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Michel Barnier
European Commissioner for Internal Market and Services
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Follow-up to the MiFID hearing on 21 September 2010

Dear Mr. Barnier,

We are writing to express our appreciation for the opportunity to participate in the consultation hearing of the Commission on the MiFID review on the 21 September 2010.

We would particularly like to emphasize our support for Chairwoman Maria Velentza's conclusion on the hearing that:

- There is a financialization of the commodity markets, and a holistic approach is needed;
- Consideration of systemic risk in commodity markets should not be limited to the risk posed to financial systems but should include the wider ramifications for food and energy supplies;
- Where evidence on which to base policy is inconclusive, a preventive and precautionary approach should prevail when designing the regulation response.

We would ourselves stress the need to enforce aggregated position limits on commodity markets for financial entities and their affiliates, and that end-users and financials should be clearly differentiated, also challenging the dual nature (hedging/speculative trading) of most major multinationals, in order to prevent adverse effects and therefore making aggregated position limits an effective regulatory tool and helping to clarifying clearing provisions. We would also underline the need for transparency in markets, as well as for the public. Attached you find a list of evidence on the issue of financialization of commodity markets. Please feel free to contact us for further information.

Finally, we would greatly encourage the Commission to broaden the range of representatives on panels for future consultations, including those affected both directly and indirectly by Commission proposals.

We are strongly interested to continue and widen the cooperation with the European Commission, and would therefore like to meet, to continue discussion and the exchange of information.

Yours sincerely,

Antonio Tricarico (CRBM – Campagna per la Riforma della Banca Mondiale)
Julian Oram (WDM – World Development Movement)
Jutta Kill (FERN)
Kenneth Haar (CEO – Corporate Europe Observatory)
Markus Henn (WEED – World Economy, Ecology & Development)
Myriam Vander Stichele (SOMO – Centre for Research on Multinational Corporations)
Nick Hildyard (The Cornerhouse)
Steve Suppan (IATP – Institute for Agriculture and Trade Policy)

Copies of this letter sent to Ms. Maria Velentza and MEP Sharon Bowles (Chair ECON)

Evidence on the effects of financialization of commodity markets

Food

1) Gilbert, C.: "How to understand high food prices." Journal of Agricultural Economics (2010: 420):

"By investing across the entire range of commodity futures, index-based investors appear to have inflated food commodity prices."

2) FAO: Final report of the committee on commodity problems: Extraordinary joint intersessional meeting of the intergovernmental group (IGG) on grains and the intergovernmental group on rice (September 2010):

"Unexpected crop failure in some major exporting countries followed by national responses and speculative behaviour rather than global market fundamentals, have been amongst the main factors behind the recent escalation of world prices and the prevailing high price volatility."

3) De Schutter, O. (UN Special Rapporteur on the Right to Food): "Food commodities speculation and food price crises: Regulation to reduce the risks of financial volatility" (September 2010):

"The global food price crisis that occurred between 2007 and 2008, and which affects many developing countries to this day, had a number of causes. The initial causes related to market fundamentals, including the supply and demand for food commodities, transportation and storage costs, and an increase in the price of agricultural inputs. However, a significant portion of the increases in price and volatility of essential food commodities can only be explained by the emergence of a speculative bubble."

4) UN High Level Task Force on the global food security crisis (July 2008):

"The impact of speculation in futures and commodity markets on food prices has also highlighted the importance of appropriate regulatory measures to ensure that on-going integration of financial markets provides the basis for increased benefits, rather than risks, for the poor."

5) Agriculture and food policy centre (Texas University): The effects of ethanol on Texas food and feed (2008):

"Speculative fund activities in futures markets have led to more money in the markets and more volatility. Increased price volatility has encouraged wider trading limits. The end result has been the loss of the ability to use futures markets for price risk management due to the inability to finance margin requirements."

6) von Braun, J. (Bonn University): Article in Financial Times (August 2010):

"The setting of prices at the main international commodity exchanges was significantly influenced by speculation that boosted prices. Not only are food and energy markets linked, but also food and financial markets have become intertwined – in short, the "financialisation" of food trade. There are increasing indications that some financial capital is shifting from speculation on housing and complex derivatives to commodities, including food."

Commodities

1) Tang, K. (Princeton University) & Xiong W. (Renmin University): "Index Investment and The Financialization of Commodities" (2010):

"This paper finds that concurrent with the rapid growing index investment in commodities markets since early 2000s, futures prices of different commodities in the US became increasingly correlated with each other and this trend was significantly more pronounced for commodities in the two popular GSCI and DJUBS commodity indices. This finding reflects a financialization process of commodities markets and helps explain the synchronized price boom and bust of a

broad set of seemingly unrelated commodities in the US in 2006-2008. In contrast, such commodity price comovements were absent in China, which refutes growing commodity demands from emerging economies as the driver."

2) Philips, P. (Yale University) and Yu, J (Singapore University): "Dating the Timeline of Financial Bubbles During the Subprime Crisis" (May 2010):

"a bubble first emerged in the equity market during mid-1995 lasting to the end of 2000, followed by a bubble in the real estate market between September 2000 and June 2007 and in the mortgage market between August 2005 and July 2007. After the subprime crisis erupted, the phenomenon migrated selectively into the commodity market and the foreign exchange market, creating bubbles which subsequently burst at the end of 2008, just as the effects on the real economy and economic growth became manifest."

3) Baffes, J. and Haniotis, T. (World Bank): "Putting the 2006/2008 Commodities Boom into Perspective" (2010):

"*We conjecture that index fund activity (one type of "speculative" activity among the many that the literature refers to) played a key role during the 2008 price spike. Biofuels played some role too, but much less than initially thought. And we find no evidence that alleged stronger demand by emerging economies had any effect on world prices."*

4) UNCTAD: "The global economic crisis: Systemic failures and multilateral remedies" (2009):

"The evidence to support the view that the recent wide fluctuations of commodity prices have been driven by the financialization of commodity markets far beyond the equilibrium prices is credible. Various studies find that financial investors have accelerated and amplified price movements at least for some commodities and some periods of time. Some of these effects may have been substantial and some persistent, but the non-transparency of existing data and lack of a comprehensive breakdown of data by trader categories make it difficult to examine the link between speculation and commodity price developments directly. The strongest evidence is found in the high correlation between commodity prices and the prices on other markets that are clearly dominated by speculative activity."

5) Report of the UN Commission of Experts on Reforms of the International and Monetary System (September 2009):

"*In the period before the outbreak of the crisis, inflation spread from financial asset prices to petroleum, food, and other commodities, partly as a result of their becoming financial asset classes subject to financial investment and speculation."*

6) Branson, R. (Virgin Group), Mike Masters (Masters Capital) and David Frenk (Better Markets Inc.): "Letter to the Economist" (July 2010):

"There is strong evidence that speculation exacerbated the last oil and food bubble. Speculation will fuel the next one too, unless meaningful speculative position limits are established."

7) Frenk, D. (Better Markets Inc.): Review of Irwin and Sanders 2010 OECD report (June 2010):

"1) The statistical methods applied are completely inappropriate for the data used. 2) The study is contradicted by the findings of other studies that apply more appropriate statistical methods to the same data. 3) The overall analysis is superficial and easily refuted by looking at some basic facts."

8) Turbeville, W. C. (Former Vice-President of Goldman Sachs) Critique of Irwin and Sanders 2010 OECD report (August 2010):

"The issue is so important that skepticism of conventional beliefs, not faith in the perfection of free markets, is appropriate for any study of the issue."