Parliamentary briefing, December 2022

Financial Services and Markets Bill

- The Financial Services and Markets Bill will scrap constraints on commodity market speculation introduced following the 2008 financial crisis.
- Commodity trading has a huge impact on ordinary people when speculators bet on energy and food prices. At a time when the world is facing a sky-rocketing cost of living crisis, this can effectively be gambling with people's lives.
- MPs are asked to attend the Report stage of the Bill on Wednesday 7 December and raise concerns around the effect on speculation and its real world impacts.

We're experiencing a sky-rocketing cost of living crisis, at the heart of which are energy and food price hikes. One of the driving forces behind these is commodity market speculation. Banks and investment funds are gambling on basic products that they have no role in producing or interest in actually buying.

We've been here before. Back in 2008, a major food price crisis gripped the world, spreading poverty and panic. Yet behind that crisis, there was no actual shortage of food globally. Rather, financial markets were gambling on basic food stuffs, creating a crisis which left millions of people unable to afford food.

In the wake of the crisis, reforms were introduced to improve transparency and set limits on speculation. This sought to return the commodity markets to a better reflection of market fundamentals and improve the market functioning. The reforms were a good start, but they weren't enough, and we see the same problems recurring.

Now is the time to improve and strengthen the regulation of speculation. However instead, the Financial Services and Markets Bill would get rid of these reforms.

Food speculation - lessons from 2008

There can be a role for speculative trading in commodities, including food. Farming is a precarious matter, and farmers often want to insure against the risks. Therefore they will hedge, by selling a 'right to buy' their product to investors, giving the farmer certainty and allowing the financiers to take the risk. The aim is to improve stability in the market.

But deregulation of commodity markets on both sides of the Atlantic from the 1990s meant that speculative trading on these markets became lucrative. Many more financial funds suddenly entered the market, using new and risky forms of trading. For these speculators, they actually benefit from the volatility - it is as prices change that they make their profits.

By 2006, commodity index funds had grown to $260 billion. Then in 2007, as the housing market collapsed under the weight of sub-prime mortgages, the trade in commodities became even more attractive.

This drove the spike in food prices in 2008-9 - the price of wheat went up 136% while the price of rice doubled. This was not due to a shortage of food at all. In fact the world was producing more food than ever before, outpacing population increases.

Current cost of living crisis

Today, we have again been facing rapidly increasing commodity prices, particularly of food and energy.

In the spring, the FT warned that derivatives trading was driving up oil prices. Analysts wrote that “Oil prices in 2022 are being driven not by fundamentals but by those betting that prices will soon exceed $125, $150, or $200/bbl”.

In March many basic food commodity prices reached higher than the levels reached in 2008. In April speculators made up a full half of the wheat futures market – a dangerous level. The Economist later assessed that the spike was due to ‘overexcited’ trading - and noted that the subsequent fall back in prices had yet to be passed through to consumers. Banks have made billions.

There are of course other contributing factors, including the climate crisis, Covid disruption and the impact of Russia’s war in Ukraine. However financial speculation is again playing a key role, and prices have become increasingly detached from market fundamentals.

Earlier reforms

In the aftermath of the 2008 crisis, reforms were introduced on both sides of the Atlantic. In Europe, these were done as part of the MiFID II reforms, which the UK helped to shape. The key aspects were:

- stronger transparency regulations, requiring more traders to post information in real time on bids and offers, improving knowledge of the state of the market and reducing the scope of so-called ‘dark pools’
- regulations on ‘position limits’, under the responsibility of the financial regulator, the Financial Conduct Authority (FCA), with clear thresholds for the maximum size of trades in a commodity derivative

This was a good start, although campaigners had called for stronger measures. In the event, these reforms were not enough to successfully dampen the impact of speculation, and the measures have also subsequently been watered down. In the US, the Trump administration removed some of the constraints that were introduced there.

Financial Services and Markets Bill

The bill would revoke these reforms:

- reducing transparency
- removing the regulator’s duty to set position limits and leaving this instead to the trading floors, on an optional basis, which will lead to far weaker rules

The impact will be to take the brakes off speculation. This would be damaging at any time, but in the midst of the current cost of living crisis it is reckless and will cost lives.

We are also concerned about the bill’s proposal to force regulators to cheerlead for the financial industry through an ‘international competitiveness’ objective. We support calls for the bill to instead introduce statutory objectives on climate goals and on financial inclusion.

Report stage debate

MPs are asked to attend the Report stage debate on Wednesday 7 December and raise concerns about the scrapping of constraints on commodity market speculation introduced following the 2008 crisis, and the impact this is likely to have on people’s lives.

For more information, please contact Nick Dearden, nick.dearden@globaljustice.org.uk or see our evidence to the bill committee and our briefing.