The RBOB GAMBIT

This paper is about how the President of the United States can save the World from an economic meltdown, put the U S economy back on the path to growth, return millions of Americans to work, correct many of the economic injustices of the past decade, help save the economy of Europe, help the Chinese avoid much of the expected inflation in their economy, allow millions of people in many third world countries to afford to eat, and get reelected at the same time. Oh, and this won't cost the American Taxpayers one red cent. He gets the girl and saves the world.
This all sounds like hyperbole, but really its not, well maybe the last sentence is a little hyperbolic.

Just a thought that I wanted to throw out there.

martin horzempa

Background

The current recession began when gasoline spiked 133% to top out over $4.00/gal in 2008. There had been slow but continued improvement in the economy since the recession began until gasoline prices returned to over $4.00/gal in the early summer of 2011. Since then growth prospects have been cut in half due to falling demand from consumers who represent over 70% of the economic activity in this country.

Is this a coincidence or are the two events related? A little research reveals that they are indeed related, as 4 of the last 5 recessions began when the price of oil spiked. The reason for oil's spikes in the past was disruptions of the supply of crude oil such as the 1973 Middle East War, the Iranian Revolution and the first Gulf War. But there were no such problems with the supply in 2008. In 2011 when the Libyan fighting broke out Saudi Arabia moved quickly to replace the short fall of Libyan production.

So why are the markets no longer following the laws of supply and demand? What is going on in the commodities market that gasoline and oil would catapult at times when there is plenty of supply and demand has moved down since the recession started?

During the summer of 2008 with oil trading over $140.00/bbl, John Hofmeister, president of Shell Oil Co, in his testimony before congress said proper range for the price of oil should be "somewhere between $35 and $65 a barrel."

From the testimony of Michael W. Masters testifying before the Committee on Homeland Security and Governmental Affairs on May 20 2008:

> "I have been successfully managing a long-short equity hedge fund for over 12 years and I have extensive contacts on Wall Street and within the hedge fund community. It's important that you know that I am not currently involved in trading the commodities futures markets. I am not representing any corporate, financial, or lobby organizations. I am speaking with you today as a concerned citizen whose professional background has given me insight into a situation that I believe is negatively affecting the U.S. economy While some in my profession might be disappointed that I am presenting this testimony to Congress, I feel that it is the right thing to do."
>
> "You have asked the question "Are Institutional Investors contributing to food and energy price inflation?" And my unequivocal answer is "YES." In this testimony I will explain that Institutional Investors are one of, if not the primary, factors affecting commodities prices today. Clearly, there are many factors that contribute to price determination in the commodities markets; I am here to expose a fast-growing yet virtually unnoticed factor, and one that presents a problem that can be expediently corrected through legislative policy action."

“Commodities prices have increased more in the aggregate over the last five years than at any other time in U.S. history. We have seen commodity price spikes occur in the past as a result of supply crises, such as during the 1973 Arab Oil Embargo. But today, unlike previous episodes, supply is ample: there are no lines at the gas pump and there is plenty of food on the shelves.”

“If supply is adequate - as has been shown by others who have testified before this committee - and prices are still rising, then demand must be increasing. But how do you explain a continuing increase in demand when commodity prices have doubled or tripled in the last 5 years?”

“What we are experiencing is a demand shock coming from a new category of participant in the commodities futures markets: Institutional Investors. Specifically, these are Corporate and Government Pension Funds, Sovereign Wealth Funds, University Endowments and other Institutional Investors. Collectively, these investors now account on average for a larger share of outstanding commodities futures contracts than any other market participant.”

“These parties, who I call *Index Speculators,* allocate a portion of their portfolios to “investments” in the commodities futures market, and behave very differently from the traditional speculators that have always existed in this marketplace. I refer to them as “Index” Speculators because of their investing strategy: they distribute their allocation of dollars across the 25 key commodities futures according to the popular indices – the Standard & Poors - Goldman Sachs Commodity Index and the Dow Jones – AIG Commodity Index.”

