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TO PROHIBIT FUTURES TRADING OF POTATOES
ON COMMODITY EXCHANGES

GOVERNMENT

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HEARING

BEFORE THE

SUBCOMMITTEE ON AGRICULTURAL RESEARCH
AND GENERAL LEGISLATION

OF THE

COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

S. 770

A BILL TO PROHIBIT TRADING IN POTATO FUTURES ON
COMMODITY EXCHANGES

NOVEMBER 15, 1979

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry



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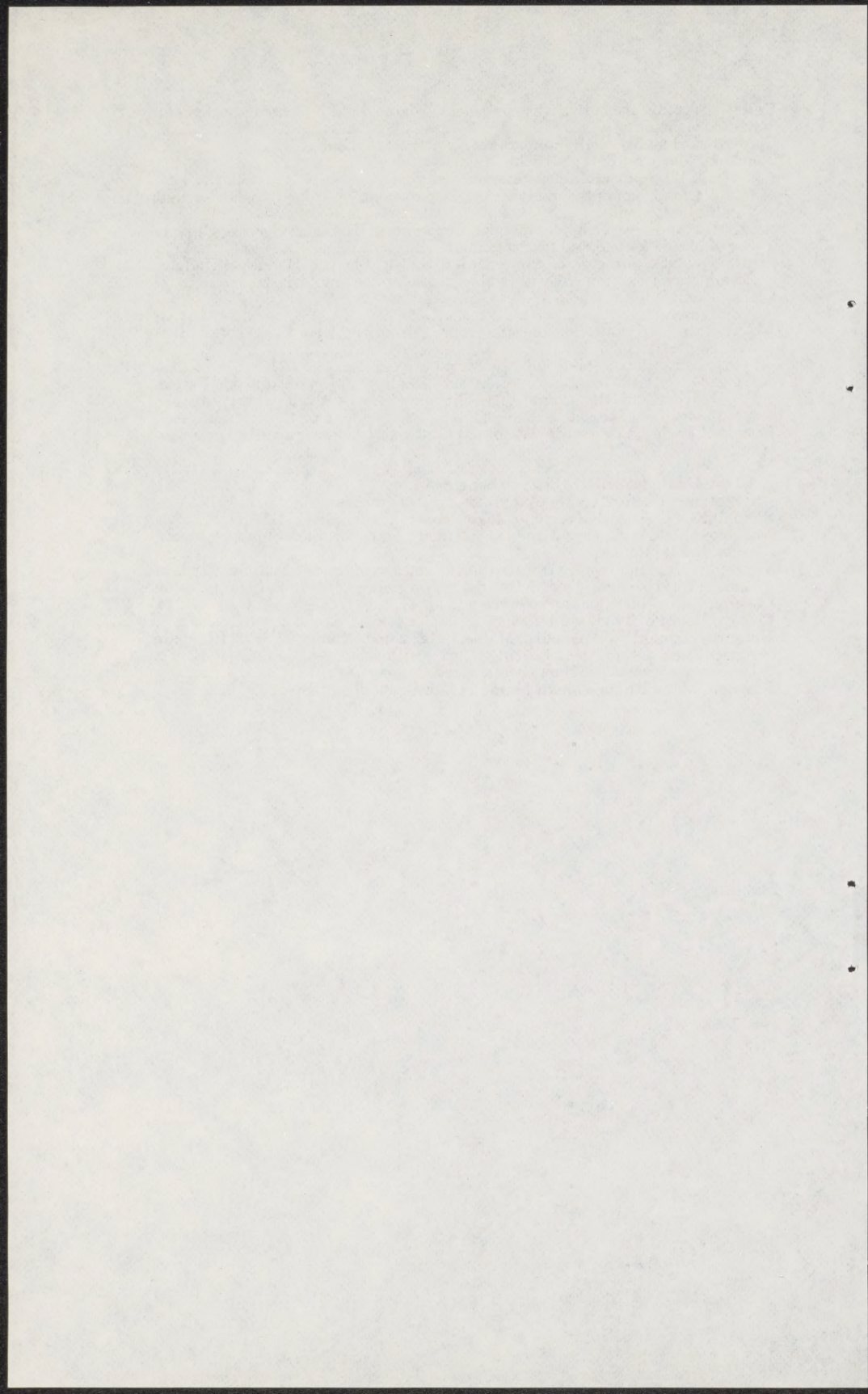
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TO PROHIBIT FUTURES TRADING OF POTATOES ON COMMODITY EXCHANGES

THURSDAY, NOVEMBER 15, 1979

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL RESEARCH
AND GENERAL LEGISLATION OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 324, Russell Senate Office Building, Hon. Donald W. Stewart (chairman of the subcommittee) presiding.

