely heavily for their trade balance. But this problem has now been doubled by rising price volatility in food *imports* from the global markets. One possible solution to this second problem lies in isolating countries as far as possible from the risks of instability posed by the global markets. Wherever appropriate, regulators should switch incentives to encourage the production and consumption of 'non-traded' crops rather than the global ones that can be subject to worldwide market shocks.

In addition, official physical reserves should be built up of the foods that poor populations rely on, in order to stabilise their availability and prices. There are various options for how to operate them on national, regional or global level.

These regional reserves and regional trade in general should be supported by trade protection measures: there's no reason why poor countries should protect their food producers less than the rich ones.

2. Virtual reserve or stabilisation fund on futures markets

The second proposal starts with the claim that the problem comes from increasing financialisation of world commodity markets, in other words from their domination by financial investors and speculators rather than the trade interests for which they once were established. As it is, the most powerful players on the commodity markets are currently the banks. The International Food Policy Research Institute advocates what it calls 'two-pronged' global collective actions for food price stabilisation, consisting of:

- small, decentralised physical food reserves to facilitate a smooth response to food emergencies and humanitarian assistance; and
- a *virtual* reserve facility, backed by funded promissory notes, which can be used for timely intervention in futures markets to prevent price spikes and to keep prices close to long-run fundamentals.

3. Revival of global supply management

For major agricultural crops, we should reconsider physical supply management in the global markets. Innovative methods should be investigated market by market, and introduced or reintroduced with support from international institutions wherever they are found to be feasible.

Many different tools have been used in the past to manage supplies: manipulation of public or private stocks, import and export quotas, tariffs, corporations' controls over their own production and distribution systems, and tight commercial control over outsourced agricultural production. Any new public systems should learn from the methods used by commercial schemes of supply management, which are often more flexible and better adapted to the ways in which the markets themselves operate.

4. Regulation of agricultural commodity markets

Given that the prices of most major agricultural commodities (except rice) are determined on futures markets, a much stronger regulation of the financial markets seems indispensable if we are to address price volatility. Such a regulation should take into account all the problems that have arisen since the 2008 crisis. We have five main proposals in this area:

- Restrict or prohibit access to commodity markets for non-commercial participants.
- Legislation should outlaw any acquisitions of quantities of physical food commodities if they are made primarily for the purchasers' financial gain.
- Strong action should be taken to force a reduction in financial institutions' control of commodity markets.
- There should be comprehensive regulation of 'over-the-counter' trade taking place outside the formal exchanges, including the clearing of all transactions made on it.
- Impose a transactions tax on all financial investments in food commodities, in those places where there is not a complete ban on them.



Regulating Food Commodity Markets

In the years 2007 and 2008, the developing world faced an economic *tsunami* as a wave of food price increases swept over it from global markets over which they had little or no control. The impact on individuals' food supply and national food security was such as to draw widespread attention to the old – but largely ignored for decades – problem of commodity price volatility.

As a consequence, the French government decided to make this the priority topic for the G20 group during the year of its Presidency (November 2010 to November 2011). Meanwhile, a new crisis might be coming up since the middle of 2010, as the rising prices in the figure below show.

