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Gambling On Hunger: Is Wall Street Fueling Global Unrest?

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WASHINGTON -- Since July, the price of corn has jumped 62 percent. Wheat has climbed by two-thirds, and soybeans are 38 percent more expensive. For many of the world's poorest citizens, the costs of both basic necessities and things that make life bearable are climbing out of reach: sugar has jumped by 81 percent, tea by 42 percent and arabica coffee by more than a quarter. Soybean oil has risen by half and fuel, overall, is a quarter more expensive than it was this summer.

In Tunisia, protesters' demands for lower food prices helped spark a revolution. In Egypt, the government's most significant concession to the uprising -- before President Hosni Mubarak stepped down -- was to offer major increases in food subsidies. On Feb. 3, the Bahrain government responded to protests with generous food subsidies, before adopting a violent strategy against demonstrators. Demonstrators have gathered in Algeria, Morocco and Yemen to protest food prices, as well.

There's no question that people in the Middle East and northern Africa are hungry for freedom. But people are also simply hungry. "We're in an era where the world and nations ignore the food issue at their peril," Josette Sheeran, the head of the World Food Program, told Bloomberg in a prescient January interview.

The current crop of deposed heads of state may have Wall Street to thank for their forced retirement. While the causes of helter-skelter commodity prices are complex -- natural disasters such as floods and droughts can play a big role, as can interest-rate shifts engineered by central bankers around the globe -- rapid-fire trading and speculation on the Street can magnify the problem.

In an era when vast pools of capital shift in and out of markets for basics like food and oil with the a few computer keystrokes, trading can cause prices to see-saw in ways that are sometimes harrowing and hard to control.

And this wouldn't be the first time. Less than three years ago, another food crisis was marked by rampant financial speculation that helped cause prices to skyrocket and prompted regulators to examine whether traders were also gaming oil prices. At the time, governments were also flush with enough cash to boost food subsidies and calm protesters. This time around, governments ravaged by the crisis lack the financial wherewithal to tamp down prices with subsidies.

Wall Street says that trading keeps food and energy markets liquid, allowing farmers to plan ahead when planting their crops or helping oil producers to know how much crude they can ship. Often, of course, that's true. But there also can be a more brutal calculus at work: big price spikes are good for traders holding onto wheat or oil contracts, allowing them to stuff more money into their wallets while families struggling to make ends meet thousands of miles away suddenly find that it's become too expensive to feed themselves.

The top lobby group for the derivatives industry, the International Swaps and Derivatives Association, says it supports financial regulatory reform, but resists blame for pricing problems. "Although speculation is often blamed for causing problems in markets, the economic evidence shows that it is in fact a necessary activity that makes markets more liquid and efficient," ISDA Head of Research David Mengle wrote in a September memo.

Meanwhile, derivatives trading remains a largely under-regulated affair, even though such gambling was a major cause of the financial crisis in the United States and broadened the severity of the entire debacle.

Last year's Dodd-Frank financial-regulatory legislation sought to address the problem speculation can play in commodity markets specifically and financial markets more generally, requiring federal regulators to police the massive, multitrillion-dollar derivatives game.

But to be effective cops, regulators will need a bigger budget, something Republicans are already lining up against.

The Commodity Futures Trading Commission, which will shoulder much of the burden for monitoring derivatives trading, currently only oversees about $5 trillion worth of trading on commodities exchanges. Dodd-Frank envisions the CFTC empowered as the primary regulator of a much vaster market that involves more than $500 trillion worth of trading.

That's an ambitious goal even with the new funds the Obama administration proposed in its budget Monday, which would increase the CFTC's annual funding by 77 percent, from $168.8 million to $298.8 million. The Securities and Exchange Commission, another keyregulator of Wall Street trading, would get a $300-million boost to its $1.12-billion annual budget, a jump of 27 percent.

Despite plans for a dramatically broader regulatory mandate at these agencies, Republicans now openly plan to defund key elements of Dodd-Frank, legislation which most of the congressional GOP opposed. Among the budgets that Republicans are seeking to kneecap? Those the regulators need to do their work.

