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Speech

"The Commodity Coaster"

Speech by Commissioner Bart Chilton before the Washington Agricultural Roundtable, Brookings Institution, Washington, D.C.

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Thank you for the opportunity to be with you today. I particularly want to thank Scott Shearer for the invitation. Scott has been a friend for over 20 years. We worked together at USDA during the Clinton Administration and he is one great friend to agriculture and to rural America.

The Economy and Stimulus

Last year was a pretty topsy-turvy experience, not just for agriculture, but for all of us. The financial meltdown is still in full swing. On Friday, the unemployment figures came out and were even worse than what had been predicted. The U.S. lost over 590,000 jobs in January, up from the forecast of 525,000. The unemployment rate, which was predicted to be 7.5 percent, turned out to be 7.6 percent, up from the December 7.2 percent. By the way, the December forecast was for a job loss total of 525,000, and it turned out to be 577,000. January was the worst job loss month since December of 1974.

For the first time since 2000, 2009 may see a drop in the sales of personal computers. The US national Retail Federation is expecting container shipments to the US to fall during the first half of the year by 11.8 percent. That percentage compares to the drop during the whole of 2008 of 7.9 percent.

The economic crisis is impacting nearly everyone and the pain is real and deep. That's why I'm pleased that the stimulus package appears to be moving forward. By the way, that's the stimulus package to fix the salvage plan to prop up the rescue bill that will correct the bailout plan. What a mess.

It seems that there was so much urgency to the original three-page Paulson plan that there was no time to make sure it worked. The bailout money stayed in the hands of banks as consumers and homeowners continued to get punched in the gut. As this all took place, corporate excesses, like extravagant teambuilding sessions in Tucson, or management meetings in Maui, continued unabated. CEO pay and bonuses were unaffected by pesky concerns about home foreclosures and job losses. It's enough to make any thinking person recoil in disgust.

President Obama and the Congress have certainly shown their negative reaction to this contemptible behavior, and I commend them for trying to get it right this time. What they are talking about doing is better than the plan some proposed: having displaced homeowners pack CEO golden parachutes.

What is clear today, now more than ever, is that there needs to be a stimulus package and it needs to be implemented as soon as possible.

Roller Coasters

I want to share something a little different with you today. One day in early August 1977, at 1:15 in the morning, Elvis—"the King"—arrived with some guests at "Libertyland," the amusement park in Memphis, Tennessee, wearing a blue jumpsuit. He wore a black leather belt with a ginormous turquoise-studded buckle. The King had rented Libertyland until 7 in the morning. While he was there, he repeatedly rode the Zippin Pippin—Libertyland's roller coaster, and lost his buckle. That was the last time anyone saw Elvis in public. He died eight days later on August 16th.

There is some debate about where the first roller coaster was built in the U.S.—in Pennsylvania or at Coney Island. Coney Island seems to win out in most of the debates. That's where LaMarcus Adna Thompson (also known as the "Father of Gravity") built his coaster in 1884. The longest roller coaster is in Japan—the Steel Dragon. The world's fastest and highest roller coaster is the Kingda Ka at Six Flags in New Jersey. It travels at speeds up to 128 mph and reaches a height of 456 feet, with a 418-foot drop.

My favorite roller coaster is the "Rock 'n' Roller Coaster" at Disney World. There is a giant Fender Stratocaster at the entrance to the indoor ride that has over 900 speakers throughout the building blasting a beating score of five Aerosmith songs. The ride goes from zero to 57 miles per hour in 2.8 seconds—nearly 5 Gs. Shuttle astronauts experience 3 Gs. The Rock 'n' Roller Coaster is sort of like Space Mountain on speed.

My point is—and I know some of you doubt there was one—that if you lined up each of these roller coasters next to each other, the ups and downs wouldn't look too dissimilar from the commodity markets over the past year. We have seen highs and lows that make people's stomachs turn every bit as much as the Zippin Pippin.

Commodity Markets

A year ago, corn was at a high of $5.00, but today corn is at $3.77. Wheat was $10.00, and is now $5.62. Oil was $89.00, and reached a high of over $147 a barrel in July and is now trading around $40 per barrel. Gasoline last summer topped $4 a gallon and now is around $1.85 a gallon.

