Regulatory capture, civil society & global finance in derivative regulation: An analysis of commodity derivative regulation in Europe

Johannes Petry

Abstract:
The paper analyses the divergent outcomes of post-crisis derivative regulation in Europe. In the aftermath of the financial crisis, most regulatory issues only represent incremental changes of existing practices and incentives, tweaking rather than reforming the financial system and, mostly, these regulations have been captured by the financial industry. A few regulations however seem to have greater impacts on the functioning of financial markets. The regulation of commodity derivatives through MiFID II is an example of such a fundamental change. Adopting a modified version of the institutional supply and demand (ISD) framework, this paper analyses the regulatory processes of these MiFID II and the occurrence of regulatory capture. This paper argues that meaningful regulatory change in commodity derivative regulation was primarily achieved through the lobbying of civil society groups (CSOs) that were able to prevent the regulation being captured by capitalising on the normative aspects of commodity trading and forming alliances with economically powerful actors. As against to more complex and technical regulations, CSOs were able to raise public awareness on the topic of food speculation and its negative impacts and capitalise on this development. Backed by the economically powerful agriculture industry and discursively connecting commodity derivatives with food speculation, CSOs were able to create pressure on elected officials to adapt more stringent regulations. Methodologically, process tracing is used to compare the influence of civil society and business interests in the regulatory process on derivatives.

1 VERY FIRST DRAFT. Comments are welcome Please do not cite without the authors permission.
2 University of Warwick & University of Konstanz.
1. Introduction: Financial regulation, regulatory capture and civil society

After the financial crisis of 2007-2009, a process to reregulate financial markets was initiated as previous regulatory arrangements had not been sufficient to prevent a catastrophe. Most scholars agree that these pre-crisis regulatory arrangements were to large extents “captured” by those interests that they were ought to regulate (e.g. Baker 2010; Johnson 2009; Tsingou 2010). But far from a paradigm shift, the post-crisis regulation of finance seems to be incremental – “rather tweaking than reforming the system” (Tsingou 2010: 22) – and scholars warn again a renewed capturing of regulations by the financial industry (e.g. Lall 2012; Rixen 2013; Scholte 2013).

Regulatory capture occurs when those groups that are ought to be regulated, have gained control over the regulatory process (Stigler 1971). In the regulation of global finance, Baker (2010) describes the development of “multilevel regulatory capture” in the financial governance architecture prior to the financial crisis of 2007-2009. Many aspects of global financial markets were either self-regulated by the financial industry (Tsingou 2006) or formally regulated by public authorities but also captured (Helleiner/Porter 2009). Regulatory capture was a global phenomenon, prevalent at national (Johnson 2009), supranational (Dorn 2012) and transnational levels (Tsingou 2008), and many experts indicate it a main reasons for the crisis (Warwick Commission 2009).

Five years into the crisis, many scholars agree that not much has changed. The regulation of capital requirements (Lall 2012), shadow banking regulation (Rixen 2013), accounting standards (Botzem 2013) and credit rating agencies (Dorn 2012), have again been successfully captured by the financial industry. Many regulatory developments resemble more a “muddling through” (Lindblom 1959) than a “paradigm change” (Hall 1993). As Manuela Moschella and Eleni Tsingou (2013a: 193) tellingly stated in their recent assessment of post-crisis regulatory processes, “the key feature of the regulatory reform has been its incremental, non-paradigm-changing dynamic.”

In such situations, many scholars emphasise the need for effective intervention through civil society organisations (CSOs; e.g. Anheier 2012; Brassett 2009; Fioramonti/Thümmler 2013; Scholte 2013). But CSOs are remarkably absent from the regulatory processes. This is highly problematic as the window of opportunity to
regulate financial markets is quickly closing and progress on re-embedding financial markets into society (Polanyi 2001 [1994]) has been limited.

This paper analyses under which conditions CSOs are able to prevent regulatory capture. To answer this question, the European regulation of commodity derivatives (MiFID II) is analysed, one of the few exceptions where meaningful regulatory change has occurred. Commodity derivatives, which are associated with food speculation and assumed to have contributed to, if not caused, the food crises of 2007 and 2010, have been successfully regulated in both the US and EU, for instance through the imposition of position limits on trading these products. As this paper highlights, CSOs were crucial for changing regulation of commodity derivatives.

The essay is structured as follows. The second section provides theoretical explanations for regulatory capture and for the power of global finance in financial regulation. Thereby, the institutional supply and demand (ISD) framework is outlined. In section three, the regulation of commodity derivatives is analysed. Hereby, a case study of the regulatory process is conducted, by applying the ISD framework. Section four concludes.