"There was a great deal of concern about some of the policy in Dodd-Frank, and there was a lot of money put in for new programs, so I assume they have to be challenged before they get entrenched financially," Sen. Jeff Sessions (R-Ala.) told reporters Monday. "Fundamentally, every single program needs to get examined to see if they can justify the demands."

House Republicans likewise argue that the CFTC and the SEC -- key regulators of Wall Street trading -- haven't justified such demands, and are demanding deep cuts to both agencies' budgets. The House GOP plan would chop the CFTC budget by roughly a third, and pare $25 million from the SEC. At a time when the CFTC in particular needs a hiring binge to write and enforce new rules in keeping with Dodd-Frank, the cuts it faces are potentially crippling.

Last year's reform legislation specifically zeroed in on speculation involving agricultural commodities in an effort to stave off the next food price spike. In one of the few major victories the bill offered progressives and other advocates of tighter regulation, then-Sen. Blanche Lincoln (D-Ark.) included language that would end federal subsidies for speculation on food and energy derivatives, requiring banks that enjoy government guarantees to spin off those derivatives operations into sub-companies with no access to federal perks.

Another key Lincoln measure, known as a position limit, was designed to clamp down on market manipulation by requiring regulators to limit the total amount that individual traders can bet on any commodity.

Former House Financial Services Committee Chairman Barney Frank (D-Mass.) said that the recent run-up in food prices demonstrates why Democrats were right to address even areas of the financial system that weren't solely or directly related to the banking collapse. "It highlights the fact [that] there are reasons to this over and above preventing another crash," he told HuffPost. "The derivatives issue was not just [about] preventing a major crash, but having some limitation on the extent to which speculation drives up prices."

It is now widely accepted that speculation helped fueled the price hikes of 2008: Economists at Princeton University, World Bank, the European Commission, the Peterson Institute for International Economics, the International Monetary Fund, Rice University, the Massachusetts Institute of Technology, and the Texas A&M University Agricultural and Food Policy Center have all published studies indicating that speculation played a role in 2008's commodity-price swings.

"Look, you have no market without speculators, so I like speculators," CFTC Commissioner Bart Chilton told HuffPost. "But it's more like a casino right now than anything else."

THE HUMAN COST

David Kane is a Catholic missionary who has worked on poverty-relief efforts for most of his professional life, living in regions as diverse as Seattle and Sao Paolo. In recent years, he's spent most of his time in the Washington, D.C. office of the Maryknoll Office for Global Concerns as a lay missioner, coordinating with other missionaries to advocate on behalf of the global poor. In early 2008, he began receiving a series of reports from coworkers in Asia, Africa and Latin America. The cost of food was skyrocketing, they said, with harrowing results. Families that once bought rice and beans by the kilo could suddenly only afford cupfuls. Others stopped being able to put food on the table every day. Children lost weight and stopped growing.

"The food crisis in 2008 was a horrible story for our missioners all over the world," Kane told HuffPost. "So we decided to focus on this issue. It's a pretty easy thing to fix from a technical standpoint, and would have massive effects all over the world. If financial speculators can just toy with food prices whenever they want, there's nothing we can do for food security."

This year, the world hunger outlook is growing even bleaker than it was in 2008. According to the United Nations' Food and Agriculture Organization, global food prices reached their highest level ever in January, after climbing for seven straight months.

Food price hikes typically have a muted impact in the United States, where consumers spend only a small fraction of their income on what they eat. But in many other parts of the world, ordinary citizens spend as much as 80 percent of their earnings on meals, and such increases can have a devastating impact.

"A box of cereal is a great example," Kane said. "The actual commodity price influence on a box of cereal is incredibly small -- food prices can double and we'll just pay an extra dime here. But for families in Africa or Asia who buy 50-pound sacks of wheat or rice, that kind of price change is a huge problem. They're much closer to the pure commodities themselves."

Commodities traders have wielded huge influence over the lives of farmers and manufacturers for more than a century, and the Populist movement of the late 19th century was one of the first mass protests against the growth of that influence. Regulations were eventually enacted to temper the role traders could play in the markets.