Present: Senators Stewart and Boschwitz.

STATEMENT OF HON. DONALD W. STEWART, A U.S. SENATOR FROM ALABAMA

Senator STEWART. Let us get underway, if we can. We have a lot of witnesses today. They have come a long way. They want to have the opportunity to give their testimony, and I want to give them that opportunity, the opportunity to be heard.

The Committee on Agriculture, Nutrition, and Forestry is vitally concerned with ensuring the orderly marketing of our Nation's agricultural production. This is true whether we are dealing with wheat, soybeans, or potatoes.

Futures trading is an integral component of the marketing system. Today, the Subcommittee on Agricultural Research and General Legislation will receive testimony on Senate bill 770, a bill that would prohibit potatoes futures trading. This bill was introduced by Senator Church for himself, and Senators Muskie, Burdick, and Young.

Potato futures trading is a continuing issue, and apparently, one that has been addressed by this committee in the past. In 1976, the Subcommittee on Agricultural Production, Marketing, and Stabilization of Prices conducted a hearing on the default of the May 1976 potato futures contract traded on the New York Mercantile Exchange, that was caused by the failure either to liquidate their positions or to deliver in accordance with the terms of the contract.

As part of its preparation for the consideration of the Futures Trading Act of 1978, this subcommittee, which was then ably chaired by Senator Leahy from Vermont, conducted an indepth review of what had taken place in potato futures trading since May 1976.

Since the reauthorization of the Commodity Futures Trading Commission in 1978, a new Russet potato futures contract has begun trading on the Chicago Mercantile Exchange, and there was

a sudden termination of trading last spring on the Maine potato contract traded on the New York Mercantile Exchange.

Additionally, the committee has now received a potato futures study prepared by the Department of Agriculture, which was required by section 27 of the Futures Trading Act of 1978. I believe this comprehensive study will serve as a good basis for our consideration of Senate bill 770. Prohibiting the trading of futures contracts on a particular market is not a step that should be casually taken. It has been over 20 years since such a step was taken. The banning of onion futures trading in 1968 was that step, and they still to date adopt that action.

A quick review of the witness list for today attests to the interest in S. 770, a relative newcomer to the whole area of futures trading, frankly, a relative newcomer to the Senate. I am looking forward to being educated, which I am quite sure you all have the capability of doing, on the particulars of potato futures trading. I am interested in your views as witnesses on this particular piece of legislation.

Particularly, I am interested in the views of the potato interest and the utility and viability of futures trading in potatoes and what the potential effects of a ban on this form of futures trading could be.

Let us set a few ground rules. Due to the number of witnesses who desire to testify today, I would request—and let us try to stick to this as closely as we possibly can—that all witnesses limit their oral testimony to 10 minutes.

All written statements which you have prepared will be included in the hearing record as well as your oral testimony.

And I want to say as the chairman that if you want to make a statement that is less than 10 minutes, do not feel obligated to go the full length of time that has been provided for you, because we will certainly understand, and we have some questions, of course, to ask.

Our first witness today is the chief sponsor of the bill, the Honorable Frank Church, from the great State of Idaho.

Senator Church, we are glad to have you here with us and look forward to hearing your testimony.

STATEMENT OF HON. FRANK CHURCH, A U.S. SENATOR FROM IDAHO

Senator CHURCH. Thank you, Mr. Chairman.

The reputation of this committee, set by Senator Talmadge, for commencing its hearings promptly, on time, is very fortuitous this morning, because I have been summoned by the majority leader to the Senate floor at 9 o'clock, and thus, have been faced with the dilemma of how to be in two places at once.

Senator STEWART. I do not know why you are here, then.

Senator CHURCH. Well, because this is a very important bill, Mr. Chairman, and strongly supported by the farmers I represent, the potato growers themselves.

I would like to make a brief statement in behalf of the bill and then just submit supporting material from the Idaho Growers & Shippers Association, the Idaho Potato Commission, and from the National Farmers Organization.

Senator STEWART. The supporting material will be included in the record.¹

Senator CHURCH. Thank you very much, Mr. Chairman.

