



Industrial Energy Consumers of America
The Voice of the Industrial Energy Consumers

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STATEMENT OF PAUL N. CICIO
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ON
EXCESSIVE SPECULATION IN ENERGY COMMODITIES
BEFORE THE
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES
HEARING ON REVIEW OF LEGISLATION AMENDING THE COMMODITY
EXCHANGE ACT
JULY 10, 2008

Mr. Chairman and Members of the Committee,

My name is Paul N. Cicio. I am president of the Industrial Energy Consumers of America. Thank you for the opportunity to testify before you on the important issue of excessive speculation in energy and commodity markets in general.

IECA is a 501 (C) (6) national non-profit non-partisan cross-industry trade association whose membership is exclusively from the manufacturing sector. IECA promotes the interests of manufacturing companies for which the availability, use and cost of energy, power or feedstock play a significant role in their ability to compete in domestic and world markets. IECA membership represents a diverse set of industries including: plastics, cement, paper, food processing, aluminum, chemicals, fertilizer, brick, rubber, insulation, steel, glass, industrial gases, pharmaceutical, construction products, automotive products, and brewing.

Immediate action by Congress is needed to eliminate excessive speculation in energy and food related futures markets and increase domestic energy production.

At the heart of the matter is that every consumer in the country assumes that the government is protecting their interests and that commodity markets are operating with the public's interest at heart. Nothing could be further from the truth. The futures market that is relied upon for price determination in the spot physical market no longer reflects underlying supply and demand fundamentals. Existing law and government institutions that are in place have failed to protect the public interest. Excessive levels of speculation are un-necessarily raising the costs of energy for every homeowner, farmer and manufacturer.

We urge the Congress to take action to eliminate excessive speculation in futures markets and to increase the domestic supply of energy. Removing excessive speculation will have an immediate short term impact on commodity prices. The Congress cannot under-estimate the impact this issue is having on our country through un-necessary high energy costs and inflationary impacts. Make no mistake that excessive speculation is occurring and futures markets have become over-run with players that futures markets never intended as participants.

For energy, taking action to remove the moratorium on the Outer Continental Shelf and provide access to the Alaskan National Wildlife Refuge Reserve (ANWR) will increase domestic supply of natural gas and oil in coming years. The combination of eliminating excessive speculation, increasing domestic production, implementing cost effective energy efficiency and responsible conservation will go a long way in solving our nation's energy crisis.

The manufacturing sector is dependent upon globally competitive energy to compete in the market place. We are substantial consumers of natural gas for fuel and feedstock and also use large quantities of electricity.

The high price of natural gas has significantly contributed to the loss of manufacturing jobs. Since 2000, 3.3 million manufacturing jobs have been lost which account for 19 percent of all manufacturing jobs. According to the July 4, 2008 USA Today, manufacturers lost 33,000 jobs in the month of June alone. It also reports that U.S. manufacturers have lost 353,000 jobs so far this year despite the weak dollar that has helped to make exports more cost competitive.

It is also important to note that natural gas prices set the marginal price of electricity in a growing portion of the country. As natural gas prices rise, so does the price of electricity. The two are connected and the increase in the price of electricity is another unintended consequence of higher natural gas prices because of excessive speculation. High natural gas and electricity prices are resulting in a new round of demand destruction that drives high paying manufacturing jobs offshore.

The case for natural gas

US natural gas prices are not linked to crude oil prices and are not impacted by international supply disruption concerns, yet prices have surged along side crude prices in recent months.

Unlike crude oil that is priced globally, natural gas is a North American market and is priced domestically. In most years, we produce about 82 percent of our natural gas in the US, import about 15 percent from Canada and import about 3 percent in the form of LNG. If global demand for crude oil exceeds supply, the price will rise globally. If demand for natural gas rises or falls in the US, only US consumers will pay either higher or lower prices. Crude oil and natural gas pricing are distinct and separate and there is insignificant substitution capacity. Natural gas prices are disconnected to crude oil prices in the physical markets.

There is no shortage of US natural gas. Domestic supply is meeting demand and expanding slowly. National inventories are slightly below their five year average; LNG import capacity has increased and is greatly under-utilized. There have not been any hurricanes or production stoppages. However, despite this fairly stable supply and demand picture, the price of natural gas has soared.

From one year ago, the price of natural gas has risen from \$5.94 mm Btu to \$13.58 mm Btu, a 129 percent increase. Why, then, has the price of natural gas risen so high so quickly? The answer is that larger and larger quantities of capital have flowed into the futures markets by means of index funds, institutional investors like pension funds, hedge funds and sovereign funds.