Today, thanks to trillions of dollars worth of financial speculation in commodities -- which are bounced around on computer screens and loosely regulated -- Wall Street's role is even more entrenched and potentially more destructive.

"Commodity markets functioned fairly and effectively for over sixty years," wrote David Frenk, executive director of the market-transparency advocacy group Better Markets in a June paper. "In 2000, the Commodity Futures Modernization Act deregulated commodities markets ... providing loopholes for speculation through completely unregulated shadow markets."

The lion's share of that speculation is taking place in an unregulated, multitrillion-dollar dark market that was born in 2000, when Congress passed the CFMA. A sweeping piece of legislation, it placed many financial derivatives beyond the reach of regulatory supervision. Secret trades were explicitly legalized, ensuring that most players in this so-called "over-the-counter" market would be unable to access key price information.

For the U.S. housing market, the legislation ushered in the era of CDOs, CMOS, CDOs-squared, the credit-default swap, and other "synthetic" products that zipped across the shadow banking system -- a financial joyride that ultimately ran aground.

But the same legislation also radically changed the way basic commodities changed hands in the global economy.

Banks and hedge funds can bid on the price of commodities either by purchasing physical bushels of wheat or by taking out financial contracts tied to the value of those bushels of wheat. Some contracts, known as futures, are traded publicly like stocks at places like the Chicago Mercantile Exchange or the Intercontinental Exchange, while others are traded in the secretive over-the-counter markets.

But most over-the-counter contracts mimic the futures contract -- a bet that at a given point in time, the price of a commodity will reach a certain level. Traders can bet that oil will be worth $120 a barrel in March, or that wheat will reach $10 a bushel by April. These contracts were initially developed as a type of price insurance for farmers and manufacturers -- if economic forces push prices too high or too low, commercial businesses can still get paid. This all depends on speculation to function. Every farmer who wants to be insured against price fluctuations needs someone to take the other side of that bet -- often, a speculator.

Too much speculation, however, can wreak havoc. When the amount of speculative capital in these markets overwhelms their usage by farmers and commercial firms, speculation itself has the opportunity to drive prices.

"The recent flood of speculative money into commodities markets is increasing price volatility and pushing up further the prices of raw commodities and food products," 10 Texas A&M economists wrote in a 2008 report.

Speculation in other commodities can push up the price of food, since the commodities are often "indexed" together. Speculation in oil is particularly important, since transportation costs are a major factor in the prices food, and oil is a key ingredient for many fertilizers.

"Paper oil and physical oil are about the same thing, economically. If you're going to have speculation, you're going to have some impact on the price of physical oil," said economist John Parsons of MIT's Center for Energy and Environmental Policy Research. "We can have speculation in the share of a high-tech stock. If people believe that a stock is going to be worth more in the future, they can bid up the price now. We can have similar speculation in housing or oil or other commodities."

And speculation in commodities took off after the deregulation of 2000. The over-the-counter market exploded from about $674 billion in 2001 to $13.2 trillion by June 2008, according to the Bank for International Settlements. The more transparent, regulated forms of speculation grew with the over-the-counter gambling. Between June of 2000 and June of 2008, the U.S. futures market for oil grew from bets on 517 million barrels, or $16 billion, to bets on 1.44 billion barrels, or $202.5 billion, according to a 2010 paper by Parsons. Commodity index funds -- new speculative vehicles that allowed fund managers to bet on "baskets" of multiple commodities all at once -- jumped in popularity, growing from $15 billion in 2003 to $200 billion in 2008, according to a 2009 report by the Senate Subcommittee on Investigations.

New players entered the market, not all of them slick Wall Street high-fliers. Some of the biggest money in commodities speculation today comes from ordinary, boring pension funds and retirement investors that make simple, relatively cautious long-term bets. And sometimes these pension funds facilitate big problems.

"These big investors just come in and plop down billions of dollars on one side of the bet," Kane said. "They make the obvious bet that prices are going to go up over the long haul and it throws off the whole market."

"They can't buy a 20-year contract for oil," Chilton noted, because such long-term contracts don't exist. "They buy a three-month or a six-month contract, and when they have to renew it, every trader in the market jumps in and bids up the price."