2. Theoretical perspectives on regulatory capture, financial regulation & civil society

Many scholars emphasise the role of CSOs in regulatory processes, as a “key source of ethical agency” (Brassett 2009: 449), as the social sphere where important responses to crises are most likely to emerge (Fioramonti/Thümmler 2013) or as countervailing force against the power of business interests (Anheier 2013). What role does civil society play in the regulation of global finance?4

Previous to the financial crisis, CSOs mostly addressed public financial institutions such as the International Monetary Fund (IMF) or the World Bank. They mostly missed to directly address the larger and more decisive forces of private finance that had captured financial regulations (Scholte 2013). After the crisis, financial market

3 For an analysis of commodity derivative regulation in the US, see Clapp and Helleiner (2012).
4 No be clear, civil society is not a unitary entity. It is rather an arena distinct from market and state where various types of actors engage in public participation. These are, among others, self-organized citizens, social movements, NGOs, business associations, labour unions, loose (online) networks or philanthropic foundations (Fioramonti/Thümmler 2013).
regulation became a more salient issue and civil society actions against global finance gained more momentum (the Occupy movement is an example for this; see Kern/Nam 2013). But when it comes to actual regulatory processes, most parts of civil society have been largely absent, leaving the field to established think tanks and financial industry groups (Ford/Philipponnat 2013). All in all, the number of CSOs in financial regulation is very limited and they stand against hundreds of financial lobbyists (see Anheier 2013). The success of CSOs in influencing the regulation of commodity derivatives is hence an important case that sheds light on the characteristics that enable civil society to prevent regulatory capture.6

In literature on the regulation of global finance, four broad categories of causes are brought forward as explanations for the pervasive influence of global finance in financial regulation. These are: “institutional design / revolving doors; lobbying; degree of political salience; and intellectual capture” (Baker 2010: 648). This paper applies the institutional supply and demand (ISD) framework from Walter Mattli and Ngaire Woods (2009) to analyse the regulation of commodity derivatives. In recent years, the ISD framework has been used by several scholars to analyse regulatory processes in global finance (Baker 2012; Helleiner 2009; Lall 2012). The virtue of this framework is that it encompasses all the individual explanations that are brought forward by scholars of global finance (Baker 2010, cited above) and combines these with theories of regulatory capture. The ISD framework acts as a tool box: it enables to check all possible explanations brought forward in the financial regulation literature, helps to distinguish between them and find out which are most useful in explaining regulatory change.

In the following, the ISD framework is outlined and existing explanations from the regulation of global finance literature are integrated. This is done to provide a (rather

---

5 Noticing this one-sided development, in 2010 a cross-party group of Members of the European Parliament (MEPs) called for a “Finance Watch”, a civil society counterlobby to the financial industry (Ford/Philipponnat 2013). Next to Finance Watch, a few NGOs with wider agendas of social and economic justice, such as attac, SOMO, WEED or WDM, have also advocated for more financial regulation.

6 Two other areas than hint towards larger changes in financial regulation are high frequency trading (HFT) which was also regulated through MiFID II, and the financial transaction tax (FTT). The FTT, however, is not far enough evolved to provide meaningful insights into regulatory issues and any discussion on HFT without a clear picture of the FTT regulatory process would be incomplete.
unconventional) review of the literature as well as to specify the framework and adapt it to the conditions specific to financial regulation.

**ISD-framework: Integrating financial regulation and regulatory capture**

Drawing on George Stigler (1971), the ISD framework assumes that regulations can, under certain conditions, be captured by those groups that are supposed to be regulated (Mattli/Woods 2009). Stigler (1971) argues that every regulated group has an incentive to influence regulation to their benefit. The problem is that the social costs of an insufficient regulation are externalised and have to be paid by the society (Mattli/Woods 2009): the “privatisation of profits” and “socialisation of losses” in the financial crisis exemplifies exactly such a situation. The ISD framework is able to assess whether a change of regulation occurred and how regulatory outcomes emerged through the influence of societal groups. The framework operates with two four variables: First, the institutional supply where regulation takes place; second, the demand side conditions for regulation: information, interests and ideas (Mattli/Woods 2009).

**Institutional supply: institutional voids & revolving doors**

The first condition is the institutional supply, the setting in which “rules are drafted, implemented, monitored and enforced” (Mattli/Woods 2009: 17). Open and public forums, multiple access points without entrance barriers, proper due processes, oversight mechanisms, inclusiveness and transparency characterize an extensive institutional setting, which leads to an increased representation of common interests. In contrast, a limited institutional context is marked by club-like forums, which are exclusive, and closed to the general public as well as non-transparent and secretive – conductive to regulatory capture.

In financial regulation, especially before the financial crisis, limited access possibilities were a condition conductive to regulatory capture as financial regulation often took place in exclusive settings (Tsingou 2010). Anheier criticises the institutional architecture of financial market governance as under-institutionalised, creating an “institutional void” in which actors engage in self-servicing behaviour as rules are
limited or not enforced (Anheier 2013: 3). The institutional design prevents civil society from counterbalancing and monitoring the activities of global finance (Anheier 2013; Fioramonti/Thümmler 2013). At the same time, the institutional architecture allowed regulators and regulated to switch employment between financial firms and their regulators, a phenomenon known as “revolving doors” (Seabrooke/Tsingou 2009).

Extensive institutional supply, however, is a necessary but not sufficient condition for the pursuit of common interests. In addition, it is essential to analyse the demand-side conditions for regulation, which contribute to situations of capture as well. The demand conditions for regulation are information, interests and ideas, which can either be broad or narrow.