From the testimony of Michael Greenberger, professor at the University of Maryland School of Law before the Subcommittee on Oversight and Investigations of the United States House Committee on Energy and Commerce:

“One Page Summary of Testimony”

“2. Since their creation in the agricultural context decades ago, it has been widely known that, unless properly regulated, futures markets are easily subject to distorting the economic fundamentals of price discovery (i.e., cause the paying of unnecessarily higher or lower prices) through excessive speculation, fraud, or manipulation. The Commodity Exchange Act (“CEA”) has long been judged to prevent those abuses.”

“In examining the questions relating to the high price of energy to American consumers, it is useful to remember that as of January 2002, the cost of crude oil was @ $18 a barrel; by the end of 2005, it had risen to @ $50; and, as of today, the price, which has recently flirted with a record high $100 a barrel, now rests at @ $88 per barrel. In early 2004, the average retail price of gasoline of which crude is a major component was @ $1.50 per gallon. As of today, the average price of gas is slightly below $3 per gallon, with substantial speculation that it will soon soar to over $4.00. Since March 31, 2007, or the "close" of last winter's heating season, the wholesale price of heating oil has risen 32%, from $1.88 per gallon to a record high of $2.77 per gallon. As I show below, these soaring price rises continue despite the fact that supplies of oil both in the U.S. and worldwide remain relatively stable."

"The 2006 PSI Bipartisan Staff Report on Crude Oil and Natural Gas Speculation.

In June 2006, the staff of the Permanent Subcommittee on Investigations ("PSI") of the Senate Homeland Security and Government Affairs Committee issued a bipartisan report making clear that the dramatic increases in commodity prices described above were not attributable (as conventional wisdom insisted at the time) on problems of supply/demand. Instead, price spikes were caused by dysfunctionality in the recently deregulated energy futures markets and in the maladministration by the CFTC of its no action process pertaining to purported "foreign boards of trade." In that report, The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat, the staff showed, for example, that "U.S. oil inventories are at an eight year high and OECD inventories are at a 20 year high," and that the "last time crude oil inventories were that high in May 1998 – at about 347 million barrels – the price of crude oil was about $15 a barrel","

From Michael Greenburg's testimony to the Before the House Energy and Commerce Subcommittee on Oversight and Investigations on June 23 2008:

"Over 30% of the U.S. delivered futures benchmark largely determinant of the price of oil here and throughout the world is now being traded on an exchange headquartered in Atlanta, with trading engines in Chicago and trading terminals placed all over the U.S. Relying on an outdated 1999 CFTC staff no action letter granted to a now defunct U.K. subsidiary, the U.S. owned Intercontinental Exchange (ICE) and the CFTC assert that United Kingdom regulators, rather than the U.S. CFTC, should have primary oversight of that exchange. CFTC permission has now also been granted to the Dubai Mercantile Exchange, in partnership with U.S. owned NYMEX, to begin trading that same U.S. delivered contract in the U.S. under the regulatory oversight of the Dubai government, creating the 'London/Dubai' Loophole for U.S. speculation."

As shown above the current state of the commodities markets in the United States is completely dysfunctional; the prices of the future contracts no longer represent the demand and supply balance in the real world they only reflect the fact that billions of dollars have been bet that commodity prices will continue to explode while the consumers of the world are footing the bill, those here at home primarily through the high energy prices and billions around the world through both high energy prices and high agricultural commodity prices.

Most cited above seem to believe that at a minimum $30.00 /bbl to $40.00 /bbl has been added to the price of a barrel of oil due to excessive speculation and given the fact that oil now trades well above $80.00 a barrel one can assume that this is still the case. The American Petroleum Institute reports that 1 barrel produced 19.4 gallons of gasoline based on average yields for U.S. refineries in 2000. Assuming that the rest of the barrel didn't go to waste and was used for other distillates then the price of the speculation would about $0.75 /gal to maybe $1.00 /gal. The EIA says that U.S. consumed about 378 million gallons per day during 2010. Using the $1.00/gal figure the cost to the American public for this speculation would come to about $137.97 billion per year. Yes that's $137,970,000,000 per year and this has been going on for years, it's no wonder the economy is buckling and people are losing their homes and jobs.