FLY ME TO THE MOON

In the spring of 2008, prices for just about every commodity in circulation skyrocketed. U.S. consumers felt the price surge at the pump, as gas eclipsed $5 a gallon in parts of the nation, but food riots erupted in other countries.

Many mainstream economists, including Federal Reserve Chairman Ben Bernanke, dismissed the possibility that Wall Street excess played any role in the crisis, insisting that the price increases were due solely to supply and demand forces in the real economy. And indeed, the increase in commodities prices over the past decade tracks significant changes in the global marketplace. When China's booming economy joined the World Trade Organization, a huge source of new demand for just about everything entered the international market, pushing prices up globally.

In a complex global market, it is difficult to distinguish whether speculators are driving a particular price movement, which is generally tremendously difficult, or simply profiting from movements dictated by real-world consumer demand and producer supply. While many had suspicions during the 2008 bubble, it has taken years of research to convince economists that speculation drove the price movement. It has changed, however, even at some hubs of conservative economic thinking.

The 2008 data, in retrospect, are difficult to square with supply and demand fundamentals. According to the U.S. Department of Energy, in the first half of 2008, global demand for oil was falling as global supply increased. That should have been a recipe for cheaper oil, not its highest price in history.

When prices for food and oil surge upwards, people don't eat. But wild speculative swings can also inflict pain on the way down.

As reports of severe hunger poured into Kane's D.C. office in mid-2008, he headed to João Pessoa, Brazil, where he'd spent nine years working with people who survived by salvaging items from the local dump and selling them to manufacturers. This was always a difficult lifestyle -- these "recyclers" lived in a landfill and fed themselves by selling trash. As commodity prices surged, they had actually benefited.

But when the bubble burst, prices plummeted to levels lower than anyone in the recycler community had ever endured. When Kane arrived in late 2008, basic survival had become a struggle, he said. Families he had worked with as recently as 2005 had been torn apart. One old friend turned to prostitution to fend off starvation, he said, while others started selling crack cocaine.

"People's houses just became completely empty as they sold off their radios, their clothes, everything they had to pay for food," Kane said.

Even for a man who spent his life working with the poor, the food crisis shocked Kane. He returned to the United States in 2009 and met with trade experts, economists and financial insiders, trying to figure out what policies could be enacted to prevent another catastrophe. He said he was both encouraged and frightened by what he learned.

The United States had previously imposed rules that successfully prevented financial trouble in the commodities markets for decades -- they had simply been abandoned in 2000, as a Democratic White House and a Republican Congress bowed to bank lobbyists. So Kane started his own blog, Stop Gambling on Hunger, and began working as a financial-reform advocate in Washington. The Maryknolls joined the Commodities Market Oversight Coalition and Americans for Financial Reform, umbrella groups for public-interest organizations looking to rein in the financial sector following the 2008 banking crash.

A MATTER OF LIFE OR DEATH

Kane and other activists readily acknowledge that food price swings are not brought on by Wall Street alone. Their point, they say, is that for an issue with life-or-death consequences for some of the world's poor, it's critical to eliminate whatever problems are driven by financial excess. And the events of 2008 made it clear that speculation put food prices on a rubber band.

"Speculation is not the only issue by any means," Kane said. "But it is certainly an issue and it's very easy to address from a technical standpoint."

The U.N.'s Food and Agriculture Organization has taken notice. In a September meeting, the group cited "growing linkage with outside markets, in particular the impact of 'financialization' on futures markets" as a "root cause" of recent food price volatility.

Is speculation behind the current run-up in food prices? Experts are divided. There have been major events in the physical economy for food -- a flood in Pakistan and the failure of a wheat crop in Russia, which may be evidence of so-called global weirding brought on by climate change. The use of corn in biofuels and depleting government grain stockpiles may also be playing a role in spiking demand, as could increased living standards in parts of the developing world. But the potential is certainly there. Speculative bubbles often start with a price surge brought on by real events.

According to Chilton, there are more speculative bets in commodities markets today than ever before, even 2008. The number of bets on food, in fact, are up 18 percent from June 2008 levels. Individual traders are taking super-sized gambles, with a single trader capturing upwards of 20 percent of the entire oil market at a time.

