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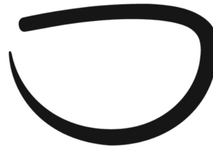

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Section VIII
Financialization in the food system
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How financialization influences the dynamics of the food supply chain

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The growing interlinkages between the financial and agrifood sectors have to a large extent shaped the dynamics in the latter, from land ownership to food retail. This article describes the different ways and means, and ever deeper levels of financialization that continue to develop. The dynamics resulting from this financialization of the food supply chain pose serious challenges to the key function of the agrifood sector—to provide nutritious food to as many people as possible in an environmentally and socially sustainable way. To restore this main function of the food sector, this article suggests that it is important to bring changes in the financial sector.

Prioritizing short-term financial profits: The dynamics of the stock market

A first basic element of financialization has been the listing on the stock markets of many companies that produce, trade, and distribute seeds, inputs, agricultural produce, and processed food. By selling their shares on a stock exchange, these companies subject themselves to pressure from shareholders and financial advisors to increase the value of their share prices and dividends. "Walls of money" from individual and institutional investors aim to achieve the highest possible returns and consider the profitability of socially and environmentally useful investments to be highly uncertain. Even private pension funds that endeavor to invest sustainably need to legally prioritize a secure rate of return (in order to pay out pensions) over

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avoiding negative social and environmental impacts. A growing number of companies report on environmental, social, and governance aspects in ways that are mostly separate from their regulated financial accounts, often simply concerning the management of these aspects while only selectively reporting on-the-ground impacts. Agrifood companies, however, overwhelmingly focus their communication on high financial profits because they know that when their share value fails to live up to shareholders' expectations, they become susceptible to being acquired by competitors. As a result, the pursuit of short-term profits and the interest of financial stakeholders are prioritized at the expense of other non-financial stakeholders' right to food, decent work, and healthful food consumption (Anderson, 2009).

The way this kind of financialization challenges the core functions of the food system is illustrated by the emphasis on short-term financial profits and the fear of being acquired, which in turn have spurred companies to pursue a business strategy of expansion. The larger the company, the more bargaining powers it has to squeeze profits out of the weakest links in the agrifood supply chain on either the buyer or the seller side. This in turn can initiate a vicious cycle of ever more integration, concentration and large-scale production, processing, trade, and retailing (McCarthy et al., 2014). In their efforts to expand market share and financial profitability, food processors have been known to implement strategies of increasing sales through omni-present foods, in the worst case targeting children through deceptive advertisements with the goal of selling addictive sugary, salty, and fatty (cheap) processed food (Isakson, 2014; see also Scrinis, this issue).

Another strategy employed by large food processors is to buy up their smaller-scale competitors. The targeted companies include those that offer more innovative socially and environmentally sustainable products (MacDonald, 2011). By acquiring these companies, the financial strategies of the large food manufacturers can put the dynamics and long-term viability of more sustainable production methods at risk. In the case of food retail companies, the larger and more concentrated they become, the more they can make profits by using abusive buying practices. In such circumstances, it is difficult for small farmers and small food suppliers to find outlets for their products. Indeed, the cheaper their food products are—with low pricing in the fruit sector often used as a marketing strategy to attract clients—the more clients supermarkets acquire, leading to more market share and profits (Vander Stichele & Young, 2009).

Agrifood businesses and conglomerates that are not listed on the stock market are also subject to the dynamics of competition, concentration, and focus on high financial profits (Murphy, Burch, & Clapp, 2012) as they have to compete against listed companies' strategies and operations.

Shaping the structure of the food supply chain

The financial sector also influences the structure of the food supply chain through its financial products, services, strategies, and players. Two examples are banks' lending practices and the

increasing involvement of investment funds in land acquisition. Both practices are serious challenges to small scale or agro-ecological farming, which are increasingly recognized as part of the solution to the current social and environmental pressures on the food supply (Silici, 2014).

Banks' lending practices

An obvious area in which the financial sector directly affects farmers is lending. Banks are reluctant to give loans to small farmers, as they consider them to be risky and non-profitable. When banks do provide loans, the conditions attached sometimes require farmers to invest in larger-scale farming in order to improve their profitability. In some egregious cases, banks have offered loans that include, without the farmer's knowledge, an interest rate swap, which is a speculative way to protect farmers against higher interest rates and can in fact result in losses for the farmer, as was the case in the Netherlands (Follow the Money, 2014). Debt burden on farmers has an enormous impact on their operations, their income, and their rights, as debt repayment is legally enforceable and is given the highest priority.

The many farmers who cannot be financed by banks must resort to alternative forms of financing, most of which are under unfavourable terms. Farmers can turn to agribusinesses for financial and hedging services, to contract farming, to long-term contracts with buyers and supermarkets, or to the derivatives markets (see below) in order to hedge against the risk of price changes. In none of these options do farmers have a strong bargaining position vis-à-vis the counterparty, making it difficult for them to protect their own interests (Vander Stichele & Young, 2009).

