

3. Speculators, storage and commodity price spikes

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The rapid increase in commodity prices during the last year has led to questions about the rationality of markets, and about whether the need to protect the most vulnerable people warrants government market interference. Actions to correct “manipulative” or “speculative” behavior including “hoarding” or “price gouging” are under active discussion in the United States and elsewhere. Many countries have instituted price controls or other price-lowering measures, such as export controls and import tariff reductions, in order to protect the poor or politically powerful groups.

Our research on speculators and storage addresses several related issues. We examine whether there is evidence in the market of irrational speculative bubbles that are inconsistent with competitive behavior and which should be prevented or corrected by public intervention. Has the much-discussed flood of cash from hedge funds distorted the market in detectable ways? Have low interest rates set off the price spike, as has been suggested?

Using a market model that treats food consumption as essential, so that price rises without bound as stocks approach zero, our research shows that runs with prices rising at a rate higher than the rate of interest are not only rational but likely to be a recurring feature of markets. Those who view evidence of prices rising faster than the rate of interest as proof of panic or irrationality are misinterpreting the data.

We also examine the rationale for public intervention in the accumulation, holding and disposition of commodity stocks. Is there a market failure that makes intervention necessary, or is the private market likely to be efficient? Is there likely to be excessive, monopolistic hoarding by the private sector? Are there other efficiency reasons to intervene? The argument that monopolistic hoarders hold stocks off the market and exacerbate shortages was an old one in Adam Smith’s day. As Smith suspected, it reflects confusion regarding how a monopolist raises prices. A monopolist of storage services would provide too little, not too much, storage, just as a monopolist of diamonds makes money by restricting supply, not by flooding the market.

However, there is another, more convincing, argument for failure of storage markets. As the current situation in many developing countries illustrates, in times of scarcity governments feel compelled to act to lower prices of food. One way net exporters try to do this is by imposing export controls, as the United States did briefly, in 1973, and as India and many other countries have done recently. Another way to lower prices is by banning hoarding by the private sector, as other countries have done recently. These actions discourage private storage in times of plenty, since traders understand that government policies will reduce the gains they would otherwise receive during times of scarcity. Governments might want to commit, in times of plenty, not to undertake these kinds of actions during times of scarcity, but this commitment is not credible. Governments' inability to commit not to intervene during times of scarcity is a type of government failure that induces failure of the private market. This failure leads to inadequate private storage and, paradoxically, justifies the kind of public intervention during times of scarcity that we currently see. The design of optimal intervention in this situation is a challenge for commodity economists.