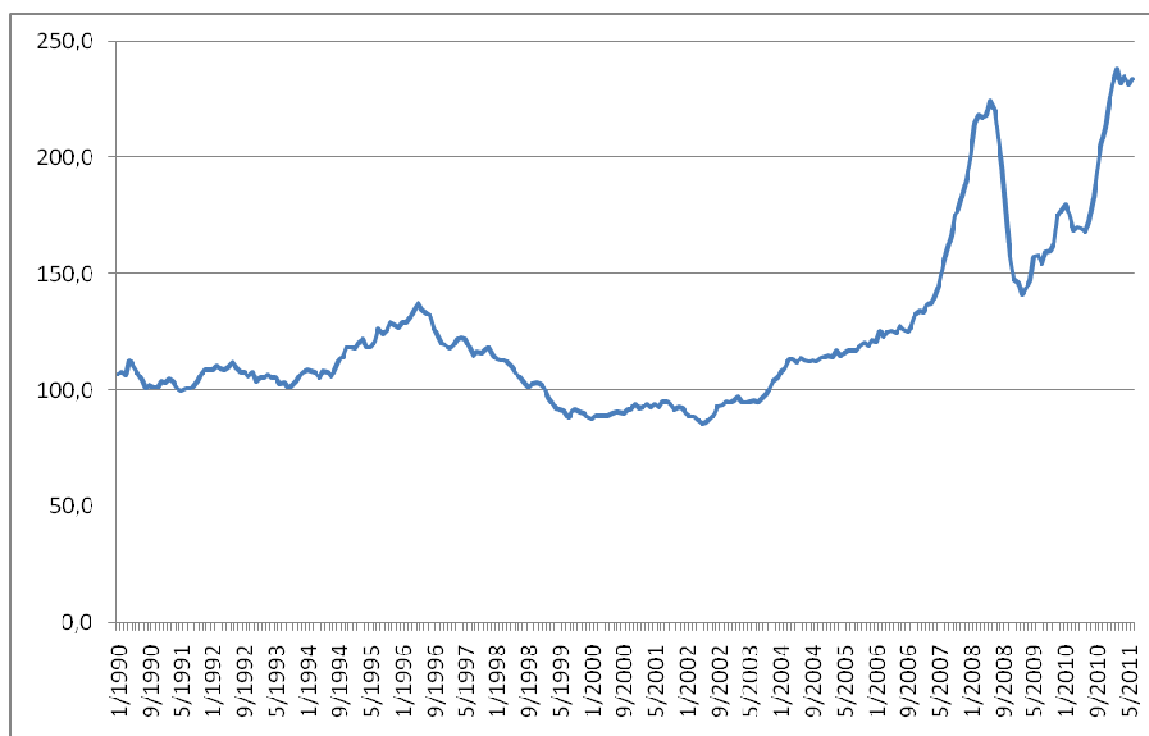
This briefing presents four proposals to tackle the central problem of controlling global food prices for the sake of poor developing countries' food security. It must be remembered that this is not an entirely novel problem, although the suddenness and scale of the staple cereal price increases in 2007-08 were unprecedented. Commodity markets *are* volatile by nature, but numerous mechanisms have been used in the past to cope with this at various times and in various places, for example:

- Buffer stocks and quotas to improve the balance of supply and demand.
- Contracts for future purchase and sale, which lock in prices for individual agents
- Guaranteed international markets at reliable prices, such as the European Union (EU) used to provide to African, Caribbean and Pacific countries in the now-disbanded sugar and banana protocols.
- Systems of 'compensatory' finance which aimed to provide monetary compensation for adverse commodity price shocks experienced by developing countries. Examples were the EU's Stabex fund and the International Monetary Fund's Compensatory Financing Facility.

Other ideas in the air in poorer countries include greater trade with their neighbours and a greater resort to growing crops that do not enter widely into international trade and therefore will not be affected by the global volatility of global prices.

This paper will present four proposals, which stem

Food Price Index 1990-2010 (2002=100)



Source : FAO

from different points of view of what the central problem is and how it can best be tackled. The main lines of argument of each proposal are these:

- improve food security in developing countries by reducing their dependence on unstable global markets for basic foods, including via the use of physical food reserves;
- create new mechanisms to counter price volatility in the global markets under the conditions that broadly prevail at present;
- alter those conditions in order to cut back the degree of 'financialisation' of the markets and reduce the impact of speculation within the commodity price-setting institutions;
- with item 3 achieved, explore novel methods of physical supply management which will learn from commercial and other experience, and be more flexible and less bureaucratic than previous public attempts at the same.

These approaches are not mutually exclusive or contradictory. Rather, they explore various ways to overcome the problems faced on commodity trade and development. Some schemes focus on intervention in physical commodity markets while others try to address volatility originating in commodity derivatives trading. There is in practice some overlap between the four approaches, especially between the first three ones, all of which suggest some form of intervention in commodities trading, while the last one is about regulating the market itself.