"If there's a large concentration in markets, it can skew prices," Chilton said. "The folks that are taking the other side of the trade are folks that are aware of what's going on. If they need to make a trade and there's only a couple of people offering a trade, they've gotta accept it."

If Wall Street starts predicting big future price increases, companies that actually own physical stocks of a commodity can be encouraged to hoard it and wait for a bigger payout. This activity, in turn, leads to higher prices for the actual goods, as they become scarcer in the marketplace. That hoarding activity, economists say, can help determine whether a speculative bubble is building in any commodity -- from wheat to copper to cotton. This hoarding can take many different forms. Oil drilling, for example, can simply slow down, a sort of underground stockpiling. But tracking the aboveground hoarding of physical goods is enormously difficult. Food can be stored just about anywhere, from barges to warehouses to silos to households. Gathering accurate data on how much wheat or rice is being stored worldwide is nearly impossible.

That makes financial data extremely important to understanding global food markets -- and financial regulation critical to ensuring that Wall Street excess doesn't lead to trouble for Brazil's poor. Bringing the secretive over-the-counter derivatives markets into the light is important not only for U.S. investors, but for the global poor.

The sheer size of the over-the-counter market means the CFTC and the SEC will need a major increase in staffing levels-- and that means a significantly bigger budget. But the bank lobby is fighting that funding with everything they've got, and so far it looks like they might win. A case in point: the GOP's efforts to slash the CFTC budget and modestly slice the SEC budget.

"The only possible interpretation is that crippling the agency is precisely the outcome that Republican leaders are seeking to achieve," Consumer Federation of America Director of Investor Protection Barbara Roeper said in a statement Saturday about the CFTC cuts.

Consumer advocates note that simply passing legislation requiring tighter regulation is toothless if regulators themselves don't get the funding they need to patrol their beats.

"Just because Wall Street lost round one in the legislative arena doesn't mean they won't win the fight," says Tyson Slocum, Director of the Energy Program at Public Citizen, a consumer protection watchdog. "They've had a full-court press in the regulatory arena, and they're doing much better."

The actual rule-writing process is also uncertain. The CFTC missed a January deadline for proposing position limits, which would cap the size of bets that individual firms can make, likely delaying action on such measures until the fall. The SEC appears ready to settle for only partial transparency on derivatives pricing, sparking an objection from Americans for Financial Reform.

Regulation isn't the only tool available to combat surging food prices, but it is the most targeted. If regulators refuse to take action, the Federal Reserve can choke off the flow of capital into commodities markets by raising interest rates. But doing so involves choking off the flow of capital everywhere, and in the middle of an anemic economic recovery, such an action could prove counterproductive.

Nevertheless, that very scenario -- low interest rates combined with a very weak economy -- creates the potential for problems. Without a big new source of demand in the American economy -- the only plausible source is higher government spending -- the Fed's low interest rates for big banks encourage traders to plow money into assets well beyond levels suggested by supply and demand.

"So long as you have money available to banks at zero cost, no long-term productive outlets for investment, and the capacity to make money by manipulating commodity pools, the situation is ripe for speculative excess," University of Texas economist James Galbraith told HuffPost.

"The reality is, as commodity prices go up, there's only a finite amount for food aid and things. People really are going to start dying," Sen. John Boozman (R-Ark.), who took Blanche Lincoln's seat in November, told HuffPost, adding that the danger of speculation is "a legitimate concern."

Boozman said the Fed deserves some blame. "One of the problems that we've got is the Fed doing the things that they're doing, keeping the interests rates down, is devaluing the currency, so people are fleeing into commodities," he said.

Whatever happens to the recovery at home, soaring food prices appear certain to drive the global poor deeper into destitution this year, Kane said. The Maryknolls currently have missionaries in 35 countries all over the world, and conditions are already deteriorating.

"These are countries where chronic hunger has been a problem for decades," Kane said. "They're used to living on very little, and the fact that spontaneous food riots broke out all over the world demonstrates how desperate things got in 2008, and how desperate they are now."

Elise Foley contributed reporting.