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Position Limits Backgrounder

A fundamental misperception exists in some circles that speculation is behind volatility and price increases in commodities markets. Some have argued that rules restricting position limits will curtail or reduce speculation.

In fact, position limits threaten an adverse impact on markets. As The Economist has written, "There is good reason to worry that position limits will harm markets more than help them…Investors will become pickier about the contracts they enter into as a result of the limits, which may cause markets to become less liquid, worsening volatility rather than reducing it."

The worries about the effect of position limits are also reflected in the views of the CFTC's Commissioners. Two dissented from adopting the rule. A third voted to approve because of his misreading of the law, stating, "Position limits, at best a cure for a disease that does not exist…may harm the very markets we're trying to protect."

The academic literature also reveals that the role of speculation in the commodity markets is misunderstood. As Professor Craig Pirrong has written, "As yet there is no serious theory, and certainly no serious evidence that speculators have distorted commodity prices." In addition, one CFTC Commissioner at that time -- Michael Dunn -- stated earlier this year, "To date, CFTC staff has been unable to find any reliable economic analysis to support either the contention that excessive speculation is affecting the markets we regulate or that position limits will prevent excessive speculation."

Numerous studies have been commissioned to assess the presence and effect of excess speculation in commodities markets, and they have universally found no discernible evidence of excessive speculation:

- The Task Force on Commodity Futures Markets of the International Organization of Securities Commissions ("IOSCO"), co-chaired by the CFTC and the United Kingdom's Financial Services Authority, determined that market fundamentals, not speculation, caused the price volatility in physical commodities markets in 2008.

- The International Monetary Fund's World Economic Outlook, published in October 2008, found that "there is little discernible evidence that the buildup of related financial positions [in commodity markets] has systematically driven either prices for individual commodities or price formation more broadly." Similar conclusions were reached by the CFTC Inter-Agency Task Force on Commodity Markets, the European Commission, and the Government Accountability Office.

- A report prepared by the G20 Study Group Commodities in November 2011 indicates that the main factor behind rising commodity prices is not speculators but rising global consumer demand that is outstripping supply.

- A January 2009 memo prepared by the Government Accountability Office (the "GAO Memo") found, based on both public and non-public data, "limited evidence" that speculation causes changes in commodity prices. The GAO Memo reviewed numerous empirical studies, all of which "generally employed statistical techniques that were designed to detect a very weak or even spurious causal relationship between futures speculators and commodity prices," and concluded that "the fact that the studies generally did not find statistical evidence of such a relationship appears to suggest that such trading is not significantly affecting commodity prices at the weekly or daily frequency."

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