1. Food reserves and protection from global prices

Most poor countries rely heavily on exports of food commodities to balance their national income; to them, volatile prices on the global market have always been a problem. But the problem has gone much worse in recent years, as the same countries depend more and more on food *imports*. The 2008 food crisis affected even countries which achieved a broad balance in their staple food supplies, such as Zambia.¹ Even in that country the national average price for white maize, its main staple food,

increased by 88 per cent between May 2008 and March 2009.²

One solution to the problem lies in isolating countries, as far as possible, from the risks of instability posed by global markets. Volatility in a crop's price will then affect only one country or at most the countries of a region, not most of the world at once. In many developing countries the essentials of agricultural production, and the basis of local food supplies, remain to this day relatively independent of the vagaries of world markets.

Moreover, the worldwide grain price spikes of 2007-08 and since the second half of 2010 had quite a limited impact on the prices of local cereals (such as millet and sorghum), and *a fortiori* those of pulses and tubers (such as yams and cassava). However, growing imports of food products, facilitated by dumping prices and the weakness of import protection, have greatly transformed eating habits even in remote rural areas, where every village now has its own bakery, reducing by its very existence the outlets for local staple products.

The general approach to the crisis should be people-centred, not market-centred. It should concentrate on *who* is at risk and how to support them. Markets, including global markets, are of vital importance; but they are means to an end, not the end itself. The food price crisis demonstrates how easily they can fail in agriculture and the food trade. We do not raise here the issue of price *levels*: all else being equal, poor farmers would need *higher* prices – this would also benefit landless rural labourers as long as higher prices lead to higher wages. But *volatile* prices help no one except financial speculators and some commercial middlemen.

Faced with the *tsunami* of volatile world prices, the goal would be to detach national food economies from excessive dependence on world food trade, which is dominated by three cereals: wheat, rice and maize. As indicated above, there are many traditional foods which are at least as nutritious as these, remain familiar to farming people and evolve in harmony with local conditions (unlike crops which originated on other continents). Their markets are geographically limited and therefore unlikely to spread any market problems over to other parts of the world. Following an advisor of the French government, "it is more likely that solutions will arise mostly from policies aiming to brake the transmission of instability [from the

¹ Tembo *et al* (2009), Table A1, p. 29.

² Global Information and Early Warning System on Food & Agriculture, www.fao.org/gIEWS/pricetool2/.

global] to the national level, and to reduce its impact on vulnerable populations... Agricultural markets have always known unstable prices, but producers and consumers were protected from them by public policies.”³

Wherever appropriate, incentives should switch to encourage the production and consumption of ‘non-traded’ crops rather than the global ones. In Africa it is recommended to move away from any excessive promotion of maize, rice and wheat, and the same applies for the current emphasis on rice in Asia. Going back to a greater variety of sources of food, including traditional crops, could also improve nutrition and public health. For example, millets contain more proteins, minerals and vitamins than wheat or rice and are more resilient, requiring less water to grow. But while Indian rice production has increased by 125 per cent and wheat production by 285 per cent since the late 1960s, millet production has barely changed at around 18-20 million tons per year.⁴ At a recent conference on this topic in Arusha, Tanzania, “the total number of species presented was enormous. The sheer number of underutilized species that could contribute to peoples’ food security presents a big challenge for work on these crops.”⁵ This is because they tend to be part of submerged, local food cultures.

In addition, official physical reserves should be built up of the foods that poor people rely on, in order to stabilise their availability and price. By buying stocks when prices are low and releasing them when prices are high, food reserves assist both the stabilisation of prices and food security; if managed properly, they can be run at a profit.

Food reserves do not have to be national. Under the European CAP before it was reformed, intervention stocks were run by each member state but under rules that were agreed by all states jointly. Whatever actual form the food reserve takes – and the CAP was designed to meet West European needs in the 1960s, not to help the least developed countries 50 years later – a similar combination of national or local stocks with joint regional decision-making seems appropriate. Most of all, they should be controlled by the country or group of countries they are meant for. There have recently been proposals to create a global food

stock, but that would remove from governments the control that they themselves need over national food security. Donor agencies can by all means be invited to advise on the establishment and running of food reserves, but they should not own them or control them.

Use protection to support regional reserves and regional trade. There are various options for how to operate food reserves – nationally, regionally or globally. In many cases the most effective way to reduce international agricultural price volatility for the benefit of poor countries is to regulate it at the regional level. Many countries already have national food reserves of some sort, and regional reserves could be built on the basis of these. They could emerge gradually, depending on how fast member countries gain experience of managing national food reserves and develop mutual trust expands through the regional trade. However, “past experience teaches us that the use of reserves to stabilise prices only works if it is undertaken in a “protected” market.”⁶ We therefore propose that trade negotiations should permit every major country or sub-continental region to protect its markets for staple food products.