Banks' lending practices also have a considerable impact on the rest of the food supply chain. Banks rate large-scale businesses as less risky than small- or medium-sized enterprises. In other words, a food-processing conglomerate is more likely to receive a bank loan than a small innovative company, and a supermarket is more likely to receive a bank loan than the neighbourhood grocery store.

The dynamics of investment funds: Land ownership

Rising food prices and the prospect of food scarcity have made land and agricultural production a lucrative investment for financial players. Specialized investment instruments have been created to finance the large-scale acquisition and exploitation of land all over the world. In the case of illegal acquisitions—land grabbing as it is called—existing land or customary rights, as well as other human rights, are often disregarded. GRAIN (2012) listed the type of financial entities engaged in 35 million hectares of land grabs in 66 countries, which include a wide range of financial players such as hedge funds, private equity funds, insurance companies that manage their own assets, sovereign wealth funds managed by states, and investment management companies targeting institutional investors, including pension funds.

Hedge funds' and private equity funds' involvement illustrate the high pressure to make profits. To finance an operation, the funds tend to rely mostly on debt (with hedge funds using very high leverage ratios) as well as on rich investors attracted by the promise of high profits. The funds typically sell the land and financial assets after six to eight years—a short period of time compared with the lifetime investments that farmers put into their farms. High profits are needed to repay the loans and the investors, in addition to paying the typically high bonuses of fund managers. The emphasis on short-term financial gains results in practices that can easily lead to breaches in the rights of local communities and farmers, and provides few incentives to invest in long-term environmentally sustainable agricultural production.

Financial instruments that deepen the financialization of the food supply chain

A third element of the financialization of the food supply chain is the wide range of financial services, products, and investments provided by the financial sector that cause and support advanced financialization. The agrifood sector becomes the basis on which speculators bet billions of dollars, which contrasts with the problems to finance actual (ecological small-scale) farming. Food commodities become subjected to financial market strategies that are far removed from the realities and needs of the sector, as illustrated by the fund industry and commodity derivatives markets.

How the fund industry uses the agri-food sector

The stock market listing of various agriculture and food-related companies has allowed investment funds to invest billions of dollars/euros in the shares of the listed companies. The managers and marketers of these funds, often banks or asset management companies, attract investors with expectations of high financial returns. They are therefore only interested in companies that are likely to generate high financial returns and neglect the social and environmental performance of companies that are smaller or have lower returns.

One particular kind of fund is an exchange-traded fund (ETF), which issues shares that individual and institutional investors can buy (or sell) on a (specialized) stock exchange. ETFs can simply track a group of shares of agricultural companies, without the fund manager actively buying or selling those shares based on the economic performance of those companies. As with company shares, some financial players even speculate with the shares of ETFs.

Commodity index ETFs offer the return of the price of a commodity index, minus the fees for managing the fund's assets. The commodity index that such an ETF tracks is created by an investment bank (which earns fees from the index's intellectual property rights) and is composed of a basket of commodity derivatives (see below, usually a mixture of agricultural and non-agricultural commodities derivatives) traded on commodity exchanges, where prices are set

on a daily basis. These ETFs buy commodity derivatives directly, or indirectly (through a total return swap), on the exchanges. The majority of the fund's assets, however, are not commodity derivatives but other securities. These fund strategies increase the interconnectedness between the financial and commodity markets and are contributing to financial and speculative motives for derivatives trading rather than signals from the physical agricultural sector (Vander Stichele, 2012).

Agricultural commodity derivatives markets

Where there is price volatility and risk, such as in the agricultural sector, the financial sector sees opportunity, leading investors to become active in the agricultural commodity derivatives markets. Agricultural commodity derivatives are meant to be insurance instruments that allow farmers to protect themselves against price insecurity and volatility ("hedging") and to get a loan from the bank that is not willing to take price risks. However, they remain speculative instruments that can result in losses for farmers if the bets made on the initial price go in the opposite direction. They are a financialization of the risk that farmers are left to confront individually while their counterparties include speculators that have huge resources to take the risk. Because physical agricultural markets are not regulated and their price setting is opaque, agricultural commodity exchanges have become important price benchmarks for many agricultural products.

