National Farmers Union
Testimony of Tom Buis

Before the
U.S. Senate Homeland Security and Governmental Affairs Committee

Financial Speculation in Commodity Markets: Are Institutional Investors and Hedge Funds Contributing to Food and Energy Price Inflation?

Tuesday, May 20, 2008
Washington, D.C.

STATEMENT OF TOM BUIS, PRESIDENT
NATIONAL FARMERS UNION
BEFORE THE SENATE HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE
CONCERNING: FINANCIAL SPECULATION IN COMMODITY MARKETS: ARE INSTITUTIONAL INVESTORS AND HEDGE FUNDS CONTRIBUTING TO FOOD AND ENERGY PRICE INFLATION?
MAY 20, 2008

Good morning, Mr. Chairman and members of the committee. I appreciate the opportunity to testify on behalf of the farm, ranch and rural members of National Farmers Union (NFU). NFU was founded in 1902 in Point, Texas, to help the family farmer address profitability issues and monopolistic practices while America was courting the Industrial Revolution. Today, with a membership of 250,000 farm and ranch families, NFU continues its original mission to protect and enhance the economic well-being and quality of life for family farmers and ranchers and their rural communities. We believe that consumers and producers can work together to promote a quality domestic supply of safe food.

Food is not an optional commodity for anyone, regardless of income demographics. As a farmer from Indiana and a national farm leader, I find it appalling that anyone in America, or the world, goes to bed hungry. America's farmers and ranchers have almost always produced a surplus of food commodities year in and year out. For the most part, food price increases are not about the lack of production, but other macro-economic factors including trade distortion, distribution and political decisions. I will outline the major factors impacting retail food items and outline concerns regarding recent activities in the commodity futures market.

Cause #1 – Energy Prices
Studies have shown that energy costs have twice the impact on retail food prices as the price of corn. A report by John Urbanchuk of LECG reports that a one dollar increase in corn results in a 0.3 percent increase in the consumer price index for food, whereas a one dollar increase in gasoline results in a 0.6 percent increase for food. With the average food item traveling more than 1,500 miles before reaching the final consumer, it is no wonder that food costs are increasing when looking back the last seven years; gasoline prices have increased 198 percent per gallon, diesel fuel prices have increased almost 250 percent per gallon and crude oil has increased 453 percent according to the Department of Energy's Energy Information Agency. A Merrill Lynch analyst estimates the biofuels industry is reducing gasoline prices by 15 percent per gallon today. The U.S. average price per gallon would increase $0.50, from $3.39 to $3.89 today without biofuels.

Cause #2 - Weather Related Production Shortfalls
In 2007, most major wheat growing regions experienced weather related production problems. The United States, Canada, Australia and Europe all experienced weather related production shortfalls at the same time. In response, wheat prices reached record levels and export demand skyrocketed, as world wheat stocks reached new lows. While some have blamed U.S. farmers for shifting wheat acreage to corn, it should be noted that very little U.S. wheat acreage is suitable for corn production. It takes more water to grow corn than wheat and most of the wheat acreage that could be converted to higher value commodities, such as corn or soybeans, long ago made the conversion. USDA's 2008 planting intentions indicate an increase in wheat acreage, as the higher prices are more economically favorable than other commodities.

Cause #3 - Weak Dollar and Export Demand by Emerging Economies
Today, the U.S. dollar's value has fallen to a 30-year low, according to USDA, as compared with other major currencies, which in turn makes the price of U.S. commodities increasingly competitive abroad. Since the value of the dollar was delinked from gold, we have witnessed the linkage between a weak dollar and higher commodity prices. Last year we saw record agricultural exports in terms of volume and value despite record high market prices. Total agriculture exports in 2007 amounted to a record of nearly $90 billion, an increase of $20 billion over 2006. At the same time, the value of agricultural imports is rising, on average 10 percent growth per year since 2001 according to USDA. With rapidly growing economies across the globe, a new demand has been created for food commodities. The new middle class populations in Asia, Latin America and Africa have demanded an improved diet including meat and dairy products.

Cause #4 - Speculators in the Commodity Markets
The committee has asked what effect institutional investors and hedge fund participation has had on current food and energy prices. My response is, we cannot fully know. NFU has called upon the Commodity Futures Trading Commission (CFTC) to conduct a thorough and comprehensive investigation regarding the recent activity of the commodities market and increase transparency in the commodity futures trading markets. Until the investigation is completed, NFU has urged CFTC to place a moratorium on any new commodity index trading.