In recent times many developing countries have found their food security imperilled by the reduction of barriers to food imports from global markets. Often the imported foods are subsidised by the producing countries, but even where this is not the case, this could cause harm to the local economy if domestic producers are not given the time or means to adjust to new sources of competition. That is particularly important in countries where a large part of the population relies on agriculture for its livelihoods.

Protecting domestic markets proves often necessary if we want local farmers to gain enough to pay themselves for needed investments. In fact, the more developed a country is, the *less* likely it is to import staple foods and the *more* likely it is to use protective measures against such imports. Thus, the average duty on cereals in the EU remains at 50 per cent compared with 5 per cent in the West African Economic and Monetary Union (UEMOA). If West Africa is the most underdeveloped region in the world, it is also the one with the lowest average rate of agricultural protection – 13 per cent, against 16 per cent for the least developed countries and 20 per cent for

³ Buba (2011), quoted in ROPPA (2011), p. 7. Translated by the authors.

⁴ Millet Network of India (undated), Table 3.

⁵ International Society for Horticultural Science (2008), p. 3.

⁶ Buba (2011). Translated by the editor.

developing countries in general.

If order to be fully efficient, however, these measures should be accompanied by others, such as the development of infrastructure to reduce transport costs and intensify intra-regional trade, and the financing of investments for the irrigation of rice and other staple foods. It is also necessary to transfer food-processing technology in order to reduce a region's imports of wheat and other foods. The industrialised world and international institutions should provide temporary aid for poor consumers in the least developed countries, by financing coupons for local staples at lower prices, as it is the case in models which are still current in the United States, Brazil and China. As for India's system, "the government intervenes at the consumer end via its procurement, stocking and distribution policies ... the rice mills are obliged to sell a certain proportion of their milled rice ... to the state agency at a predetermined price, which is often lower than the market price... The food thus procured is stored and distributed at subsidized prices to meet the consumption needs of the poor via the [Public Distribution System]."⁷

Promote the most sustainable agricultural methods. The commodity import problem arises again with the question of the inputs used by the farmers – in most developing countries, and especially in the poorest of them, farmers have to import the chemicals and minerals that are at the heart of "modern", intensive systems of agriculture. That's why they were unable to take advantage of higher food prices in 2008 – the prices for main production inputs went up even more... Indeed, throughout the whole period since the last big commodity price boom in the 1970s, prices for manufacturing goods have been increasing faster than cereal prices – and the prices of industrial inputs used in agriculture have been increasing even faster.⁸

Here again, domestic resources and more traditional ways of doing things can often help. Instead of attempting to copy the industrialised farming of the rich world, resort can be made to sustainable agroecological practices to provide manures and pest control independently of volatile oil, chemical and fertiliser prices. Indeed, when farmers are consulted on methods of soil nutrition and pest control, rather than being lectured by

scientists what they should do, the results can be striking. As reported by researchers in Zambia and Malawi investigating how substances in wild plants can be used to control insects and other pests: "We found that most farmers were very knowledgeable about the pesticidal properties of a large number of plants (...), although they use relatively few of them on a regular basis."⁹

In other words, agroecological methods provide alternatives to applying minerals and chemicals for soil nutrition and crop protection, offering both economic and environmental benefits.¹⁰ This has been described as the 'functional use of biodiversity', combining research at the genetic, species and ecosystem levels rather than working on genetic improvements alone.¹¹ One area which combines these approaches is **agroforestry**, where trees are used in conjunction with agriculture to improve *both* output and sustainability. An example is the placing of *Faidherbia* acacias (or 'fertiliser trees') among crops. They give shade – which in tropical conditions can increase the yields of many crops – and shed their leaves during the early rainy season, releasing nitrogen into the soil, and then remain dormant throughout the crop-growing period. It is reported that, "in Malawi, maize yields are typically 2-3 times higher when the crop is grown under a canopy of *Faidherbia*."¹²

2. Virtual reserve or stabilisation fund on futures markets

The second group of proposals addresses the problem of 'financialisation' of world commodity markets, *i.e.* their increasing domination by financial investors and speculators rather than the trade interests for which they primarily exist. Indeed, banks like Goldman Sachs, Morgan Stanley, J.P. Morgan Chase and Barclays Capital are today the key global players on the commodity markets. Since the last decade they have created more demand for commodities with exchange-traded index funds, and since 2009 they have moved into a twin-track strategy involving both physical commodities and transport or storage facilities, such as shipping and the companies that own the

⁷ Gulati and Dutta (2010), pp. 281-82.

