

37th Committee of Food Security

October, 2011

Thank you Mr. Chairman

CME Group's origins stem from the Chicago Board of Trade and the Chicago Mercantile Exchange, commodity exchanges founded by Midwestern US farmers who banded together more than 160 years ago to develop markets to allow them to manage price risk and get fair prices for their crops. Like back then, exchange-listed futures markets today continue to serve two important functions – they create price transparency and they allow risk transfer. In a world where it is critical we produce sufficient food to feed the population at as low a cost as possible, the functions an exchange provides are more important than ever, and policies that support these important economic functions are part of the solution to our current problems.

Futures prices reflect supply and demand. Factors like rapidly increasing demand for corn from Asia or a drought in US that decimates wheat supplies will have an impact on agricultural prices. It is important to understand, prices respond not only to actual changes in these factors, but also to the anticipation of these changes by producers and consumers. In the case of adverse weather for example, consumers anticipating smaller supplies buy today to cover future needs. At the same time, farmers hold off selling because of production

uncertainty. These activities - the human response to perceived changes in supply and demand, create price volatility. When global stocks of grain are very tight, as they are now and as they were during the 1970's, this price volatility is more pronounced than when stocks are plentiful as they have been through much of the 80's, 90's and into the 2000's.

Why are transparent prices important? Price transparency levels the playing field. While a wheat consumer in Africa may not have access to the same level of information about a regional drought occurring in the middle of the United States as a multinational trading company, they will see these events reflected in prices. As a consumer they will understand that future food costs may be increasing or as a producer they will know their production is worth more. Without this transparency, smallholders have no window into the value of their production.

These prices also send important signals. Agricultural producers require capital to increase production, be it from external investors or local banks. Regions like the Ukraine, the historic breadbasket of Eastern Europe, have the capacity to significantly increase production but to do so need additional capital. Food production competes for financing and high prices bring that finance to them. Without capital, production won't meet the increased food demands and people will suffer. However well meaning, policies which seek to control prices rather than promote transparency will cause more damage than good.

Futures markets serve a second critical function – risk transfer. The purpose for a cash market – that is a market where physical commodity are bought and sold - is to transfer the commodity from producers through the distribution channel to the consumer. The purpose of a futures market, beyond providing price transparency,

is to transfer price risk from those who wish to mitigate it to those willing to accept it.

The cost of price volatility is typically passed through the value chain and ultimately increases the cost of food. The ability to transfer this risk both reduces the cost as well as creates additional stability in the production system. Western producers have the financial reserves to survive adverse markets much better than their developing market counterparts. The benefits of functional risk management mechanisms are much more important for those less-well-capitalized market participants. Suggestions to limit market participation, and consequently limit market liquidity will simply increase the cost of managing risk and for those producers on the margin, will make it cost prohibitive.

CME Group believes that effective markets play an important role in solving the challenges facing us today.

- We believe that a principle based approach, where core philosophical principles are agreed to between regulators and the regulated, are more effective than more prescriptive approaches. No amount of regulation will dampen demand or increase supply, and consequently the price volatility of a commodity. Working with our regulator, the US Commodity Futures Trading Commission we have developed a framework where we already have self-imposed position limits and an extensive system of market oversight that prevents price manipulation while allowing for significant product innovation.
- We suggest that to increase the global food supply, we need to expand the agricultural productivity. Food production is competing with many other

uses of capital and only with clear price signals from transparent markets will we be able to attract this capital to build production capacity. Policies which prevent the market from working freely ultimately don't solve the underlying problem and people suffer as a result.

- We strongly feel that there needs to be a social safety net to protect the poor impacted by high and volatile prices. This ensures social protection while allowing farmers- who themselves are frequently the poor and hungry in developing countries – to attract the money they need to make a living. Local governments are best positioned to provide this and these policies can and should coexist with open markets that provide long-term solutions.
- To be successful, we believe that while prices provide important signals to the market to increase production, that production must be able to flow from areas of production to areas of demand, unencumbered by tariffs, embargos or other trade barriers. The free flow of commodities globally benefits both producer and consumers.
- Additionally we believe the cost of volatile markets disproportionately impacts smaller producers who are less able to absorb it. Programs which provide information and education to market participants as well as help them manage these risks are extremely beneficial and effective. A world class example of this is the program offered by ASERCA, an agency of the Mexican government, where they subsidize the cost of risk management products for agricultural producers and consumers.
- Lastly, we would suggest the approach of blaming speculators for price volatility not only fails to solve the real problems, but enacting policies

based on this assumption can in fact increase volatility and food costs as they decrease market liquidity and increase the cost of managing risk.

We at CME Group have been part of the agricultural landscape for 160 plus years as an innovator in developing markets where global market participants go to manage agricultural price risk. We believe markets like ours will continue to be a key part of the solution to our current problems and look forward to help in any way we can.

Thank you again for allowing me the opportunity to address this esteemed body.