To illustrate the point we have compiled the following information. Using EIA 2007 data, the US consumes on average 1,971,357,597 MM Btus of natural gas

per month. On July 3, 2008 50,731 natural gas contracts were traded on the NYMEX for the August contract. At this rate, the NYMEX trading activity in the prompt month (August) is 8 times the total US monthly average consumption volume. But this is only the NYMEX volume. It is a widely held view that the Over-the-Counter (OTC) markets, the dark markets, trade three to four times the volume that is traded on NYMEX. If the OTC market is three times larger, natural gas traded volume is greater than 24 times the physical consumption. What is frightening is that the rate of trading volume continues to rise.

Excessive speculation must be stopped

There is no question that excessive speculation has increased the price of energy and commodities in general. Trading volumes are now reportedly 22 times that of the underlying commodity volumes and, as a result, speculators are trading with other speculators with no regard to the underlying supply versus demand fundamentals.

According to one estimate, assets allocated to commodity index trading strategies have risen from \$13 billion from 2003 to about \$260 billion in early 2008. Futures markets were never intended to be used as an inflation hedge or an asset class. Futures markets were established to serve price discovery for sellers and buyers of the commodity.

We strongly encourage you to include provisions that will do the following.

1. Ensure only bona fide physical hedgers qualify for hedge exemptions

Direct the CFTC to re-examine the definition of “hedging” to ensure that hedge exemptions are only available to *bona fide* hedgers and not to speculators. This will prevent speculators from using this exemption to avoid position limits.

2. Prohibit pension funds, index funds funds from speculating in commodity markets.

Futures were never intended to be used as an asset class for investment purposes. Using futures as an ‘asset class’ to hedge against inflation or to feather the performance of pension funds destroys the underlying functioning and efficiency of price determination for which we rely on futures. In the past, gold was used as a hedge against inflation, but using energy or food commodities directly and negatively damage families, farmers and manufacturers. The Congress must decide whether it supports families and American businesses or hedge funds, pension funds and sovereign funds. It’s just that simple.

3. Fully close the Enron loophole

Require that all energy exchanges be subject to appropriate federal regulation, including reporting requirements and position limits, by prohibiting any energy

contracts from being traded on exempt commercial markets. This includes Swaps. Speculative position limits must “look-through” the swaps transaction to the ultimate counterparty and hold that counterparty to the speculative limits.

4. Close the foreign exchange loophole

(a) Require all foreign exchanges offering energy commodities through a U.S.-based terminal to be subject to the same regulatory requirements applicable to U.S. exchanges, including position limits, margin requirements, and reporting.

(b) Subject U.S. traders trading energy derivatives on non-U.S. markets to the same reporting and recordkeeping requirements as those trading on U.S. exchanges. This prevents them from avoiding CFTC oversight by trading overseas.

4. Provide greater transparency on energy swaps

Direct the CFTC to impose reasonable recordkeeping and ‘large trader’ reporting requirements on all energy swaps made in the U.S. or made by U.S. traders anywhere in the world, while taking steps to ensure that participants’ information is kept confidential and not disclosed to competitors.

5. Enhanced reporting requirements

Direct the CFTC to devise new classifications of trades to break out speculators or swaps as a separate category, and direct the CFTC to enhance its Commitments of Traders Report to include trades using the Intercontinental Exchange (ICE) in Europe and other similar exchanges.

6. Disclosure requirements

Require companies who promote market positions (such as market analysts) to disclose their positions if they talk publicly. Or ban conflict of interest such as analysts’ statements that enrich analyst’s portfolios.

7. Lower position limits and margin policies to benefit physical hedgers.

We believe that individual entities from the hedge funds, index funds, and sovereign funds can provide more capital for trading than most energy producers or sellers. It is paramount that we prevent a few entities from developing market power.

8. Identify sovereign fund positions

Require the CFTC large trader report to identify sovereign funds and their positions. The participation of sovereign funds in commodity markets must be

made clear to the CFTC because financial derivative price movements have a direct impact on the price of the physical commodity. A cause and effect.

9. All companies must register and file reports to Security Exchange Commission

Require all companies who participate in US commodity markets, including hedge funds, to register and file reports to the Security Exchange Commission just like all other companies.

10. Ensure that the banks are not borrowing capital from the Federal Reserve at low interest rates to speculate in the futures market.

We encourage the Congress to ensure that Federal Reserve monetary policy is not causing higher energy and food costs by providing cheap money to banks to speculate on commodities. Attached charts show an almost linear relationship between lower Federal Reserve interest rates, increased borrowing by banks and corresponding higher commodity prices. We are concerned that the timing is not coincidental.

Thank you.

Appendix A.

Intended federal funds rate			
Change and level, 1990 to present			
Change			
(basis points)			
Date	Increase	Decrease	Level (percent)
2008			
30-Apr	...	25	2
18-Mar	...	75	2.25
30-Jan	...	50	3
22-Jan	...	75	3.5
2007			
11-Dec	...	25	4.25
31-Oct	...	25	4.5
18-Sep	...	50	4.75
2006			
29-Jun	25	...	5.25
10-May	25	...	5
28-Mar	25	...	4.75
31-Jan	25	...	4.5