⁸ Lines (2011), p. 9.

⁹ World Agroforestry Centre (2010), p. 31.

¹⁰ See Lines (2011), pp. 35-38.

¹¹ Pimbert (2010), p. 2.

¹² World Agroforestry Centre (2010), p. 8.

London Metal Exchange's official warehouses.¹³

These are not roles that banks should play. Their predatory "internalisation" of transactions – the use of customers' and clients' deposits and investment funds to turn a profit for the banks themselves via proprietary trading on derivatives markets – must be brought to an end. The domino effect created by networks of linkages through interbank lending and the derivatives markets was not only the main cause of the 2007 credit crisis (and therefore the 2008 banking crash); it is also the principal reason for the banks' excessive political power.

Evidence available so far suggests that unregulated derivatives markets and dealings overpopulated by financial investors with little interest in physical commodities have increased the risk of excessive volatility - although we require more analysis to understand just *how* the financialisation process gives rise to volatility in relation to market fundamentals. Furthermore, the scale of excess may have become so large that stakeholders in physical commodities cannot rely any longer on price signals emanating from futures markets to make informed decisions concerning demand and supply conditions. Under such conditions, futures markets can cease to perform their main functions, which are price discovery and risk hedging for those engaged in physical trade.

When market fundamentals change fast, it can be hard to maintain commodity prices within a particular reference zone with conventional stabilisation instruments. It may then be more effective to aim intervention at inducing a swift change into trading behaviour itself, away from destabilising 'noise' trading. This is the line of reasoning behind proposals emanating from the International Food Policy Research Institute (IFPRI).¹⁴ It advocates what it calls 'two-pronged' global collective actions for food price stabilisation:

- small, decentralised physical food reserves to facilitate a smooth response to food emergencies and humanitarian assistance;
- a *virtual* reserve facility, backed by funded promissory notes, which can be used for timely intervention in futures market to prevent price spikes and to keep prices close to long-run fundamentals.

Under the first prong, the World Food Programme would manage a series of food reserves in various locations in the developing regions. These would be maintained by the international community in addition to strategic reserves held by specific nations. This would be financed by funds provided by the so-called G8 + 5 countries (G8 plus Brazil, China, India, Mexico and South Africa).

The second prong would be operated by countries that become members of the proposed scheme and backed by a virtual reserve with access to the futures markets and financed by promissory notes. The scheme would rely on two institutions, an "Intelligence Unit" and a high-level "Technical Commission". The former, in fact an international public agency, would closely monitor price movements, and design and maintain dynamic price bands in the light of market fundamentals. It would make regular public announcements of price forecasts and a band of "acceptable" prices, which would fluctuate with the development of fundamentals over time. This should allow traders to anchor their expectations more in market fundamentals, and hence help prevent 'noise' traders from engaging aggressively in destabilising speculation.

In order for these scheme to work correctly, it should be possible to switch all market interventions on and off at ease, and to adapt them to specific conditions of each market. On one hand, an intervention should not impede futures market development and deepening, as sufficient liquidity is critical for effective risk hedging. Hence, under normal, tranquil conditions markets should be left to function efficiently with little interference. However, in the event of speculative bubbles developing and prices moving significantly outside the dynamic price band set in relation to demand-supply fundamentals, an intervention in the futures market would be activated by an authorised order from the high-level Technical Commission on the basis of a 'trigger' provided by the Intelligence Unit. For example, the intervention could take the form of a counterbalancing futures 'short sells' position so that spot price rises are moderated.¹⁵

Such a system would give market a breathing space and facilitate the orderly realignment of commodity prices to shifting fundamentals.

