Statement of Senator Susan M. Collins

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

Committee on Homeland Security and Governmental Affairs
May 20, 2008

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In December, I participated in the hearing of the Permanent Subcommittee on Investigations chaired by Senator Levin regarding speculation in energy markets. Oil prices were then headed for $95 a barrel. We thought it an outrage. Now most people would call it a relief.

With oil now above $125, millions of Americans face dire hardship. A few days ago, I met with an employee of a heating-oil company from Maine. He's telling customers to expect home heating oil to rise to $4.50 a gallon next winter. In the summer of

2005, before the supply disruptions caused by Hurricane Katrina, the average price in Maine was $2.09 a gallon.

Maine has long, cold winters, and oil is the main heat source in most of our homes. Maine's housing stock and people are older, and incomes are lower, than the national average. That is a formula for a winter of hardship. My visitor told me of an elderly customer forced to hand over half of her Social Security check for her budget-payment plan.

I have talked with countless families forced to charge their oil bill to their credit cards. Maine families, on average, use 800 to 1,000 gallons of oil during a heating season. For our poorest citizens, LIHEAP assistance would cover only about a hundred gallons at the prices he fears for this winter.

Mainers, like other Americans, are facing record gasoline prices and the highest rate of food-price inflation since 1990. As my constituent said, "Something is wrong."

Truly, something is wrong – deeply wrong. Senior citizens and young working families, truckers and fishermen, small shops and big factories – all face difficulties and even disaster from the price trends in food and energy. Bringing about immediate relief is difficult, but we are beginning to take some initial steps to mitigate the distress somewhat. We have forced the Administration to stop the bizarre practice of taking oil off the market and putting it into our already enormous Strategic Petroleum Reserve during a time of record prices. Also, we have begun a tough review of the effects of our ethanol-promotion policies on food prices.

And the new Farm Bill has an important provision that eliminates the so-called "Enron loophole" in our commodity-market regulatory system that exempted electronic exchanges from the trading and reporting requirements imposed on other commodity exchanges, such as those in New York and Chicago. This will give regulators a clearer view of who is trading, what they are doing, what effect they are having, and whether laws against market manipulation are being respected.

Which brings us to the subject of today's hearing. Over the past few years, a weak stock market and lower interest rates have persuaded many investors – including managers of pension funds, 401(k) plans, and endowments – to put cash into commodities markets. A recent press release promoting a new commodities fund pointed out that

commodities offer average returns that beat stocks and bonds over time, they move independent of other investments, and their prices go up if inflation increases.

These investors aren't buying and selling actual barrels of oil, bushels of corn, or herds of live cattle. Their commodity investments – estimated at upwards of $250 billion – are in futures contracts, options, swap agreements, or other financial instruments that seldom lead to taking possession of the underlying product. These financial markets provide useful services in risk-hedging and price discovery for the farmers and other producers, grain-elevator companies, commodity brokers, and others involved in the production and use of physical products.

Participants in the commercial markets have long used speculators' willingness to accept risk as a way to lock in prices for crops or hedge other risks. But many of them, including the National Farmers Union and the National Feed and Grain Association, now believe that the massive trading in the non-commercial futures market has disrupted the normal flows of price information and has caused price movements that expose them to crippling margin calls.

Federal economists contend that index-fund and institutional investors tend to follow changes in the physical market or react to news rather than directly push commercial prices up or down.

They tell us that fundamental factors like rising demand in developing countries, the declining dollar,

weather events, geopolitical news, OPEC production decisions, refinery capacity limits, and ethanol policies account for the dramatic developments we've seen in markets for agricultural and energy commodities.

But many other intelligent, informed, and concerned people believe the large flows of speculative capital into the non-commercial side of futures markets are having disruptive and destructive effects. That view is, of course, consistent with earlier findings by the Permanent Subcommittee on Investigations that speculative investments in excess of what normal commercial risk-hedging requires creates a "virtual" demand that can have a real effect on commercial market.

Today's hearing should give us robust

presentations of both views of the commodity markets. I do not expect the hearing to settle the debate, but I do expect that it will show we cannot afford to ignore the possibility that financial speculators are disrupting the vital hedging and price-discovery functions of commodity markets.

A critical point of inquiry must be whether the market monitors and regulators at the Commodity Futures Trading Commission have adequate resources and authorities for their work. I was astonished to learn from Chairman Lukken of the CFTC that since 1976, the Commission's workforce has declined by 12 percent while the volume of commodities contracts it must monitor has risen by more than 8,000 percent.

The CFTC has nonetheless imposed more than

$2 billion in sanctions over the past five years for actual or attempted manipulation, fraud, and false reporting. Vigorous CFTC enforcement requires more resources, especially given the new authority Congress has just granted the Commission.

I believe the CFTC must also look into *legal* practices such as large purchases of commodity-linked financial products by institutional investors to ensure that they are not disrupting essential market functions or exerting artificial pressure on the price of the underlying commodities.

Achieving more transparency and reducing unintended disturbances to food and energy markets is more than a matter of fair dealing and economic efficiency. It is essential to help avert disaster for millions of Americans struggling with the soaring

costs of feeding their families, filling their gas tanks, and heating their homes.

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