Some say that the primary drivers of roller coaster commodity prices were simple supply and demand fundamentals. I don't disagree that fundamentals played an important and perhaps even driving role. That said, speculators, particularly non-commercial speculators who were new participants in these markets, also played a role in my opinion. As the securities markets began to fail due to the subprime mess and the degrading economy, money flowed into these futures markets like never before. In fact, fully $200 billion in new capital was injected into these markets by passive long investors in about a year. It simply flies in the face of common sense to think that $200 billion didn't have some impact. I came under some criticism from my colleagues and the staff at the agency for taking that position when prices were going up, but as passive long investors, and others, left the markets and prices began to tumble, I think it was more difficult not to conclude that there was a strong relationship. Nobody can convince me that the drop was purely market fundamentals of supply and demand. There was a classic commodity bubble burst as traders left the markets in droves.

The result of high prices last year impacted consumers in the U.S. and all around the world. In agriculture, the traditional market participants—participants for whom these markets were originally established—had trouble hedging their risks because of increasing margin requirements and the lack of credit. Producers were essentially told they were not tall enough to ride. Pure and simple, oversight of these agricultural risk management and price discovery markets is the mission, mantra and mandate of the CFTC, and we need to do all we can to ensure that they remain effective and efficient for agricultural market participants—producers and processors. To me, that means figuring out what we need to do in the future. Just because prices are low now doesn't mean we should sit by and wait for another ride on the commodity coaster.

Markets, Oversight & Resources

That's why I'm so pleased that Chairman Peterson and the House Agriculture Committee are moving forward on legislation to address some of the important issues that need attention.

The CFTC only sees a very small portion of the derivatives traded in the US. In fact, we routinely see only what is traded on exchanges—about $5 trillion. That may seem like a lot, but get this: Credit Default Swaps (CDSs) accounted for somewhere between $55 and $60 trillion. CDSs were totally off the radar screen of any federal financial regulator. That's the result of the Commodity Futures Modernization Act of 2000, in which Congress codified the CFTC's previous administrative actions exempting these transactions from oversight. It turned out to be a big mistake and the collateral damage of that deregulation led to the inability of regulators to see what was going on. In the wake of the subprime fiasco, CDSs played an assisting role in further damaging our frail economy. While the CFTC and the transactions we oversee were not at the epicenter of the subprime crisis, it is obvious that "dark market" OTC derivatives contributed greatly to our current troubles, and we need to get a handle on this, and do it quickly.

The ability of the CFTC to oversee markets depends first upon our ability to see into currently dark markets and secondly upon our ability to have the regulatory tools to do something about problematic transactions that could result in fraud, abuse or manipulation. That is why Chairman Peterson's proposal to give us additional authority to not only obtain information, but to further regulate is so important. If we adopt much of what he has proposed, we can ensure that commodity markets will have improved stability and safety, and that traditional markets participants will continue to have a voice in these critically important markets.

Additionally, two weeks ago several Senators joined together to call for increased resources for the Securities and Exchange Commission (SEC). By comparison, the CFTC oversees exchanges with significantly greater market capitalization than the SEC. The SEC has about 3,450 employees, while the CFTC struggles with about 450 staffers. It is not a popular thing to call for more money for federal employees, but without cops on the beat, crimes can take place. That is why I've called for 150 new investigators and for increased computing technology.

Criminal Authority

Finally, the CFTC's current authority enables us to investigate and prosecute administrative and civil violations of the act. However, only the Department of Justice (DOJ) can prosecute criminal violations of the Commodity Exchange Act (CEA). Section 9 of the CEA makes it a felony to engage in any of the conduct enumerated in Sections 9(a)(1) – (4), as well as any willful violation of any provision of the Act or the Commission's rules and regulations. Bifurcation of civil and criminal authority between the CFTC and DOJ creates obstacles to effective enforcement.

Violations of the CEA often involve highly technical and complicated trading schemes. To prosecute these violations effectively, attorneys and investigators must be experts in the functioning of markets. CFTC enforcement personnel are specially trained to handle these matters, unlike DOJ prosecutors who are more likely to be generalists, unfamiliar with the mechanics of derivatives trading and the interstices of the Act and regulations. While DOJ attorneys do an excellent job in their prosecutorial functions, it is simply asking too much to expect them to be expert in the types of complexities that our enforcement attorneys deal with on a daily basis.