¹³ See for example the last two paragraphs of the *Financial Times* blog article at <http://ftalphaville.ft.com/blog/2011/05/18/572046/please-wait-10-months-for-your-aluminium-thank-you/>.

¹⁴ von Braun and Torero (2009).

¹⁵ Nissanke (2010), pp. 46-48.

3. Revival of global supply management

For some tropical crops traded on global markets, we also need to reconsider physical supply management. Innovative methods should be investigated market by market. These systems should be introduced or reintroduced wherever they are found to be feasible, with financial support from international institutions. While there may be some markets where something like the former International Commodity Agreements (ICAs)¹⁶ will provide the best mechanism available, other methods of supply management will be more suitable in other cases. These might include novel forms of international supply chain agreements which combine economic mechanisms and social and environmental chapters.

To give an example, the multi-stakeholder World Banana Forum was established in December 2009, at a meeting at the FAO's headquarters in Rome,¹⁷ in order to explore the possibility of such an agreement. The Forum brings together banana companies, agricultural unions, trade unions, non-governmental organisations, research institutes and governments, and wants to ensure that every actor on the supply chain, from the producer to the retailer, receives a fair price which covers their costs plus a reasonable profit margin, and that consumers understand the need to pay a sufficient price to guarantee sustainable livelihoods for everyone along the chain.

The instruments used to manage supplies at different times have included the manipulation of public or private stocks, both import and export quotas, tariffs, corporations' controls over their own production and distribution systems, and tight commercial control over outsourced agricultural production (supply chain management). The

physical reserves discussed above can be counted as one of these. Such mechanisms have been used either to limit supplies in order to keep prices up or to manipulate supplies with a view to evening out price fluctuations. Many different tools have been used by a variety of actors – private firms, organisations defending farmers' interests, coalitions of producer states (such as the OPEC), or producing and consuming countries operating in concert in the former ICAs.

Supplies can be managed with a view to either raising or lowering the price level on national and international markets. There are methods for pushing supplies up (e.g. subsidies to domestic producers, and import tariffs), cutting them back (e.g. production or export quotas), or doing either at different times with the aim of reducing price volatility (e.g. a buffer stock or variations in quotas). However, any scheme can come under severe, unpredictable strain at times, and provisions to accommodate that should be built in. For instance, the severe recession in the early 1980s made commodity supply management very difficult to maintain and led indirectly to the collapse of both the corporate "Gentlemen's Agreement", which had kept aluminium prices stable for many years and the International Tin Agreement, which ran out of money to defend its floor price. In future the possibility of such strains could be built into any agreement of this sort with something akin to a *force majeure* provision.

Any new public systems should also learn from commercial schemes of supply management. The basic issue is to know who controls the market or supply chain. Over recent decades the control of commodity markets (and with it, the ability to manage supplies) has gradually shifted from the producer to the consumer end of supply chains, as well as from public to private authorities.

One of the problems of the former ICAs lay in their one-size-fits-all nature: every market was to be addressed by an agreement between all, or as many as possible, of both the producing and the consuming nations on the market, and the methods used were limited to buffer stocks and export quotas to keep prices within a predetermined price band. Relying exclusively on buffer stock management for stabilisation is both inefficient and costly in the face of rapidly shifting market fundamentals such as those observed in the last few years; this point was already addressed above. Similarly, the earlier historical experiences show that stabilisation schemes based on export quota allocation among producing countries entail significant transaction costs to the negotiating

¹⁶ The ICAs were set up to combat the inherent flaws of the commodity markets and provide developing countries with greater certainty as to their export earnings. They were negotiated between the main producing and consuming countries of a commodity and existed for various commodities at different times between the 1930s and 1980s. They aimed to even out price fluctuations, usually by buying stock off a market at times of surplus and falling prices, and selling it back when a shortage developed and prices rose again. The biggest of them, the International Coffee Agreement, operated with export quotas, coffee being a perishable product.

¹⁷ Further information is available at www.fao.org/wbf.

parties as well as other technical problems such as coordination failures and free-rider problems.

Successful supply management, whether led by public or commercial agencies, has taken many different forms, some of them being much more flexible than the ICAs. The lesson from this – as with development strategies more generally – is that the method chosen should be that which is best suited to the practical situation faced.