I appreciate this opportunity to testify before your subcommittee, to urge approval of my bill to abolish potato futures trading, S. 770.

I first introduced this bill over 2 years ago, in response to a long history of abuses and manipulations on the potato futures market. These repeated incidents have all worked to the disadvantage of the potato grower.

I will not take the committee's time to recount the entire rocky history of potato futures trading. It is enough to know that on March 9, 1979, the New York Mercantile Exchange halted all trading in spring potato futures. Public accounts indicated that potato growers were narrowly spared a repeat of the massive 1976 default.

Mr. Chairman, the abolition of potato futures trading is not a unique step. Onion futures were at one time traded in this country, yet, as a result of a bill that I introduced many years ago, the trading in onion futures was banished. That occurred in 1957, and I have never had an onion grower come to me and ask that onion futures trading be reinstated.

The bill was passed because onion futures trading suffered from many of the same problems which have plagued the potato futures trading. There are several characteristics of potato futures trading which suggest that potato futures trading will never serve the grower as a viable marketing tool. Like onions, potatoes are a comparatively small crop. Both are highly perishable crops. Manipulation of onion futures was easy, as it continues to be with potatoes. The truth is that futures trading does not work well with all agricultural commodities. It did not work well with onions, and it will not work well with potatoes. There is no rational basis for abolishing onion futures trading as the Congress has done, while continuing potato futures trading.

In the years since we abolished onion futures trading, I have yet to hear, as I have said, a single onion grower complain that he needed or missed the banished onion future speculation.

I would similarly call this committee's attention to the fact that potato growers from Maine to Idaho have for years endorsed efforts to ban potato futures trading. This spring, the potato growers of Idaho surveyed their members and found that over 80 percent of the respondents favored banning potato futures trading.

A large portion of Idaho's potato crop enters the fresh potato market. For years, growers, packers, and shippers of fresh Idaho potatoes have complained that manipulations of the futures market unfairly affect the price of the fresh market.

Since the volume of potato futures trading is relatively small, it is easy to understand why growers feel that their cash prices can be manipulated by a handful of speculators on the futures market.

Additionally, Idaho potato growers are concerned that the good name and reputation of Idaho baking potatoes will be lost or damaged by being lumped together with other potatoes under a general Russet-Burbank futures trading contract.

¹ See pp. 247-250.

Idaho's potato industry has spent millions of dollars and years of effort to establish the distinct identity of the Idaho potato. They rightfully resent the current Russet-Burbank trading contract, which seeks to trade all Russet-Burbanks under one general label.

It has been suggested that my bill to ban potato trading futures goes too far. This view holds that a few modifications to regulations governing potato futures trading, and a few changes of procedure, will make the potato futures trading an acceptable activity.

Mr. Chairman, Idaho potato growers reject this view. They fully understand that you cannot push water uphill. Congress established the Commodity Futures Trading Commission to serve as a general watchdog over futures trading. Some felt that the negative effects of the long and short speculators in potato futures would be placed behind us with the creation of this Commission. History has proven otherwise.

Potato growers across our land remain committed to abolishing potato futures trading once and for all. If this committee acts to approve this legislation, its voice will be heard, and I think Congress itself will be induced to take such action, and we will have removed the burden of this legalized gambling, where the farmer always seems to lose.

Mr. Chairman, many of the growers of Idaho and representatives of the potato industry of my State would have liked to be present today to share with you their opposition to potato futures trading. Quite frankly, they could not afford the expense of traveling to Washington, D.C., since last year was a disastrous year for the potato farmers of our State.

Senator STEWART. We appreciate your testimony this morning. It once again indicates the fine work that you are doing for the people of Idaho and the future of your State in general.

Thank you very much for being here. I understand that you have to leave and go to the floor.

Senator CHURCH. Thank you, Mr. Chairman.

Senator STEWART. Our next witness is Senator William S. Cohen, from the great State of Maine. He is here today to make a statement, I assume, in support of the legislation.

Senator COHEN. Not quite.

Senator STEWART. His colleague is on the floor, and is to be here a little later on.

Senator COHEN. I believe Senator Muskie plans to be here by 9:30 or so.

Senator STEWART. You go ahead, and I did not mean to prejudge your statement.