The really sad thing is that this is public knowledge; there have been numerous congressional hearings, people having been complaining to the CTFC and the FTC, the president even spoke of this problem during the 2008 campaign. Does this remind you of the housing bubble and the sub-prime mess that continued for years while our leaders watched and did nothing.

The CFTC has been dithering for years knowing full well what the problem is and they still haven't done anything to regulate this thievery. The Dodd-Frank bill was passed in July 2010 with provisions to correct this very problem and after over a year of deliberations the CFTC has still failed to act. While there have been many meetings there has been no action. The original timeline as stipulated in the Dodd – Frank Act was for publication of the new rules by Dec 17, 2010 and they still are not through writing them. In point of fact this problem started when the CFTC granted secret exemptions to allow 19 financial institutions to begin operations that are at the heart of the current speculative binge. The CTFC also relinquished their authority over the International Commodities Exchange (ICE), where much of the speculative abuse is currently taking place, in complete disregard of their mandate to ensure the integrity of the commodities markets. It is hard to believe that the spread between WTI and BRENT benchmarks has been over $25.00 /bb on a commodity that is completely fungible and could be transported to the Shetland Islands for less then $2.00/bb.

The Gambit

> RBOB is an acronym for "reformulated gasoline blendstock for oxygen blending." It is the benchmark gasoline contract on the New York Mercantile Exchange, so basically it is the wholesale price of gasoline before blending for different areas and climates.

> From Wikipedia: GAMBIT is defined as "1. (in chess) An opening in which a player makes a sacrifice, typically of a pawn, for the sake of some compensating advantage.
> 2. A device, action, or opening remark, typically one entailing a degree of risk, that is calculated to gain an advantage."

The RBOB Gambit is simply this: The country is suffering a major financial slowdown precipitated by a drastic increase in the price of oil and thereby gasoline (the RBOB contract can be said to be the wholesale price of gas) caused by massive speculation in the commodities and futures markets. Laws have been written and rewritten for decades to stop this very problem, the most recent being the Dodd – Frank Act. The CFTC by the actions of its commissioners have failed in their duty to enforce these laws. The CFTC is part of the executive branch and thereby under the direct control of the President. By exercising the power of his office, Barak Obama has the means to revive the economy, increase employment, stem the tide of bankruptcies and home foreclosures, reduce basic food and energy prices for billions around the world and thereby help revive the world's economic engine. Requiring the CFTC to pass rules to ensure that commodities markets are free of excessive speculation as required by the congress is not only his purview it is his duty. It is legal, requires no new legislation, can be done in weeks not months, costs nothing, and will return hundreds of billions of dollars of purchasing power to American consumers that will drive growth. This singular act of presidential leadership will signal to everyone that the president has the interest of the Main Street rather than Wall Street as his primary focus. Expedient execution of the RBOB Gambit will change the political discussion in the country and probably secure re-election of him while helping the Democrats at the polls. Failure to act swiftly, while still good for the American people, diminishes its effect on electoral politics, as it will have little time to impact the unemployment rate and economic forecasts before the election.

The key to economic recovery is the revival of the consumer sector of the economy.
The key to the revival of the consumer sector is a reduction of the retail price of gasoline.
The key to the retail price of gasoline is the wholesale price of gasoline (thus RBOB).
The key to the wholesale price of gasoline is the price of oil.
The key to the price of oil lies in restoring the integrity of the Commodity markets.
The key to all costs of living lies in restoring the integrity of the Commodity markets.

Fix the commodity markets and you fix the economy.

The President is the head of the executive branch and as such it is not only his purview but also his responsibility for the proper functioning of the CFTC (the Commodities Futures Trading Commission). The President appoints the commissioners and he has the Right and Duty to fire them if they are not performing their duties.

The beauty of the Gambit is that it doesn't require any new laws, just enforcement of existing ones. The Republicans have been refusing to help fix the economy in hopes that they will be able to regain power, but the President can accomplish what needs to be done if he will step out of his comfort zone, follow the LAW and lead from the front.

The Gambit will amount to a savings of conservatively $200 billion a year or about one and a half employee tax cuts.
EVERY YEAR.