There are both technical and political factors in the success of supply management, and they have been summed up as follows:

Technical requirements:

- a coherent market, which renders market intervention possible;
- a competent administration to implement the chosen mechanism;
- tactical flexibility based on judgments of the market, not fixed rules;
- compatible policies for competing products: market intervention should not alter a commodity's competitive position against potential substitutes.

Political requirements:

- an ability to exert power over the supply chain, whether by a private firm (due to market concentration) or by the state;
- an underlying solidarity among those who control the process;
- on agricultural markets, some influence of farmers over the system;
- on international markets, the presence if possible of a 'swing' producer which is ready to vary its production in the interests of the market as a whole; and
- A readiness to exploit the wider politics of the market in question.¹⁸

4. Regulation of agricultural commodity markets

Since the prices of most of the main agricultural commodities (except rice) are determined on futures markets, we also need a much stricter

financial regulation, taking into account all the problems revealed by the 2008-2009 financial crisis. This is a complicated and highly technical issue; all we can do here is to sketch out the main principles of what needs to be done and some of the most important changes in regulation that are required. Most of all, it's about dealing with the so-called non-commercial positions on commodity markets, in other words with transactions which serve speculative or investment goals, rather than the needs of commerce in the product actually traded. This issue has become urgent because of the vast expansion of such activity over recent years, including the development of new instruments such as index funds and exchange-traded funds (ETFs), the growing role of speculative hedge funds and of proprietary trading (banks' trading on their own accounts). Another novelty introduced in the 1980s is the rapid growth of over-the-counter (OTC) trade, which takes place off organised exchanges and out of public view, and has not hitherto been subject to regulation.

In the United States, regulating and supervising commodity is the task of the Commodity Futures Trading Commission (CFTC), created in 1975 and reinforced by the Dodd-Frank Act from 2010 (the new law still awaits implementation, though). No other parts of the world have a comparable regulation; in Europe, where the main commodity futures markets outside the US are to be found, the European Union is currently working on proposals for new regulations, but the content of many of them has not been determined yet.

We have five main proposals in this area:¹⁹

- **Restrict or prohibit access to commodity markets for non-commercial participants.** The CFTC already does this to some extent in the US, but it's regulation must become stricter and applied across the world. Effective position limits (maximum numbers of futures contracts owned by one participant on a particular market) need to be introduced, with consistent international enforcement. Suzan Newman proposes in addition "an upper limit to the proportion of futures trading conducted by non-commercial actors", to be determined market by market.²⁰

¹⁸ See Lines (2007B), pp. 12-17.

¹⁹ This section draws extensively on Lines (2010).

²⁰ Newman (2009), final paragraph of Conclusion (on an unnumbered page).

- Some hedge funds, and other types of business, are now taking delivery of physicals – and not just in gold. There has been evidence of this on the oil and copper markets, and even in rice during the 2008 price spike. This is about old-fashioned hoarding, but done by speculative investors, not merchants. However, the U.S. and the U.K. do not regulate the spot markets transacted on their territories. **Regulations must prevent this, based on laws which would make the hoarding of food commodities for financial gain illegal.**

- **Strong action should be taken to force a reduction in financial institutions' control of commodity markets.** Above all this means reducing the dominance of banks in much of the commodities trade. This domination, which has built up slowly over the last 20 years or so, can be seen for example in Barclays Capital's and J.P. Morgan Chase's extension of their activities into shipping, the purchase by Goldman Sachs of companies which own the metal warehouses used by the London Metals Exchange, as well as their more widely publicised role in OTC trade and the promotion of index funds and commodity ETFs.

Pulling the banks away from these (and many other) non-banking functions is a task for banking regulations, which should be reformed to permit banks to perform only strictly banking functions such as taking deposits, making loans and providing the infrastructure of money transfer and trade credit which keep the economy going. As a basic requirement, the most senior officers at all banks should be obliged to have banking qualifications – which many of the current generation in London and New York do not have. Banks are given financial privileges in order that they should serve the rest of the economy, *not* for the sake of financial engineering, lending to other banks or for that matter the personal enrichment of bankers.

