United States Senate
Committee on Homeland Security and Governmental Affairs
Chairman Joseph I. Lieberman, ID-Conn.

Opening Statement for Chairman Joseph Lieberman
Homeland Security and Governmental Affairs Committee
"Financial Speculation in Commodity Markets: Are Institutional Investors and Hedge Funds Contributing to Food and Energy Price Inflation?"
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AS PREPARED FOR DELIVERY

Good morning and welcome. The purpose of our hearing today is to examine the role of institutional investors and hedge funds in commodity markets and their affect on steadily rising food and oil prices. We want to know whether speculation in commodity markets – unrelated to supply and demand, or weather – is one of the reasons why food and energy prices have skyrocketed.

As everyone knows, the cost of food and energy is at record highs, creating economic distress for millions of working families in America and around the globe. At home, rising food and gasoline prices put a real and immediate strain on family budgets. In some regions of the country, major retailers have resorted to rationing items, such as rice, in response to rising demand and low inventories.

Overseas, the consequences are even more dire. Consumers in low-income countries may spend as much as 80 percent of their income on food. Food riots in Somalia have taken lives. And World Bank President Robert Zoellick has warned that 33 other nations are at risk of unrest, and one billion Asians are at risk of serious hunger or malnutrition.

In recent years, Commodity markets have attracted increasing amounts of money from large investors, such as pension funds. This influx of institutional investors and hedge funds into relatively small markets for goods such as rice and corn raises important questions about the ability of the markets to absorb these new investors without distorting or undermining fundamental supply and demand forces.

Speculative activity in commodity markets has grown by staggering leaps and bounds over the last several years. From 1998 to 2008, the share of long interests in commodities held by financial speculators - that is, market positions that benefit when prices rise - has grown from one-quarter to two-thirds of the commodity market. By comparison, during the same period, the share of the market held by actual physical traders has dropped from three-quarters to just one-third. In only five years, from 2003 to 2008, investment in index funds tied to commodities has grown twenty-fold, from $13 billion to $260 billion.

This unbridled growth raises justifiable concerns that speculative demand - divorced from market realities - is driving food and energy price inflation, and causing a lot of human suffering.

In 1938, Congress created limits on speculative activity that could threaten the orderly functioning of commodity markets - limits on the size of any one investor's holdings in the futures markets with respect to a specific commodity. The purpose of these limits is to reduce the threat of market manipulation or congestion and reduce the potential for price distortions. In 1974, Congress extended the authority for speculative position limits when it created the Commodity Futures Trading Commission. Since that time, we have seen tremendous growth in new and complex financial instruments that are marketed to large, sophisticated investors in over-the-counter transactions. These instruments, often tied to returns on commodities, are sold outside the commodity exchanges and create doubts about whether the speculative limits in the law continue to work in any meaningful way.

To examine these urgent concerns, we are fortunate to have with us a distinguished panel of experts representing the key actors and institutions that influence of commodity markets. We have asked the experts to address several critical questions. First, what effect are institutional investors and hedge funds having on current food and energy prices. Second, are food and energy price increases being driven by irrational speculative behavior, a rational response to market fundamentals, or a combination of both? Third, are rising prices creating an economic incentive for speculators to accumulate and hold stocks of food and energy commodities? And finally, does the Commodity Futures Trading Commission, the primary regulator of commodity futures markets, have the authority and resources necessary to adequately monitor and regulate commodity trading?

Our committee is uniquely situated to look across the federal government and assess the complex interaction of economic activities and regulatory policies. The issues we discuss today will help shape future debates and legislative action on the appropriate balance between free market principles and regulatory oversight in commodity markets. I look forward to our witnesses' testimony and working with my colleagues to ensure that Congress takes a thoughtful, reasonable, and balanced approach to the issues at hand. Senator Collins?

-30-