STATEMENT OF HON. WILLIAM S. COHEN, A U.S. SENATOR FROM MAINE

Senator COHEN. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to be present this morning to examine the issue of trading in potato futures. Because of the extreme complexity of the issue, and considering the diverse views of the potato industry with respect to futures trading, I feel that we should exercise some caution in this particular area. So I therefore welcome the opportunity to seek to clarify many of the complex issues, including the effects of futures trading on the Maine potato

industry and the effects of eliminating trading of potato futures contracts on all commodity exchanges.

I would like, if possible, to extract as many answers as possible of my concerns, in order to determine the best course of action for the Maine potato industry.

First, I would like to review the problems that have plagued futures trading in the recent past. Throughout its history, the Maine potato futures contract has been a controversial issue with members of Maine's potato industry.

Many growers have argued over the years that futures trading should be abolished and that trading has caused more problems than it has solved. There are others, however, who argue that the existence of a contract has been a stabilizing force in a volatile and unpredictable market.

Dr. Alan Paul of the U.S. Department of Agriculture—Economics, Statistics, and Cooperatives Service—in his recent study of the Maine problem, suggests that the industry is definitely plagued by many problems, only one of which is futures trading.

Problems with Maine potato futures trading, as well as other potato industry related problems, have increased in the decade of the seventies. The 1976 default and the suspension of trading in March 1979 are only two of the recent problems that have damaged the potato industry in general, and especially those who use the exchange as a hedging vehicle and a pricing mechanism.

Now, it is indisputable that production of round white varieties in Maine, which meet contract specifications, is declining, while potato production nationally in all varieties has increased rather dramatically.

Problems faced in the seventies have included the lack of convergence in futures prices and cash prices as contracts reach maturity. This reflects the divergence of the limited Maine round white commodity supply and the overabundant stocks of potatoes flooding the east coast cash market, which has served to depress prices.

In both the sixties and the seventies, Maine's potato varieties have changed substantially to meet the national consumer demands. The State, for example, has increased its Russet production to between 25 and 30 percent of the total crop, and since Russets do not meet contract specifications, this has limited the stocks available for delivery.

Now, this situation is coupled with an increase in the production of round white varieties, which do not store well during the winter months, including the superior variety in particular.

This trend has significantly limited, either by variety or quality, the stocks of potatoes in Maine capable of being delivered against contracts. As recent futures prices have remained higher than cash prices, many short hedgers have opted to actually deliver on their contracts when, in fact, they should be liquidating and selling on the cash market.

The New York Mercantile Exchange has submitted to the Commodity Futures Trading Commission for approval a contract which would include round white potatoes from 15 Eastern and Midwestern States. Dr. Paul recommends the expansion of the round white supply base as a potential remedy to present delivery problems. However, many in Maine's potato industry who support futures

trading in concept feel that an expanded contract will harm rather than help the Maine potato grower.

I am hopeful that the CFTC will seriously consider and review the problems raised by Dr. Paul and members of the Maine industry in the Commission's consideration of the proposed contract.

I think that questions must be answered concerning problems of deliveries to eastern terminal markets by the Midwestern States, the effects on Maine cash price in broadening the contract, and whether expanding the contract will place Maine at a disadvantage in the November and March contracts.

I think another important fact that should be considered is that there are differences of opinion on how the Maine potato industry might function in the absence of futures. I hope that the committee will address this problem and will consider what mechanisms will replace futures in price formation and how the removal of futures will affect the growers' bargaining opportunities with processors and buyers.

I believe that Mrs. Kelley will probably be offering some suggestions on that issue later today.

Dr. Paul suggests that remedies are available to improve the trading of potato futures. Two of the recommendations include financial settlements by formula, combined with provisions for physical delivery and the broadening of the contract. Should these remedies not alleviate the problem, then more severe remedies have been suggested.

A number of solutions have been suggested, including the total banning of potato futures trading. As a basic supporter of the concept of futures trading, I am hesitant to support S. 770 until I am satisfied that potato futures contracts are unacceptable and that economic benefits are in fact limited.

But I would readily concede that past and present problems encountered with futures trading are unacceptable.

I must be assured that steps will be taken to ensure the protection of the Maine potato grower. In reviewing earlier hearings on potato futures, I have found that several of Dr. Paul's recommendations have been suggested in prior years. The New York Mercantile Exchange has often responded to the problems after the fact, rather than anticipating and dealing with problems before they arise. I think this is no longer acceptable should trading in fact be continued.

I also feel that the CFTC and the exchange should work more closely in monitoring national potato problems and the Maine problems in particular.