**Information: Salience & complexity**

The first and initial condition for regulatory change is information. Through demonstration effects like a major failure or crisis, information about the negative consequences of the current (captured) regulatory regime are diffused. Information in this context functions as a trigger for regulatory change, creating an (initially) broad public demand for regulatory change (Mattli/Woods 2009: 21). In this context, information should be understood as the political salience of an issue (Culpepper 2009). Many scholars of global finance argued that before the financial crisis, the political salience of finance-related issues was very low, which was conductive to regulatory capture (Baker 2010: 652). But finance is not only a “dry affair” (Anheier 2013: 9). The complexity of finance also “distances” financial institutions from the social costs that their activities create by obscuring links and producing knowledge gaps about power and influence (Clapp 2014). This makes it harder for CSOs to challenge finance directly and create narratives that resonate with the general public. After all, narratives about human rights violations or oil spills are easier to convey than capital requirements derivatives collateral rules. The complexity of finance often excluded non-experts from regulatory processes (Ford/Philipponnat 2013).

From the ISD perspective, the financial crisis was a demonstration effect that brought finance in the political spotlight and which opened a window of opportunity for regulatory change. Such demonstration effects open a debate about financial
regulation and the inclusion of broader social externalities, reinforcing “pressure on ‘the system’ from ‘the lifeworld’” (Thirkell-White 2009: 692).

While some argue that heightened issue salience after the crisis leads to better regulation (e.g. Pagliari 2013; Young 2013), the ISD framework states that the mere diffusion of information is not sufficient to realise change, as regulatory change is a long and strenuous process. Drawing on Down’s “issue-attention-cycle” (Downs 1972), Mattli and Woods argue that political salience of an issue will decrease as other problems get into the focus of the public. Information is merely an initiator of regulatory change and the regulatory process itself is largely determined by interests and ideas (Mattli/Woods 2009: 25).

**Interests: Financial resources, expertise & coalitions**

Interests are the second demand side condition for regulatory processes. Advancing Stigler’s theory, Wilson (1980) draws attention towards the collective action problems that arise in the politics of regulation. Drawing on Olson’s (1971 [1965]) “logic of collective action”, he emphasises that “the firms seeking political protection find it easier to organize to wield political influence: since the per capita gains to them are likely to be high, they have an incentive to combine their efforts to achieve their collective ends” (Wilson 1980: 358; also Hardin 1982). Hence, the distributional consequences of regulation hence highly affect whether actors engage in collective action (Mattli/Woods 2009).

After a process of regulatory change was initiated, a number of interests get involved in the regulatory process. These interests compete with another and sometimes form coalitions to advocate certain outcomes. The three major groups are: CSOs, public or private-sector actors. Demand for regulation is broad if pro-change coalitions of a heterogeneous field of actors with diverse interests dominate the process of change: thereby effecting common interest representation in a pluralist manner. Narrow, in this sense, means that only a relatively homogenous number of actors are involved in the regulatory process, presumably those that had captured the old regulation.

---

7 Mattli and Woods (2009) actually speak of NGOs in this respect. In this paper, however, the term civil society is used as the boundaries between these two categories are fluent and many discussions in the governance of financial regulation draw on the broader concept of civil society (Anheier 2013; Brassett 2009; Scholte 2013).
In regulatory processes, different interest groups usually compete with another. Which interest group is more likely to shape the regulatory outcome often depends on their different forms of resources, “including information and expertise, organizational capacity, financial resources and even prestige and ’esteem’” (Moschella/Tsingou 2013b: 411).

Financial resources can be used to bribe officials, either through campaign contributions or through attractive employment promises (revolving doors), but also to convey messages and engage in lobbying activities actors. In financial market regulation, the unequal distribution of financial resources between civil society and finance is often noted as a major problem (Scholte 2013): according to a Brussels-based NGO, implementing meaningful financial reform is in the end often “a question of resources” (cited by Kastner 2014: 14). Sufficient financial resources also help actors to overcome collective action problems as relative costs for lobbying activities decrease (Hardin 1982; Peltzman 1993: 823). As Dür and Biévre (2007: 80) analyse in a study of NGO influence in EU trade policy regulation, NGOs “have less of an incentive to engage in collective action than do firms who experience concentrated costs and benefits.” Further, financial regulators have to consider many technical details of financial markets and products, expertise that is often only in the hand of the financial industry itself (Scholte 2013). As Dorn (2012: 208) noted, “by definition, financial market participants have more information in their areas of operation”.

Different interests might also create coalitions as they can pool advocacy resources, have a greater variety of access channels and gain more weight and political momentum (Pagliari/Young 2013). Through building coalitions with other groups, actors can “leverage” their influence (Pagliari/Young 2014). This is important, because, unlike in markets, political decisions must have justifications (Wilson 1980: 365). Hence, ideas matter in regulatory processes.