Remarks from CFTC officials that the activity in the market is responding to fundamentals is frustrating, at minimum because some farmers have been precluded from utilizing financial risk management tools. I have heard from numerous farmers that they can no longer forward price their commodities for delivery after harvest any more than 60 days in advance. As you can imagine, it is very frustrating for farmers who are paying record amounts in input costs to produce a crop, but cannot capitalize on the higher commodity prices to protect their financial risk. Meanwhile, we continue to read newspaper articles or watch television reports that say farmers are getting rich because of the record high commodity prices, which could not be further from the truth.

I have heard from numerous farmers and grain elevators around the country, including one Kansas grain elevator that contracted wheat from farmers for delivery after harvest last fall at $7.00 per bushel. When the speculative money poured into the futures market and prices skyrocketed to record highs this winter, that Kansas grain elevator was forced to pay $0.60 per bushel in margin calls, totaling $600,000 per day. It does not take long with margin calls such as these, for local elevators to reach their credit limit and stop offering contracts to farmers. The market intended to provide producers a risk management tool was not functioning.

Another example of the dysfunctional market is what happened in the cotton futures market when the price almost doubled in one day. When producers tried to market their cotton at the higher price, they were told there was no market for the physical commodity and the price collapsed shortly thereafter. We have yet to receive a satisfactory explanation from CFTC officials as to what caused this situation. Obviously it was not based upon market fundamentals and again farmers were precluded from being able to capture the higher prices.

A similar scenario played out in 2006 when the Amaranth hedge fund lost $2 billion in natural gas derivatives, eventually going bankrupt. The Senate Permanent Subcommittee on Investigations found in a June 2007 report that Amaranth evaded limits on the size of speculative positions by moving its trading from NYMEX to exempt and unregulated markets. Amaranth's speculation caused significant price movements prior to its demise. When Amaranth failed, unexpected declines in price occurred. This same fact pattern can occur in agricultural markets. And, farmers, who have been denied the protective tools the commodity markets are supposed to provide, will be the ones taking the fall.

Producers are very concerned with the lack of transparency within the market functions. As a result NFU has called for CFTC to evaluate the role and impact over-the-counter (OTC) trading and swaps are having on the markets. Without a full understanding of these trades or their impact, it is impossible to say that manipulation of the commodity markets is not occurring. NFU supports the proposal to clear swaps in certain OTC positions in an effort to create more transparency into the markets. It is my opinion that CFTC authority needs to be strengthened in order to ensure the regulators know exactly what is happening in the marketplace. As long as parts of the trading are not in regulated markets or reportable markets, how can anyone say with certainty that the markets are performing their function of price discovery?

We have witnessed the results of unclosed loopholes in the regulatory process of futures trading. The recently passed farm bill addresses one of the loopholes, which allowed energy futures trading on unregulated international markets. NFU was pleased that the "Enron Loophole", which both Enron and Amaranth used to manipulate energy prices, will now be closed. NFU had previously endorsed the "Close the Enron Loophole Act" so as to provide CFTC regulatory oversight of energy futures trading and address the volatile energy derivatives futures market. The Enron scandal is a perfect example of what an opaque marketplace means for the American public and stresses the importance of including this important legislation within the farm bill. Other positive steps taken within the farm bill include increasing the criminal and civil penalties for market manipulation and strengthening CFTC's authority over retail foreign currency transactions. I hope CFTC will not be afraid to use this new authority.

In public comments filed with CFTC, NFU expressed opposition to any increases in the speculative position limits as proposed by the Commission in 2007. The speculators have an important role to play in the commodity markets in terms of function, but unabated activity has negated that role and should not be allowed at the expense of farmers and traditional users of the markets. We are in unchartered waters today with the involvement of speculators in our markets and I believe it warrants a review from CFTC or third-party objective entity.

NFU believes that CFTC needs to take a broader look at the concept of manipulation. Unfortunately, CFTC's test to determine manipulation requires that an individual or group of traders acquire a market position that enables them to *consciously* distort prices in noncompliance with market fundamentals. What CFTC is failing to recognize is that the deluge of money from Wall Street and hedge funds in and of itself is driving prices artificially high in a potentially destructive manner. It is still manipulation, if only in a slightly different sort.

In summary, if CFTC officials are correct and there is nothing wrong with the markets' function, why are some farmers precluded from participating? Exactly how much institutional and investment money is being invested into the commodity markets? What happened in the cotton case? These are unanswered questions that cannot be left ignored. Without a properly functioning and regulated futures market, a train wreck is headed straight for rural America that will jeopardize our ability to continue providing a safe, affordable and abundant food supply for this nation.

I thank the committee for the opportunity to be here today and look forward to any questions you may have.