I am concerned that in reality, the recommendations made by Dr. Paul might in fact not work. I am hopeful that the exchange, as well as the CFTC, will respond and comment on the recommendations made by Dr. Paul, including the negative remedies, which include limits on the size of positions held by individual traders, tapering down of limits as contract maturity approaches, increasing margin requirements as the contract moves to maturity, and trading for liquidation only.

I would welcome comments from the industry on the feasibility of any or all of these remedies. I would also welcome information

on the acceptance of the proposed 15-State contract in the affected States.

I think that this most serious problem must be resolved and the Maine potato industry stabilized. As the records indicate, Maine potato growers can withstand no additional financial catastrophes or the industry is certainly going to continue its decline.

Mr. Chairman, I am hopeful that these hearings will point the way toward the resolution of this controversial issue and will strengthen the Maine potato industry.

I have a series—and I am not trying to filibuster until Senator Muskie comes off the floor—

Senator STEWART. He will be given ample time, and we might even take a break before he gets here.

Senator COHEN. I have a series of questions that I would like to read into the record verbally now, so that the witnesses who will be testifying later might respond to them as they come before the Chair.

Senator STEWART. If you wish, you can leave them here with me after you leave, and I will be sure that they do.

Senator COHEN. Well, I would like to give them a little anticipation, so they can perhaps be thinking of them as we are testifying today.

Senator BOSCHWITZ. Excuse me, Senator.

Senator COHEN. Yes, sir.

Senator BOSCHWITZ. Mr. Chairman, I also have some conflicts, so I am going to have to leave and hope to come back a little bit later. I will be back a little later.

Senator COHEN. Senator Boschwitz and Senator Muskie are conducting an intensive fight to see if we cannot allocate more fuel assistance to the Frost Belt States, including Maine and Minnesota.

Mr. Chairman, I have some questions that I would like to address to the Commodity Futures Trading Commission and the New York Mercantile Exchange.

First, what guarantees can you make to ensure that recent problems encountered in 1976 and 1979 will not happen again—and I am referring to their monitoring capabilities and staff understanding of the peculiarities of the Maine potato market.

Second, what is the level of acceptance by growers in the 15-State contract area and their opinion—and I am referring to the proposed contract of the New York Mercantile Exchange being reviewed by the CFTC.

For the New York Mercantile Exchange only: First, why haven't the recommendations made in the past, referring to Dr. Paul's suggestions, been accepted and utilized by the exchange—and I refer to the financial settlements by formula, combined with provisions for physical delivery in the more severe recommendations; second, if the expanded contract is not approved by the CFTC, what will happen to potato futures contracts on your exchange? Will the Maine only contract be continued? Third, how much will the expanded contract increase available supplies for delivery in the traditional problem months of April and May? Is it realistic to assume that Maine will still be the only State with substantial supplies available in these months?

Questions for the USDA and Dr. Allen Paul: First, why have the benefits to hedgers decreased in the past decade?

Do you see the expanded contract as a realistic remedy for this situation?

Second, what transportation and delivery problems do they anticipate in the Midwestern States, delivering to eastern terminal markets, as specified by the New York Mercantile Exchange contract?

Third, how will the expanded contract affect the Maine cash price, and what effects, if any, will this trading have on present Maine cash prices?

Fourth, will the expanded contract place Maine at a disadvantage in November and March contracts?

Fifth, how will the industry function in the absence of futures? Are there mechanisms to replace futures in price formation and in bargaining with buyers and processors?

For the Potato Council and Mrs. Dorothy Kelley: No. 1, do you feel that the remedies suggested by Dr. Paul are feasible and would solve any of the problems encountered?

No. 2, as I asked Dr. Paul, what will replace futures trading as a bargaining tool and pricing mechanism? Will growers be able to secure favorable prices from processors?

No. 3, what percentage of Maine growers presently use the exchange, in your estimation?

And finally, for the National Potato Council and Mr. Don La Pointe, what is the level of acceptance to the 15-State contract as proposed by the exchange, in his opinion?

Those questions, Mr. Chairman, I think will be helpful to me in coming to a conclusion as to whether I would support this particular measure if it is reported on the floor.

Senator STEWART. Thank you, Senator. If you will send those questions up—you went over them a little rapidly—I will submit them to the people who are out there, furiously trying to scribble down the questions, so we can make sure they have them.

Senator COHEN. Certainly, and thank you, Mr. Chairman.

Senator STEWART. Thank you.