Because of the complexity of cases under the CEA, DOJ prosecutors have been reluctant to take on these matters or have required that CFTC staff be assigned to assist DOJ prosecutors.

Because DOJ prosecutors are responsible for a broad array of cases, including violent crime and money laundering, it is difficult to get them to commit scarce resources to prosecute complicated financial fraud and manipulation cases.

Coordination of civil and criminal investigations between agencies can delay effective enforcement and complicate proceedings, providing unintended advantages to criminals.

If the CFTC were to be given criminal prosecution authority, I think it would significantly enhance the deterrent effects of the existing regulatory scheme. The likelihood of criminal prosecution would increase and wrongdoers would have to raise their concern about the potential consequences of criminal conviction and penalties.

Other financial regulators around the world, including the Financial Services Authority (FSA) in the United Kingdom and the regulator in Australia already have such criminal authorities. I've spoken recently with several of my colleagues, current and former commissioners, Republicans and Democrats. This proposal makes sense to them and I'm hopeful that it will be considered by Congress.

When people violate the law and fleece folks out of their money, they should go to jail. We should have the ability to do more than simply civil penalties.

I think the American people are sick and tired of letting swindlers get away without proper punishment. The CFTC should be given these additional criminal authorities so that we can again return to doing job one: protecting consumers.

Presidential Transition Team

There used to be an imposing bronze plaque with the visage of the Securities and Exchange Commission's third chairman, William O. Douglas, in the entrance hall of the old SEC building, emblazoned the inspiring legend, "We are the Investor's Advocate." I think with appropriate laws, rules and regulations—and remembering that mantra—we will be doing the job expected of us.

The SEC is now housed in the DOJ building next to Union Station. The older building where that plaque was displayed, interestingly, housed the PTT – the Presidential Transition Team. It couldn't be more appropriate.

As Scott mentioned, I served on the PTT Agency Review Team for USDA. I was honored to be the co-lead with Carole Jett who is now serving as Secretary Vilsack's Deputy Chief of Staff—a job with which I am fairly familiar.

All of us involved with PTT were asked not to talk about the specifics of our PTT efforts, so I'm restrained in what I can tell you about our work. That said, I am at liberty to give you a little bit of insight and background.

Despite what many thought, the job was pretty narrowly defined. That didn't stop folks from asking me all sorts of things. I was asked, for example, to try and help settle outstanding law suits, pass along lengthy letters to the then-President-elect. While my role in personnel matters was very limited, that didn't stop me from being sent more than 1,000 resumes. I passed them all along as best I could. We had nothing to do with the inaugural, yet people continued to ask for tickets, up until the afternoon of January 20th! I even had someone who wanted me to try and get an Obama coffee (a blend of Kenyan and Hawaiian varieties) served at the balls.

In truth, our job was primarily a diagnostic endeavor. We didn't create new policy or procedures. We simply reviewed what was going on at USDA—the good the bad and the ugly—and there was a little of each. We then looked at what Barack Obama had said during the campaign and tried to suggest ways for the new Administration to move forward. We provided some options. We didn't come up with this stuff by ourselves. In fact we held many outreach meetings with advocates and individuals seeking input. Many of you were part of that effort. Our client, if you will, was really the Secretary-Designate and our job was to transition out of transition.

I can tell you that we had a great team and that we all volunteered long hours for roughly two months—some of us were even involved even longer, having been doing pre-election transition work. On one day in November, I received nearly 1,000 e-mails, something that has never happened to me before, and I hope never does again.

I think we did a really good job and hope the new Secretary shares that view. I think he does. I'm very pleased and impressed with Secretary Vilsack and believe he is going to be a great Secretary of Agriculture. He has already established a super core team in the Cage and I think you will soon see some further announcements that will impress all of you.

Conclusion

We have experienced a topsy-turvy ride, not just in the economy and in commodity markets, but with the election and the war. Last year was a year that asked a lot of questions about where we were headed. I'm hopeful that this year will provide some answers. Like you, I'm hopeful that we are again going to make some real progress on important issues—issues that matter to people in their daily lives.

Thank you for the opportunity to be with you today.