IT IS THE LAW (believe it or not)
IT DOES NOT REQUIRE LEGISLATION (the Republicans are not needed)
IT IS FAST (weeks not months)
IT COSTS THE GOVERNMENT ABSOLUTLY NOTHING.(nada)
IT REDUCES THE DEFICIT (by obviating the need to under fund SSI).
IT INCREASES REVENUE (by stimulating the economy).
IT HELPS OUR CURRENT ACCOUNT DEFICIT (by reducing raw material imports)
IT WILL INCREASE WORLD TRADE (by reducing costs for all nations)
IT WILL CLEAR UP STUBBORN ACNE (sorry, couldn't help myself)

The Play

Be Open - Be Deliberate - Be Judicious – Be Expeditious – Be Presidential

The president as head of the Executive branch of the U. S. government has the responsibility and duty to correct this problem and free the American people of this burden. Below is a general plan for the moves he should make to successfully execute this gambit.

The Bully pulpit is the tool to begin with. The President should speak to the people about the problem and how firm he intends to be in acting to correct this problem. (He should telegraph his intentions – lessen the impact and allow people to begin rethinking their positions)

The President should have other members of the administration, congressmen, members of the financial community speak out on this unlawful speculation and the resultant pain it has caused the American people and everyone around the world while enriching speculators.

The President should set a meeting with the commissioners of the CFTC for the express purpose of finding out why they have failed to issue new rules concerning speculation in the commodities markets when they were charged to do this very thing by Dec 17, 2010 by congress as part of the Dodd – Frank Act.

In the meeting he has but one question to ask of the commissions: " have you established rules that ensure that speculation can no longer take place in the commodity markets?".

> If they answer in the affirmative, then see that those rules are published immediately. Begin a rapid schedule to unwind these speculative positions and normalize the markets.
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> If they reply that they haven't had enough time and they want to complete all the rules governing the market, then the President should object. This overarching rule must be sacrosanct and should be codified as such without equivocation and must be independent of and all other rules and regulations that may follow. This simple overarching rule should have been published and adapted immediately after the first meeting. Maybe :
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>> The Commodity markets in the United States of America and all of its territories, are for one purpose only, the buying and selling of fixed contracts of commodities vital to the welfare of our nation and all of it's people. To that end all markets made in commodities will be governed by the basic principal that commodity markets cash and futures are for the use of the principals: the producers and consumers of the commodity- the bona fide hedgers. All speculators allowed to participate in the markets will be subject to position limits that limit their open interest to no more than 35% of the open interest in said market in the aggregate or no more than 35% of the open interest in any single contract. This limit may only be exceeded if agreed to by the bona fide hedgers in the market. No rules, regulations, stipulations, administrative actions, special allowances or dispensations of any rules may be established which abrogates, nullifies, invalidates or minimizes this basic tenet will be allowed. Any market that trades in any commodities with physical deliveries in the United States of America and all of its territories shall be subject to this rule regardless of location or jurisdiction. No derivative, swap, contract, index or fund will be allowed that influences trading in the market of any commodity. Any and all funds, ETFs, ETNs, swaps, other synthetic derivatives or financially engineered structures or contracts that tracks or replicates any commodity will not be allowed due to the speculative influence on the cash and futures market for said commodity. Any financial instrument or structure that influences or effects the cash or futures market for a commodity by manipulating, controlling, cornering or hoarding of physical commodities shall be subject to negation by this rule.

> If they reply in the negative then the President should request their immediate resignations, if they refuse then fire them all on the spot. He should assign one of the most senior staff to acting commissioner. Instruct the new acting commissioner to immediately rescind any and all special exemptions that have been passed by administrative action in contradiction to the law and the intent of congress. Instruct him to honor all current contracts that exist because of those exemptions but to not allow any rollovers or continuation of them. Instruct the acting commissioner to begin an immediate review of any and all administrative actions involving unregulated markets that operate in the U.S. or its confines for possible changes that violate the commodities trading laws and the jurisdiction of the CFTC. Appoint 5 new commissioners to head the CFTC awaiting the consent of the senate.