[Questions submitted by Senator Cohen to the New York Mercantile Exchange and answers thereto:]

Question 1. What guarantees can you make to ensure that recent problems incurred in 1976 and 1979 will not happen again?

Answer. Since the 1976 default, the Exchange has improved its monitoring system for all commodities traded on the Exchange. Increased market surveillance by staff, the improved computer system which details each trade up to the minute during trading hours, introduction of Control Committees to oversee orderly liquidation as contracts approach maturation, and cooperation with CFTC surveillance efforts are all directed to protect the viability of a fair and orderly marketplace.

Problems with March 1979 deliveries, however, could not have been foreseen. Information from all sources, including our Maine Liaison Officer, USDA and trade channels, indicated that supplies in Maine were ample. The Maine industry was as surprised as the Exchange when the potatoes could not pass inspection in New York City. As a result, it was imperative that the Exchange take prompt, responsible action to deal with the situation.

In any business, no one can ever guarantee that problems or crises will never again arise. At best, some problems can be anticipated and averted by prompt action whenever possible. In commodities, problems often arise without warning and must be dealt with in the fairest and most equitable manner possible. In such as unpredictable environment, self-regulation is critical. The Exchange recognizes the

magnitude of this responsibility and will aggressively enforce self-discipline to ensure a fair and orderly market for the public.

Question 2. What is the level of acceptance in your opinion of the growers in the 15-state expanded contract to the new contract?

Answer. The 15-state potato contract has met generally favorable response with growers and dealers. In a state where contracting between growers and processors is commonplace, the processors bear the greatest price risk and are usually interested in futures. In a state where the grower takes his chances in the cash market, he finds hedging attractive. For example, in areas like Long Island, Michigan and Wisconsin, where growers do not have the benefit of forward contracting with dealers and processors, growers are particularly interested in having a futures contract against which their potatoes are deliverable.

Question 3. Why haven't the USDA recommendations in the past been accepted and utilized by the Exchange? i.e., Financial settlement by liquidation of contracts by formula, limiting number of contracts, and other severe recommendations made in Paul's report.

Answer. The recommendations of the USDA study (which we received late in October) are being carefully reviewed. The Chairman of the Potato Committee has appointed a special Subcommittee for the purpose of examining the provision for financial settlement proposed in the USDA report.

Other recommendations contained in the report, including restrictions on position limits and increased margin requirements are powers which the Exchange already has. The CFTC has set position limits for speculative traders and the Exchange has the right to further restrict positions for speculators, and hedgers as well, when necessary. The Exchange establishes minimum margin requirements and the margin is automatically increased as contract months approach maturity. In addition, the Exchange may raise margins at any time during the course of a contract's life.

Question 4. If the expanded contract is not approved by the CFTC, what will happen to the potato futures contract? Will the Maine-only contract be continued?

Answer. The Exchange has no reason to believe that CFTC will not approve the expanded contract. By all standards, the expanded contract will more accurately reflect market conditions since Maine potatoes are no longer the basis for potato pricing. Even if the Maine-only contract could be improved, it would have limited life-expectancy. The increased output from other states competing with Maine have reduced the viability of establishing a price based solely on Maine's supply. The USDA study confirms this view. A Maine-only contract would eventually fade away.

Question 5. How much will the expanded contract increase available supplies in the traditional problem months of April and May? Is it realistic to assume that Maine will still be the predominate state with substantial supplies available in these months?

Answer. The futures market is most viable for hedgers when it mirrors the conditions in the cash market. While Maine will remain the dominant source of potatoes in the spring months, it is not the only source. With a Maine-only contract, the futures market does not reflect the overall supply/demand balance. Other states do have round whites in the spring which can and do compete with Maine potatoes.

According to our estimates, Maine generally accounts for 50 percent of round white supplies in the late spring months. While this is a substantial proportion, it is not the entire supply. A trader who bought potatoes solely on the basis of tight supplies in Maine could have a rude awakening when potatoes from Michigan, New York, Pennsylvania or Wisconsin become available to fulfill contractual requirements.

The importance of permitting deliveries from other states is not tied as much to the absolute quantities they add to the supply, but rather to assure that the futures market does in fact account for all the factors contributing to price determination of round white potatoes.

Senator STEWART. We could at this time start with another witness. Our next witness, of course, was Senator Muskie, but I am afraid he will be detained.

Our next witness will be Hon. Read Dunn, Jr.