**Ideas: Intellectual capture & legitimacy**

Ideas can be understood as the normative order underlying a particular set of regulations and legitimizing the actions of regulated actors. In a process of regulatory

---

8 Another resource of the financial industry is its systemic importance for the economy (Ford/Philipponnat 2013) and its “structural power” (Strange 1988).
change, demonstration effects do “not only shake public confidence in [those] at fault, they may also shake the ideas, values, or ideologies that underpin the status quo, destroying the legitimacy of the old way of framing regulation” (Mattli/Woods 2009: 36). As a result, ideas may shift or be displaced by a new set of ideas. In this case, even if the interests of actors may be different, ideas “may serve as coalitional glue to facilitate the cohesion of particular groups” (Goldstein/Keohane 1993: 12). These ideas compete with each other and the narrower the interests involved in the process the more likely the new ideas legitimising the new regulation will closely resemble the old ones.

Many scholars emphasised the importance of intellectual capture in pre-crisis financial regulation (e.g. Tsingou 2010; Ford/Philipponnat 2013). Operating under neoliberal ideas, rationalized as the “logic” of free markets, financial regulation was also characterised by a “normative void” (Anheier 2013): what is perceived as appropriate (March/Olsen 1989) in financial regulation is detached from dominant social and cultural values (Anheier 2013).

Possibly, the financial crisis questioned the legitimacy of the ideas underlying previous regulatory arrangements. As Robert Keohane (2006: 57) put it, “an institution is legitimate when it is accepted as appropriate, and worthy of being obeyed, by relevant audiences.” Drawing on such a sociological, relational definition of legitimacy, Gutterman (2014) explains that especially for CSOs, legitimacy is a strategic resource as well as a necessary condition for success. The success of the Occupy Wall Street movement can for instance be explained through this, as their proposed values "largely correspond with the common moral orientations of Western democracies" (Kern/Nam 2013: 207). The question is whether and how CSOs can gain this resource in rather technical financial regulation.

**ISD-framework, revised: Putting the pieces together**

Combining institutional supply and demand one receives a four-field matrix describing possible outcomes of regulatory processes, contingent upon the conjunction of the variables (figure 1).
In the case of pure regulatory capture [A] institutional supply and demand are both limited. In the absence of broad societal demand, asymmetries in information, financial resources, and technical expertise can lead to regulatory capture although there is an extensive institutional setting; this situation is described as de facto capture regulation [B]. If demand for regulations does exist but the institutional setting is exclusive the situation is capture but with concessions and compromises [C]. If both, broad and sustained demand for regulatory change as well as transparent and inclusive institutional supply enabling access to the regulatory process, exist the regulation serves common interests [D]. Two hypothesis are derived from the ISD framework (figure 2):

- Pre-crisis OTC derivatives regulation was a form of pure capture regulation due to a limited institutional supply and a narrow demand for regulation;
- Having set in motion a process of regulatory change, the regulation after the financial crisis 2007 represents a form of common interest regulation due to an extensive institutional supply and a broad demand for regulation.
Figure 2: Hypotheses (based on Mattli/Woods 2009: 16).

To assess whether the institutional supply is limited or extensive the accessibility and transparency of different stages of the regulatory process are examined. Second, the demand conditions for regulation are identified and measured. Information is measured by public attention towards an issue; interests are identified through participation in the regulatory process; and ideas behind regulatory proposals of actors are compared, identifying differences and similarities. As participation does not automatically translate into influence (Dür/de Bièvre 2007), first, the degree of preference attainment is assessed and, second, the regulatory process is traced. Deploying both strategies helps to correct their respective biases of under- and over-estimating influence (see Dür 2008). Further, two different channels of influence are analysed: outside and inside lobbying (Dür 2008: 562). To assess the broadness of pro-change coalitions, the development of common positions by different actors is assessed (Pagliari/Young 2014: 584). In the next section, the regulation of commodity derivatives in Europe is analysed.
3. Case study: Regulation of commodity derivatives in Europe

After introducing commodity derivatives and assessing their pre-crisis regulation, the financial crisis of 2007-2009 and the food crises of 2007-2008 and 2010-2011 diffused information about the social costs of this regulation. Thereafter, the regulation of commodity derivatives through MiFID II is described by analysing the interplay of interests and ideas in the regulatory process.

Derivatives are financial products whose values are derived from another asset such as interest rates, commodities or currencies. Commodity derivatives are the earliest form of derivative contract, going back to the Phoenicians and Romans which hedged the delivery of shipped goods (Bryan/Rafferty 2006). Derivative markets have a high market concentration within a small number of financial institutions. In practice, they are interdealer or interbank markets as derivatives are developed by and traded within a small group of investment banks. In 2010, the fourteen largest OTC derivative dealers traded 82.2% of OTC derivatives globally (ISDA 2010). Geographically, the centre of OTC derivatives trading is London, which accounted for 43% of trading in 2007, followed by the US with 24%, whereas France, Japan and Germany together account for 15% (Jones 2009).

