Excessive Speculation & Position Limits

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Detecting Excessive Speculation

- Position limits intended to prevent "excessive speculation" that causes "unreasonable or unwarranted price fluctuations"
- Commodity prices are inherently volatile: how do you know fluctuations are (a) unreasonable/unwarranted, and (b) the result of speculation?
- Hard problem: What is the "right" price? If we knew that, we'd all be rich and/or we wouldn't need markets.
- Difficult to know causes of price moves, even ex post (consider current oil price decline)

Using Economics to Detect Excessive Speculation

- Econometric evidence in a non-manipulation context limited by the fact that econometricians can't observe most relevant data on demand and supply
- Best approach relies on quantity data (e.g., inventories) as well, because prices guide quantity choices, so if prices are distorted quantities are too
- For instance, inventories should accumulate if speculators are causing prices to be excessively high
- Complication: inventories and prices can move in the same direction in an undistorted market

Current State of the Debate

- Most empirical studies of recent commodity prices fail to find evidence of distortions, or that speculators caused distortions
- For instance, no spike in inventories when oil prices spiked in 2008
- Contrary empirical (e.g., Singleton 2012) and theoretical (Sockin-Xiong 2014) papers have serious flaws
- "Knowledge problem" makes definitive answers elusive, so this debate will be a hardy perennial

Round Up the Usual Suspects

- Whenever there are big moves in energy prices, blame is cast on speculators: they are the usual suspects (to steal from Casablanca)
- Recent decline in oil prices a case in point: OPEC, Russia & others have pointed the fingers at speculators, as has a less interested party (BIS)
- Fundamentals (particularly slowing demand) are clearly at work here
- BIS study has to strain mightily to blame “financialization”: its conclusions are unsupported and implausible

Do Position Limits Curve Excessive Speculation Efficiently?

- Position limits constrain the positions of individuals and single firms. May work against neo Hunt Brothers, but ineffective against broad-based speculative waves (which are sometimes blamed for distorting prices)
- Limits may constrain efficient risk transfer by unduly restricting hedging or limiting risk bearing capacity
- Over-inclusive and under-inclusive
- Limits impose substantial compliance burdens
- Cost/benefit?