Let me say this much, before Mr. Dunn proceeds. I know it is something that has to occur from time to time, and you have got to talk to your neighbor, or you might have come in, or some point might come up, or you might have to leave.

But if you would, this is a very big room, and it is hard to hear sometimes, for those who are attempting to hear. Let us be as considerate as we can of our neighbor. You have done that so far, but we have a lot of people in here today, so let us keep it as quiet as we can.

The Honorable Read Dunn, Commissioner of the Commodity Futures Trading Commission.

**STATEMENT OF HON. READ DUNN, JR., COMMISSIONER,
COMMODITY FUTURES TRADING COMMISSION**

Mr. DUNN. Thank you, Senator.

As you have requested, I will submit my full statement for the record and briefly summarize that statement orally here.¹

The potato contracts indeed have had a troubled history as the two previous Senators have indicated. The question that needs to be asked now, I believe, is whether there is a continuing economic need for the risk management and price discovery that is provided by a futures contract, and whether the problems which have been identified can be solved by changes and amendments to these contracts.

This is basically the question which was before the Congress last year when it was considering bills to ban potato futures.

The Congress resolved the question at that time by inserting in the law which reauthorizes the CFTC a directive to the Department of Agriculture to study potato marketing, including the use of the futures markets.

The Department has just completed that study and submitted it to the committee. It was disseminated for the first time just a few days ago, and Senator Cohen mentioned this study a while ago.

In my opinion, this is a professional piece of work. I think that all who are seriously interested in this problem should carefully study and consider the findings and the suggestions made by the Department of Agriculture. I do not want to go into any of the details of that report. I do not want to "scoop" the Department. I understand they will have a comment here as the next witness. Senator Cohen referred to some of the major points of it.

Suffice it to say here that I think the most important conclusion of the report is that there is a continuing economic need for a futures contract. Dr. Paul does point out a number of problems and has made a number of specific suggestions. Some of these were also mentioned by Senator Cohen. One of them, which may be the most interesting and could have the most significance, is the suggestion that the contracts be settled in cash, rather than settled by delivery. This is a very interesting suggestion, but it is rather revolutionary. As you know from previous witnesses, the exchange has also suggested some very profound changes, which will make of this contract almost a new, certainly a different contract.

The CFTC is now in the process of carefully reviewing and studying the Department of Agriculture report, and particularly, the changes that have been suggested in that report. We are also reviewing the changes that have been proposed by the exchange.

¹ See p. 107 for the prepared statement of Commissioner Dunn.

We have been visiting the various States that would be affected and contacting producers and organizations and industry in those States. We will continue our study and investigation.

If we conclude that changes and amendments to the contract are necessary in order to make it, let us say, fairer, to both sides that are using it, we can, of course, direct these changes to be made by amendment to the contract.

Should the CFTC conclude, after changes have been made, that the contract still does not meet the economic purpose test or the public interest test, we could, of course, institute proceedings to determine whether the exchange's contract market designation should be revoked.

Now, inasmuch as the Congress has authorized and directed the CFTC to make these evaluations and determinations on the potato as well as on all of the contracts, I believe that the best course of action would be to allow the CFTC to proceed with its evaluation and make its determination. Then, if Congress is not satisfied with the CFTC decision, and wishes to institute a statutory ban, it could do so without preempting the procedure which it has already established.

Thank you, Senator.

Senator STEWART. Thank you, Mr. Dunn.

I have some questions. We will begin these questions and as soon as Senator Muskie gets here, we will give him the opportunity to testify, and then get back to you. I do not mean to indicate that you are not an important person and we are not proud to have you here, but he is involved in some activity on the floor, and I know you understand.

What is the position of the CFTC with regard to S. 770?

Mr. DUNN. We do not support the bill, Senator.

Senator STEWART. Is there anyone on the Commission who does not oppose the bill?

Mr. DUNN. Yes. Commissioner Stone, the Chairman, indicated that he had a minority view. His minority view, I understand, was communicated to the chairman of this committee.

Senator STEWART. So the record is clear, we have a letter here, dated October 30, 1979. I assume that states the view of Chairman Stone, and I would just submit that myself for the record, and we will make that a part of the record.

[The following letter was submitted for the record:]

COMMODITY FUTURES TRADING COMMISSION,
Washington, D.C., October 30, 1979.