Until the financial crisis, OTC derivatives were hardly studied by scholars of global finance (Clapp/Helleiner 2012) and none of these studies focused on commodity derivatives or their regulation (e.g. Bryan/Rafferty 2006; Coleman 2003; LiPuma/Lee 2004; Morgan 2008; Tsingou 2006). With the global food crises in 2007/2008 and 2010/2011, scholarly attention shifted more towards commodity derivative markets, and most studies emphasise their increasing deregulation and financialisation (Clapp/Helleiner 2012; Clapp 2014; Feist/Fuchs 2013; Ghosh 2010).

Pre-crisis regulation of (commodity) derivatives in Europe

Before the financial crisis, commodity derivatives were not separately regulated from other derivatives in most countries and no supranational regulation existed (Gibbon 2013: 17). Rather a system of self-regulation was implemented in various national laws

---

9 Derivatives can be traded either on derivative exchanges or OTC. Exchange-traded derivatives include standardized futures and (listed) options traded on derivatives exchanges and where all payments are conducted centrally. By contrast, OTCs are individualized derivatives such as forwards, (dealer) options or swaps which are traded bilaterally and cash flows are also cleared bilaterally.
by the derivatives industry, which constituted a transnational governance network of regulations (Morgan 2008).

In pre-crisis regulation only a very limited group of interests determined the rules that governed OTC derivative markets: First, the ISDA, which represented the OTC derivative industry’s interests in regulatory processes and developed global standards for the industry, such as the ISDA’s *Master Agreement*. Second, the G-30, a policy community of academics, public officials and financial industry representatives, whose recommendations became “crucial for setting government policy” (Tett 2009: 32). Third, the DPG, an expert group set up by large investment banks that set voluntary standards for the derivatives industry. And fourth, the CRMPG, another expert group set up by the OTC derivative industry that provided market-based solutions for OTC derivative regulations.

Self-regulation was the guiding principle that shaped regulatory processes of the world’s biggest OTC derivatives markets (Morgan 2008; Tsingou 2006; for the UK see Coleman 2003; for the US see Tett 2009). Because only a small group of actors was engaged in the process of OTC derivatives regulation and established self-regulation in different national settings, a transnational regime of private self-regulation on a global scale emerged.\(^\text{10}\)

As against to the US, a comprehensive regulation of derivatives ever existed in Europe (Pagliari 2012: 47) and commodity derivatives were not separately regulated from other derivatives (Vander Stichele 2011). Position limits did not exist in most national regulations, derivative markets were largely unregulated and commodity derivative exchanges were sometimes lightly regulated (Clapp 2014; Vander Stichele 2011).

The literature on the pre-crisis regulation of derivatives in general and of commodity derivatives in particular shows that the demand conditions for OTC derivatives regulation have been very narrow. Only few interests participated in the regulatory process, mostly those of the industry itself (Tsingou 2006). The institutional supply of the pre-crisis OTC derivatives regulation was also very limited as the regulatory process was non-transparent and not observable by outsiders and every stage of the

\(^{10}\) The ISDA developed a Master Agreement which became the standard contract for all OTC derivatives and which was implemented into 50 national laws thereby establishing a transnational regulatory framework (Morgan 2008). In addition, the ISDA lobbied heavily to prevent more hard-handed regulations (Tett 2009).
policy-process took place within an exclusive environment with restricted, club-like possibilities to access. The evidence that pure capture regulation has occurred is very strong due to a very limited and exclusive institutional setting and a very narrow demand for regulation (Bryan/Rafferty 2006; Clapp/Helleiner 2012; Clapp 2014; Coleman 2003; Morgan 2008; Tsingou 2006).

If in place, traditional regulations of commodity markets, such as position limits, were abandoned in the deregulatory processes that were set in motion since the 1980s and new financial products such as commodity index funds (CIFs) were developed that increased the “unnatural coupling” of food and finance (Ghosh 2010). Figures 3-5 show the tremendous increase of investment in such CIFs.

Figure 3: Standard & Poors Goldman Sachs Commodity Index (Source: Bloomberg).
Figure 4: Dow Jones-UBS Commodity Index (Source: Bloomberg).
Figure 5: CFI investment, 1994-2008 (source Masters 2008, cited in Basu/Gavin 2011).
Speculative investment in commodity markets increased enormously. Whereas traditionally, end-users (e.g. farmers, energy companies, agribusiness) used derivatives to hedge against price movements of commodities, speculative investment became much more prevalent, occupying a market share that rose from 23% in 1998 to 69% in 2008 in the 18 most largest commodity derivative markets (Staritz/Küblböck 2013: 4). According to UNCTAD, in 2011 derivatives worth 20-30 times the value of actually traded commodities were traded (cited in Feist/Fuchs 2013: 200).

Information: financial & food crises

With the financial crisis of 2007-2009, derivatives suddenly came into the focus of government attention as they were held responsible for contributing to and accelerating the crisis (Greenberger 2010): the failure of Bear Stearns, Lehman Brothers and AIG were directly linked to OTC derivative exposure and commodity derivatives speculation was blamed for increasing food and energy prices (Clapp and Helleiner 2012). Suddenly there was awareness among public officials about the social costs associated with derivatives and their regulation.