The President should instruct the Attorney General, in conjunction with the CFTC, the FTC, the SEC, and the attorneys general of the various states to begin immediate investigations of any and all unregulated exchanges in the U.S. for any illegal actions or conduct.

He should contact all heads of states around the world regarding his actions and intentions, convey the urgency of the problem and request or even insist that they immediately commence similar actions for the good of all the peoples of the world.

The President must address the American people and all citizens of the world to explain his actions, the consequences, the effects on the markets and the benefit that will accrue to them.
(This is important – the president must convince the people that this isn't just another modest and transient dip in the cost of living but a sea change in the way business is conducted. It is only when confidence is restored will people begin to spend once again and the economy can begin a true recovery, because the people are the true engines of the economy and the real job creators.)

The Economic Effects

As the speculative positions begin to unwind most if not all commodity prices will begin to fall. The American people save in excess of $100 billion and possible as much as $150 billion in gasoline expenses alone. Savings will accrue to them in other areas of their lives such as heating oil, natural gas, reduced appliance and automobile cost, cheaper plastic goods, less expensive clothing and food costs. The annual savings to the American public could run upwards of $350 billion. Businesses will be beneficiaries of reduced production and transportation costs. People in the poorer parts of the world that are barely able to feed themselves will finally catch a break from crushing grain and food prices.

The speculators will take losses but then they have been reaping rewards that were both illegal and immoral. Some businesses and individuals will certainly suffer some losses due to the fact that they have made adjustments to the way they conduct their affairs but this should be more than offset by the benefits they accrue. The citizens of the world will benefit immeasurably. Commodity exporting countries will see a reduction of their receipts and possibly slowing of their economies but on the plus side the trouble with overheating economies will be mitigated and they may be able to reduce their interest rates and thereby help the general citizenry. Commodity importing nations will be helped by a reduction of inflation and may moderate their efforts to rein it in and thereby allow more expansion in their economies.

While some would say that this action is deflationary, and that deflation is anathema to all governments and most economists, I believe that it is not. It is just a reset of the cost of living for everyone and this will greatly increase economic activity and will generally be inflationary both in the short term as well as over the long haul. But hey, I am certainly no economist.

The U.S. economy will again return to good growth and this growth will continue to accelerate as the American people become more confident that they can trust the government to police the markets properly.

The Law

The major laws concerning the commodity markets (Futures Trading Act of 1921, Commodity Exchange Act of 1936, Commodities Futures Trading Commission Act of 1974) for over a century have as their primary object to limit undue speculation and its effects on the country.

Massive speculation has been taking place in these very markets as evidenced by many findings in multiple congressional hearings and reports to the congress by various government oversight agencies.

The CFTC has failed in its mission to enforce the laws of congress. Administrative actions by the agency have fostered more speculation. Regulations required by Dec 17, 2010 by the Dodd – Frank Act still have not been enacted.

The commissioners of the CFTC are guilty of malfeasance and incompetence.

The CFTC is part of the executive branch and under the direct administrative control of the President.

The courts have spoken on the matter of removal of the heads of executive branch agencies.

> *Shurtleff v. United States*, 189 U.S. 311 (1903) ("In the absence of constitutional or statutory provision, the President can, by virtue of his general power of appointment, remove an officer, even though he were appointed by and with the advice and consent of the Senate."

> *Myers v. United States*, 272 U.S. 52, 53 (1926) ("The President is empowered by the Constitution to remove any executive officer appointed by him by and with the advice and consent of the Senate, and this power is not subject in its exercise to the assent of the Senate, nor can it be made so by an act of Congress.")

While some would argue that Humphrey's Executor v. United States would restrict the presidents power to remove the commissioners, that would not be applicable in this case as the president's case should be based on their performance in office and their failure to execute the tasks required by law and for which they were appointed. The court held that "The President may not remove any appointee to an independent regulatory agency except for reasons Congress has provided by law."(from Wikipedia) But incompetence and malfeasance are definitely reasons for dismissal by the executive branch.

The Politics

The Initial Reaction:

> The congressional Republicans will go ballistic and rage against the president for over stepping his authority. The tea party will call for impeachment. The Democrats will apologize. The people will not really understand.

