Curbing speculation could destabilize commodity prices, study says

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Price spikes for gasoline, grain and other commodities could be magnified if lawmakers curb speculative trading in futures markets, according to a new study released today in conjunction with this weekend's G20 summit.

Congress is considering proposals to restrict a growing surge of speculation in commodity futures that some blame for a 2008 spike that netted record corn, rice and wheat prices and pushed gasoline over $4 a gallon.

But new research suggests that the billions of dollars invested by speculators may have helped stabilize prices rather than drive them up, said Scott Irwin, a University of Illinois economist who co-wrote the study.

"Restricting investments by speculators could do exactly what these proposals are trying to avoid," he said.

Irwin and Southern Illinois University economist Dwight Sanders researched the 2007-08 price bubble in commodity markets in a study commissioned by the Paris-based Organization for Economic Cooperation and Development.

The OECD, an international alliance of 31 nations that promotes the market economy, released the study as world leaders prepare for this weekend's G20 summit in Toronto to address global economic problems.

The study found no convincing evidence that speculators aggravated price increases that were already on the rise as drought cut into grain supplies and growing worldwide demand boosted oil demand, said Irwin, a professor of agricultural and consumer economics.

Instead, he says the findings indicate that the influx of cash from index traders provided a deep new pool of liquidity that reduced volatility and held price increases in check.

"It's like dropping a stone in a puddle - the bigger and deeper the puddle, the smaller the waves," said Irwin, who testified in 2008 before a House committee considering limits on speculation in commodity futures markets.

He says speculators have been wrongly targeted because the 2008 price spike occurred amid a dramatic surge of index trading that marked a major structural change in commodities futures markets. But research shows the shift was a coincidence, not a contributor, he said.

"In times of extreme market turmoil there has been a historical tendency to look for a scapegoat, and that often that ends up being the speculator," Irwin said. "The evidence that we have in this episode is not inconsistent with that historical pattern."

He says the findings suggest that Congress should rethink new limits on speculative trading in futures markets, which are included in a sweeping financial reform package under debate this summer.

"Our policymakers and regulators should look at the entire body of evidence and make policy decisions based on evidence, not conjecture," Irwin said. " 'Do no harm' is the first principle they should adhere to. There needs to be a high standard of evidence before they intervene with any kind of restrictions."

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