![Figure 6: Various FAO food price indices 1990-2014, monthly data (Source: FAO database).](image)

The massive increases in commodity and especially food speculation lead to price spikes in 2007-2008 and then again in 2010-2012. The prices for food (aggregate as well
as meat, vegetable oil, dairy products and cereals) more than doubled between 2005 and 2008, plunged down by 50%, before rising to record highs again in 2010-2012 and continuing to fluctuate until today (figure 6). The results of this food price volatility were food crises in many countries, sometimes with high death tolls (figure 7). By 2008, more than 100 million people were pressed into extreme poverty through these developments (Hiemitz 2012).

As a consequence of these developments, calls for a regulation of commodity speculation, i.e. commodity derivatives, became louder. Largely pushed for by the US and after the topic had become prominent in international fora such as the G8 and G20, the Commission announced to “examine the possibility of taking regulatory initiatives in this field” (EC 2008). After the G8 Summit in L’Aquila launched a Food Security Initiative (Hiemitz 2012), the Commission (2009) announced in October 2009 that it intended “to propose rules to give regulators the possibility to set position limits to counter disproportionate price movements or concentrations of speculative positions”. Exemplifying this push towards regulatory change, Commissioner Michel Barnier stated in January 2010 “that speculation in basic foodstuffs is a scandal when there are a billion starving people in the world” (European Parliament 2010). In the following year, MiFID II was launched to regulate commodity derivatives.
Institutional setting: supranational EU level

When analysing the institutional setting of the regulatory process, it is obvious that there has been a shift from a transnational setting before the financial crisis to a supranational (EU) setting (Young 2013). These supranational modes of governance are “typically more transparent and open to political scrutiny than networked [i.e. transnational] governance” (Kahler/Lake 2009: 259).

Especially since 1993, the EU actively promoted access and transparency (EC 1993). Thereby, several transparency initiatives were launched: monitoring of decision making processes by the Legislative Observatory (in 1994); the European Transparency Initiative (in 2005); the EU Transparency Register starting which provides information about participants in policy-making to the general public (in 2009); ensuring public access to documents of the EU’s institutions (in 2011); and the provision of information about the inter-institutional processes and communication in policy-making processes through the PreLex database.

Open access was especially facilitated through the Interactive Policy-making Initiative in 2001 as the European Commission started using the internet to conduct consultations. As the Commission (2002: 11) highlighted in its White Paper on consultations, nobody is excluded de jure from participating in policy-making processes as “every individual citizen, enterprise or association will [...] be able to provide the Commission with input”. The Commission (2002) also called for an outbalancing of industry experts by CSOs in these groups in order to secure common interest representation.

Taken together, the supranational institutional setting of the EU is much more transparent and inclusive than the pre-crisis transnational setting, a necessary condition for common interest regulation. But such supranational institutional settings can also be captured. As the Commission (2002: 16) emphasises, the “quality of [...] EU policy depends on ensuring wide participation throughout the policy chain – from conception to implementation”. If the financial industry would still be the “most frequent user of due process channels [it would] succeed in influencing the fine details of regulation to benefit themselves” (Mattli and Woods 2009: 15). The new regulation would be de facto captured. For actual change to happen, a pro-change coalition of a
broad group of public officials, CSOs and business actors had to emerge (Mattli/Woods 2009).

**Interests: preference attainment of actors in MiFID II**

In the MiFID II regulatory process, the main struggle was whether position limits should be introduced. First, if at all, and, later on, who should introduce them. Position limits restrict how much commodity derivatives are allowed to be held by non-commercial investors (those who do not use them for hedging). Introducing strict position limits directly targeted against speculation and would hence represent a “meaningful” regulatory change.

The financial industry first lobbied against the introduction of position limits and then for them to be introduced by national authorities. Setting limits at the national level would lead to regulatory arbitrage and states that were already against the introduction of limits (e.g. the UK) would adopt only light regulation (Staritz/Küblböck 2013: 20). In contrast, a coalition of CSOs, agribusiness groups and politicians pushed for a stricter regulation of commodity trading, advocating the introduction of position limits as well as a regulation through ESMA that prevented regulatory arbitrage. What motivated these actors to overcome their collective action problems and engage in lobbying activities?

The motivation of the financial industry and CSOs is obvious. The financial industry made huge profits (the top ten banks made $14.1bn in 2008) through commodity derivative speculation and hence did not want their business to be restraint (Swinnen et al 2013: 12). As commodity derivative markets are highly concentrated (Gibbon 2013) they had a lot to gain from shaping regulation in their direction. Further, they had organisational capacities (already existing lobbying organisations such the ISDA), expert knowledge and financial resources to advocate for minimal reforms.

CSOs on the other side were motivated by the normative character of the issue at stake. Next to traditional “finance” NGOs such as Finance Watch, SOMO, WEED and WDM, that previously had not been very successful in preventing financial regulatory capture, other “development” NGOs such as Oxfam, Welthungerhilfe, FoodWatch and Friends of the Earth joined them. Linking commodity derivative regulation to food speculation and “starving children in Africa” (Rice 2014), gave NGOs a high degree of
legitimacy (Gutterman 2014). Their message was easy to convey to their members (Dür/de Biévre 2007) and resonated well with the moral values of the general public (Kern/Nam 2013). Although the direct link between food price volatility and speculation was questioned by the financial industry (Clapp 2014), linking these two issues drastically reduced the complexity and turned the focus away from the discussion of technical standards towards a debate about the externalities and social costs created through commodity speculation. As their aim was to pursue a “public good” the individual costs for achieving this decreased with the number of participating actors. This is important, as limited financial resources were main obstacle to CSOs in the past.