The Secondary Reaction:

> The secondary reaction will start with the people and their realization that something has finally changed for the better. While members of the Wall Street crowd will rail against new regulations and the administration's animosity towards business, the real bankers will begin to realize that an enormous burden has been lifted from the public and small businesses and that that their lot will improve as main-street improves. Most of the business community will begin to understand that this new dynamic has tilted the financial landscape back toward real businesses and that as demand returns they will begin to make new investments. As the business community changes its view they will drag the Republicans leadership along with them, kicking and screaming. The tea party will call for impeachment. The Democrats will apologize.

The political conversation will begin to change, there will be less call for deregulation when everyone sees the effect of proper regulation and looks back on the carnage that has been caused by excessive speculation in the commodity markets.

The Optics

The American electorate is suffering a severe case of buyers' remorse and it is well founded to date. The president's approval numbers continue to slide as the economy grinds to a halt and millions are out of work and continuing to lose their homes and life savings.

The administration is being blamed for bowing to the interests of bankers and businesses while ignoring the plight of the average American, and this claim is not without merit.

Leadership by the president in executing the gambit will reverse all of this. He will have acted and acted decisively, within the law, against Wall Street, for Main Street, and for the people – finally.

If he is successful in the execution of the gambit and he is able to convince the rest of the world leaders of the righteousness of his actions and elicit their help to remove speculation from commodities markets around the globe then the Nobel Prize Committee's choice will be validated.

Summation

It was just an idea a couple of months ago, but one so compelling that it would not allow me the luxury of ignoring it. I, like most in this world, cannot stop buying gasoline or stop eating to boycott the theft caused by excessive speculation in the commodities markets, so I am left to pointing to a solution that must be instituted by others, namely the President of the United States and all other world leaders. The make up of the world's commodities markets is such that the U.S. is the single largest energy market on the planet and one of the largest if not the largest producers of foodstuffs in the world and thereby has unparalleled influence over all other markets around the globe, this will not always be the case and it would be a shame if the government of the U.S., the government of the people, by the people and for the people allowed this expropriation to be institutionalized in all markets across the globe affecting all peoples for all time . As the head of the executive branch of the United States government and thereby the person most responsible the president has the burden and duty to act to correct this injustice. My sincere hope is that this idea will strike a chord with enough people so that it will get enough airtime to be heard above the din and get serious consideration in public policy discussions and thereby provide an atmosphere receptive to finally stopping the excessive speculation in the very commodities so vital to the welfare of our nation and all nations as well as the health of our economy and the global economy.

The Gory Details

Don't take my word for it, please see the transcripts of the actual congressional testimony that I have quoted here and use the Google machine as there are gobs more on the web.

Testimony of Michael W. Masters before the Committee on Homeland Security and Governmental Affairs on May 20th 2008

http://hsgac.senate.gov/public/_files/052008Masters.pdf

Testimony of Michael W. Masters before the Committee on Homeland Security and Governmental Affairs on June 24th 2008

http://hsgac.senate.gov/public/_files/062408Masters.pdf

Testimony of Michael Greenberger before the Subcommittee on Oversight and Investigations of the United States House Committee on Energy and Commerce on Dec 12th 2007

http://democrats.energycommerce.house.gov/images/stories/Documents/Hearings/PDF/110-oi-hrg.121207.Greenberger-Testimony.pdf

Testimony of Michael Greenberger before the Subcommittee on Oversight and Investigations of the United States House Committee on Energy and Commerce on June 23th 2007

http://democrats.energycommerce.house.gov/images/stories/Documents/Hearings/PDF/Testimony/OI/110-oi-hrg.062308.Greenberger-testimony.pdf

For those who are a bit fuzzy on the workings of commodities market and are interested in the recent history of the CFTC and excessive speculation you will find chapter 4 of "GRIFTOPIA", by Matt Taibbi, informative and colorful.

Here is a link to a paper on commodity speculation and the world food crises in 2008 that sparked riots in over 30 countries.

http://www.wdm.org.uk/sites/default/files/Commodity%20speculation%20and%20food%20crisis.pdf