- **There should be comprehensive regulation of OTC trade, including the clearing of all transactions.** Any problems arising can then be traced and handled without excessive financial risk. This would avoid the huge network of contracts and obligations with clients, other banks and counterparties of

various sorts that was left behind by the bankruptcies of Lehman Brothers and AIG in 2008.

It is an illusion that commodity swaps (and most other forms of derivative) eliminate risk, when in fact they merely pass it from bank to bank and spread it around. That is indeed what led to the credit crunch in 2007: far from destroying risk, the mortgage derivatives chopped it up and passed it through so many hands that nobody knew where it was. Once the value of the underlying loans fell into doubt because of weakness in the housing market, all banks feared dealing with any other bank in case its balance sheet was poisoned by these toxic assets. Commodity swaps, if permitted at all, should only be created by specialist companies which should be fully regulated as part of the commodities sector, and in which banks can have no interest.

- **Impose a transactions tax on all financial investments in food commodities, where there is not a complete ban on them.** A precedent was set in the Indian government's 2008-2009 budget, which imposed a tax on commodity options and futures.²¹ We would levy this tax on valuations for each commodity that would fluctuate with its trade and prices, rather like the moving price bands discussed above in the IFPRI market intervention proposal. A higher rate of tax would be imposed at times of acute volatility in order to stabilise commodity derivatives prices, with bands and prices chosen for each product or market.

As is well known, the Tobin tax was originally proposed with a view to stabilising currency fluctuations.²² In James Tobin's own words, acting as "sand in the wheels", a currency transaction tax is set to "make exchange rates reflect to a larger degree long-run fundamentals relative to short-range expectations and risks".²³ Tobin applied it to currencies because that is where most of the destabilising financial speculation was to be found at the time. The commodity markets

²¹ *Financial Express*, New Delhi, April 14th, 2008, www.financialexpress.com/news/Futures-causedthe-market-manipulation/296336/0.

²² Spahn (1996 and 2002) and Nissanke (2005).

²³ Tobin (1974 and 1978).

remained largely separate from financial markets, and most financial derivatives had not yet been fully developed. Today, this sort of tax could be an effective mechanism for commodity price stabilisation, similar to the IFPRI scheme of stabilisation with the use of virtual reserve holdings.

Once such a system is seen to be operating efficiently and credibly, the *threat* alone may well be sufficient to keep prices within a target zone, without resorting to costly and sizeable holdings of reserves or buffer stocks. The scheme would be deemed a success when it drives destabilising speculation out of markets without the surcharge being actually levied. Specialised UN agencies such as FAO or UNCTAD and the Common Fund for Commodities could be candidates to perform this role in close collaboration with international bodies in charge of specific commodities. Ultimately, the success would depend on the political will of the world community to support price stabilisation. It may be recalled that the weakness of such support led to the demise of earlier stabilisation schemes.

crises, including the need to reconsider how food markets themselves operate. What's more, many of them are clouded by vested interests in the existing food economy.

The food price crisis is a crisis of *markets* – major global markets which have failed to meet society's needs over the last three to four years. The proposals made in this note have the aim of ensuring that policy affecting food prices places human needs first, learning the right lessons from the responses made on previous occasions when market mechanisms went awry. Most other proposed solutions set that essential aspect of the problem aside, or at best fail to take it to its logical conclusion. Some other mechanisms are also needed besides global markets, either to work alongside the markets or to intervene with a view to helping them to provide more reliable outcomes. We are convinced that the only effective solution will be of this sort, and we earnestly hope that the discussions on this topic at the G20 will reflect these concerns.

5. Concluding Remarks

The French government could have chosen to concentrate on numerous other topics during its Presidency of the G20. After all, in these times of continuing crisis and change in international affairs, there is no shortage of issues requiring the attention of world leaders. However, France decided to focus on the food price problem, and rightly so since it affects nearly every person on this planet (except for those that rely on subsistence production alone). The most affected are the poorest people and poorest countries – which are not represented at the G20 and have no capacity to influence the situation. Initiatives coming from the world's major powers are thus greatly needed.

This note presents a series of proposals to tackle the problem. On the whole they fall outside the run of mainstream ideas, but its authors are convinced that measures such as these are required. Most mainstream proposals in this field, whether they come from academics, aid donors, business interests or the media, fall short of the gravity of the situation after the food and financial

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