EU food markets were also hit by food volatility. Whereas, consumer markets were mostly unaffected (5% increase between 2005 and 2012) the “EU Producer Farm Price Index”, which measures selling prices received by EU farmers, also fluctuated considerably between 2008-2012, following a similar, pattern as FAO Food Price Index (Swinnen et al 2013: 3). Consequently, European farmers, that possess one of the most powerful EU lobbies, had a high incentive to join forces with CSOs. European agribusiness can be categorised as “corporate consumers” that push for regulatory change as their business model relies on goods (commodities) and services (hedging these through derivatives) that were captured by the financial industry (Mattli/Woods 2009: 32).

Although the interests of these different groups were diverse, they were united by the idea of curbing speculation. This idea, materialised as the introduction of strict position limits, served as the “coalitional glue” (Goldstein/Keohane 1993: 12) for this pro-change coalition in the upcoming regulatory process.

**Interests: tracing the regulatory process of MiFID II**

The regulation of commodity derivatives took place in four stages: A conference on the “MiFID review and commodity and exotic derivatives” in September 2010, a public consultation between December 2010 and October 2011, changes to the Commissions draft paper by the Parliament and the Council between October 2011 and September 2013 and the trialogue negotiations between Parliament, Council and Commission between September 2013 and January 2014.
During the conference, SOMO (NGO), Re-Define (think tank), CFTC (US regulatory authority), the COPA-COGECA (EU agricultural association) and Cargill (agribusiness multinational), all advocated position limits. Further, Dacian Cioloș, European Commissioner for Agriculture and Rural Development, advocated stricter regulation as price volatility would harm farmers, consumers and food industry players and processors (EC 2010).

In the consultation, most financial institutions argued against introducing position limits, whereas CSOs and agribusiness groups called for strict limits, pointing towards the dangers of speculative investment (EC 2011: Annex 13). As a result of this process, the Commission adopted position limits for non-commercial investors in their draft and assigned setting these limits to ESMA (EC 2011).

In the subsequent development, a division between the Parliament and the Council becomes obvious. The Parliament sided with the broad coalition of CSOs and agribusiness. Announcing their proposed changes to the Commissions draft paper in October 2012 the Parliament favoured: stricter regulation, increased transparency, reducing exemptions for commercial traders and strengthening the ESMAs role in setting position limits (Swinnen et al. 2013).

After 20 months of internal negotiations, the Council weakened the Parliaments proposal by advocating for national authorities to set position limits; a position that reflects the wishes of the financial industry (Swinnen et al. 2013). Sven Giegold, German MEP and shadow rapporteur on MiFID II, stated that: “the council has weakened this proposal by giving member states leeway for different and weaker rules. An unequal playing field between the member states in this crucial area of financial reform is unacceptable” (cited in Marriage 2013). As the tripartite negotiations started in September 2013, one of the open issues was whether the ESMA or national authorities should set position limits (Swinnen et al. 2013). It was at this stage that the outside lobbying of CSOs, a “blame and shame” campaign against commodity speculators, turned out to be decisive in tipping the balance towards stricter regulation.
Ideas: “blame and shame” campaign against speculators & pressure on politicians

During the regulatory process, CSOs also launched a coordinated political campaign against speculators. Through this campaign, which started in 2010 and had its climax in 2013, as well as a second wave of food crises in 2010-2012, food speculation remained a politically salient issue.

The campaign represented a coordinated effort to “blame and shame” banks for causing food crises through their speculative activities (Clapp 2014). FoodWatch targeted German and Austrian banks, WDM British banks and Oxfam French and Belgian banks, targeting the largest commodity traders in Europe. Further, more than 100 CSOs signed an open letter to “stop gambling on food and hunger” (Clapp 2014: 12).

The campaign aimed to, first, pressure banks to stop with their speculative investment in commodities, and, second, build pressure on regulators to adopt stricter regulation.

This strategy played out to be very successful. As a result to FoodWatch’s campaign, several Landesbanken, DZ Bank, Commerzbank and Österreichische Volksbanken gave up commodity derivatives trading in 2013 (Schütze 2013). Accused of “speculating on hunger” by Oxfam, PNB Paribas and Crédit Agricole shut down commodity funds. BNP announced in a statement: “despite the absence of any clear-cut conclusions regarding the relationship between financial instruments and the volatility of food commodity prices, we decided to adopt the precautionary principle and suspend subscriptions” (Newlands 2013). In a similar vein, Anthony Jenkins, CEO of Barclays, announced in February 2013 that “the bank was quitting speculative trading in grains and soft commodities for ‘reputational reasons’” (Marriage 2013; also Kelleher 2013).