Since 2000, when the U.S. commodity derivatives markets—used worldwide for hedging and pricing—were deregulated at the request of the financial sector (Fuchs, 2013), financial players have vastly outnumbered traditional hedging participants (agricultural producers, traders, processors, and end-users). Agricultural derivatives can also be traded off-exchange, i.e., bilaterally "over-the-counter" (OTC), which makes their trade more opaque and allows speculative strategies with the on-exchange traded commodity derivatives. Financial players such as hedge funds and investment banks are keen to see increasing prices of the derivative contracts they trade in order to resell them with a profit, without having the agricultural products delivered. They often only partly base their trading on knowledge of agricultural markets or agricultural production and consumption. Financial players can contribute to higher price volatility, thus undermining the integrity of the hedging and pricing functions of the agricultural commodity exchanges—even though they argue the contrary and academic studies are not conclusive (given the lack of information) (Vander Stichele, 2014). Politicians at the G20 were willing to curb food price speculation through derivatives markets after huge price spikes in 2006–08. Still, the financial sector was able to weaken regulation. For example, in the first attempt at regulation of agricultural commodity derivatives markets in the European Union, loopholes were inserted into the legislation (Vander Stichele, 2014).

Agribusinesses expanding into finance

Some investment banks have even become active in the physical commodity markets, which gives them access to first-hand knowledge to make their speculative strategies in commodity derivatives trading very profitable (Omarova, 2013). However of late, these banks have more and more sold off their physical and sometimes financial commodity departments, due to regulations amongst other reasons. Some of these units have been bought up by the commodity conglomerates (Hume, 2014), which might continue the speculative financial activities**.**

Therefore, a new trend of an even deeper financialization of the agrifood sector is that some agribusiness conglomerates, commodity houses, and even global food retailers themselves behave like financial actors. Some agribusinesses have developed separate business units through which they earn profits by engaging in, for instance, financial commodity derivative speculation, hedging services for their suppliers (farmers), providing loans, and other financial services (Murphy et al., 2012). Some even own hedge funds that provide investment services or use strategies such as buying-up land and speculating with commodity derivatives (Vander Stichele, 2012). Also some supermarkets, where most people in high-income countries shop for their food, are offering payment, credit, and saving services.

These developments make it more difficult to challenge the financialization of the agricultural sector that is now itself contributing to more speculative and financialization dynamics!

Next steps

In order to restore the key functions of the food sector, more research is needed on the whole range of influences the financial sector has in order to answer the question of how its dynamics counteract the needed solutions to social and environmental pressures that threaten the sustainability of the agricultural sector and the right to healthful food. Exposure of the distortive dynamics of profit-driven, short-term, speculative finance would reveal the financial sector's responsibility towards non-financial stakeholders, including small-scale producers, small-scale food processors and retailers, consumers, and the environment. It could contribute to reversing "distancing" (Clapp, 2014) in the agrifood sector, whereby its driving forces are not always knowledgeable about or interested in food production, nor held accountable for the impact they have.

So far, the focus of financial reforms has been almost exclusively on financial stability. Financial regulators and supervisors still need to regulate the financial sector to be at the service of the real economy, including in the agricultural sector, and to make (individual) investors more aware of their impact and more accountable for their actions. Some initiatives are already being developed, such as requiring banks to assess the social and environmental risks and impact when

providing loans, compulsory reporting on environmental, social, and governance (ESG) information—so-called "non-financial" information—with which shareholders can make more informed choices, and the development of indicators for investment funds to provide (individual) investors with more insight about the environmental and social impact of their investment. Many of these initiatives are in an early stage and could be promoted through more academic research to develop the indicators and impact assessments, as well as through public and political debates.

In order to escape the distortive dynamics of current financialization, new avenues to finance the agrifood sector are needed with long-term sustainable priorities. Alternatives are indeed being developed. For instance, in France, committed individual investors initiated a fund called "*Terre de liens*" to buy up farms from retiring farmers. This type of fund offers no promise of high returns and investors cannot easily withdraw from the fund. Instead, it focuses on the careful selection of farms and the surrounding land, creating, when possible, a direct link between investors and farm assets. The fund owners make farms available to (young or poorer) farmers for rent, supporting them in making their farming profitable but with sustainable agricultural methods. There are a growing number of initiatives for responsible investment or "impact investment" that aim at beneficial social or environmental effects as well as financial return. Research could map such initiatives all over the world, to allow them to be better known and assessed as potential solutions to the current lack of sustainable finance in the agricultural sector.

The increasing trend of ever larger-scale conglomerates, often combining agricultural and non-agricultural commodities while undertaking financial activities and strategies, require better regulations and supervision of trading and price setting in physical agricultural and other commodities. The rules or application of national anti-trust legislation and the lack of international anti-trust policies or rules need to be revised in light of the particular situation of the food sector. The trend of increasing concentration also raises the question of whether some of these commodity businesses have become too big to fail (Lane, 2012), especially when their financial services and speculative activities go wrong. More research about the different kinds of financial activities and their impact on the agricultural sector as well as on the financial sector—for example the shadow-banking sector—might provide some answers and guidance for policies, regulation, and supervision.

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