Allianz and Deutsche Bank stopped their trading activities for a few months, but reversed their decision, arguing that they found to convincing evidence for the link between hunger and speculation (Clapp 2014). The financial industry tried to fight back by publishing studies that negate the link between food prices and speculation and launch a “fake-NGO” website (http://www.commodityfact.org/). However, the “speculation causing food crises” frame is much more dominant in the public debate (Paganini 2013) and many politicians condemned these moves (Der Spiegel 2013; Teevs 2013). Ilse Aigner, German Minister for Food and Agriculture, for instance stated that “Deutsche Bank has obviously failed to recognise the signs of the times” (Hogan 2013).
As politicians are also concerned with the opinion of the public in such processes when regulatory processes are such salient issues (Peltzman 1993), especially German and French politicians sided with the agribusiness groups and CSOs.\footnote{In an interview with a representative from DG MARKT (05.06.2014), the importance of the CSO campaign in pressing MEPs to send a political signal to their voters was highlighted.}

These developments increased the case for stricter regulation in the tripartite negotiations in 2013. Although some countries in the European Council, most of all the UK, wanted to introduce national limits, the Parliament, in combination with France and Germany, succeeded in the negotiations by securing “a more European approach’ to the setting of position limits, with a bigger role for ESMA” (Brunsden 2014). As Commissioner Barnier (2014) stated after the regulation was announced, “by introducing a harmonised EU system setting limits on the positions held in commodity derivatives, MiFID II will contribute to orderly pricing and prevent market abuse, thus curbing speculation on commodities and the disastrous impacts it can have on the world’s poorest populations.” With the introduction of EU-wide position limits, advocated for by a broad coalition of CSOs, agricultural groups and politicians against the financial industry that had previously captured the regulation, common interest regulation was achieved in regulation of commodity derivatives through MiFID II.

4. Conclusion

This paper has analysed the process of regulatory change in the governance of commodity derivative markets in Europe. In the theoretical section, the ISD-framework – which analyses institutional setting, information, interests and ideas in the process of regulatory change and assesses whether these were captured – was outlined and specified to analyse regulatory change in financial regulation. This was done through including causal mechanism which explain the main reasons for regulatory capture in financial regulation. In the empirical section, the specified ISD-framework is applied to analyse the post-crisis regulation of commodity derivatives, after introducing commodity derivatives and their pre-crisis regulation, the post-crisis regulatory process is initiated through diffusion of information about the social costs of the status quo regulation. This happened through the financial and food crises of 2007-2012. Thereafter, the supranational, inclusive and open institutional setting of the
regulatory process is analysed. In the next two sections, the influence of different interest groups is assessed through analysing preference attainment and tracing the regulatory process. The last section describes the ideas which dominated the regulatory process by analysing the public campaign launched by CSOs against speculators.

Whereas many other post-crisis regulations of global finance were (at best) incremental or (in the worst case) re-captured by the financial industry, commodity derivative regulation is one of the few examples where meaningful change occurred. It is argued that, next to the financial and food crises and the inclusive, open and transparent institutional setting, which were necessary but not sufficient conditions for common interest regulation, CSOs played a crucial role in achieving this outcome. Three factors contributed to their success: they were able to mobilise against regulatory capture by building a broad coalition with agricultural groups, leveraging their interests and providing them with higher political and economic clout; they were able to frame the debate on commodity derivatives in moral terms, emphasising their connection to food price volatility, instead of losing a battle about technical details of the regulation; and they were able to uphold political salience of the issue through a coordinated public campaign against speculators which increased pressure on the regulatory process from the outside.

The findings of this paper are both politically and theoretically relevant. Politically, the EU-wide position limits that were implemented in MiFID II are expected to successfully curb speculation and financial markets seem to already adapt to this new environment. By end-2013, commodity speculation had become increasingly unprofitable for banks. Total revenues from commodity derivative trading from the ten largest investment banks have decreased from $14.1bn in 2008 to $4.5bn in 2013 while regulatory costs are constantly rising (Hume 2014). By June 2013, agricultural exchange traded funds had experienced capital outflows for 20 months and many major banks such as JP Morgan, Morgan Stanley and UBS were closing down their commodity derivative trading desks (Gibbon 2013; Marriage 2013). According to the Bank for International Settlement (2013: 5), the notional outstanding amount of commodity derivatives other than gold went down decreased from $7.204bn in end-June 2007 to $2.117bn in end-June 2013 and their gross market value decreased from $600bn in end-June 2007 to $312bn in end-June 2013.
Theoretically, the findings indicate ways for CSOs to achieve regulatory outcomes that serve a common interest. It was shown that, if certain conditions are met, civil society is able to function as agent of moral change (Brassett 2009). This is especially important in times where national democratic institutions might not be equipped to curtail global financialised capitalism. Civil society engagement might be the only way to accomplish this goal and as the last years have shown, there is no viable alternative than striving for this.
5. References


Downs, Anthony (1972) “Up and down with ecology - the issue-attention cycle” Public Interest, 28 (Summer): 38-50.


25