Hon. HERMAN E. TALMADGE,
Chairman, Committee on Agriculture, Nutrition, and Forestry,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of July 31, inviting the Commodity Futures Trading Commission to comment on S. 770, a bill "To Prohibit Trading in Potato Futures on Commodity Exchanges." I am now responding to your invitation as an individual Commissioner, rather than as the authorized representative of the full Commission. The Commission by majority vote has determined to oppose S. 770. The Commission's position will be presented by Commissioner Read P. Dunn, Jr. at your upcoming hearing on this bill. Because I did not concur in this vote, I am taking this opportunity to present my minority view.

Strong differences of opinion exist as to the desirability of a potato futures market. Throughout the 1970s, problems have developed surrounding both the Russet-Burbank contract traded on the Chicago Mercantile Exchange and the round

white potato contract traded on the New York Mercantile Exchange. As a result of market problems, the regulators and the exchanges have taken several disciplinary actions and revised the contract terms in both markets. The most recent controversy occurred on the New York market in March of this year when the Exchange declared an emergency and suspended trading in March, April and May 1979 futures.

Speaking only as an individual, I must inform you that I am inclined at this time to doubt the value of a potato futures market. This doubt arises from the unhealthy history of the potato futures market, as well as from information I have obtained firsthand from potato growers. All of the evidence is not as yet in, and, I will, of course, reserve judgment on the ultimate value of a potato futures market until it is. Under the circumstances, I can not recommend defeat of S. 770 but would prefer to see the measure kept alive pending further examination.

I hope my comments will be of use to you in your deliberations. Please call if I can be of any further help.

Very truly yours,

JAMES M. STONE, *Chairman.*

Senator STEWART. How long has the Commission, Commissioner Dunn, had the New York Mercantile Exchange's proposed expanded round white potato futures contract; how long have you had that under observation?

Mr. DUNN. Senator, are you talking about the amendments, the changes proposed, or how long has the contract been operating, the basic contract?

Senator STEWART. I assume we are talking about the amendments at this time.

Mr. DUNN. As I recall the New York Exchange's basic potato futures contract has been operating since about 1941. Now, they have recently submitted a few months ago—I do not have it precisely—

Senator STEWART. That is what I am referring to.

Mr. DUNN. Some very significant and far-reaching changes to this contract.

Senator STEWART. How long has it been since they submitted that to you.

Mr. DUNN. I will have to ask exactly how long. [Conferring with staff.] July 2 was their first submission, July 2, 1979.

Senator STEWART. What stage is that contract, or the modifications to that contract?

Mr. DUNN. Our staffs are studying the various proposals that are contained in that application.

Senator STEWART. In other words, you have been doing that since July 1979?

Mr. DUNN. That is right. It would permit the delivery of potatoes from a great many more States than are allowed under the present contract, and it involves an unusual delivery provision, delivery at par, from a great many locations in these 15 States. This is quite complicated, to try to determine whether this is really fair.

Senator STEWART. How long will it be before final action is taken on that proposal?

Mr. DUNN. I think staff recommendations on this particular proposal are nearing conclusion, and I hope that we are going to have those quite soon; am I correct there? [Conferring with staff.] Before the end of the year.

I should state, Senator, at this time, that the recommendations of Dr. Alan Paul go much further than the proposals of the New York Mercantile Exchange. And as I indicated earlier, I do think that

those are interesting and serious suggestions, which should be studied.

Senator STEWART. Well, let me ask you, were these recommendations made by the New York Exchange in response to the May 1976 default, or what caused, or what prompted these changes?

Mr. DUNN. Senator, I think that it is abundantly clear that the major problem of the potato contract, as with all perishable commodity contracts, is the delivery problem. And this is the quality associated with delivery. That is what caused a big problem in the spring of this year.

Senator STEWART. In the spring of 1979.

Mr. DUNN. Of 1979.

Senator STEWART. These were offered in July; was that why they were offered?

Mr. DUNN. Certainly, the amendments which are being proposed by the exchange are an effort to correct that problem.

Senator STEWART. Well, do you, in your opinion, think at this particular point that what they have offered is adequate and that it will correct the problem?

Mr. DUNN. Senator, it is too early to say. Our staff has not completed its investigation, and we have not gotten even a preliminary report of their investigation.

Senator STEWART. Are these the only alternatives that you are looking at at this time, just the proposals presented by the New York Exchange?

Mr. DUNN. Well, as I said, also the suggestions of the Department of Agriculture, which are very interesting, and some of them, even revolutionary.

Senator STEWART. Is staff looking at those proposals, too?

Mr. DUNN. Our staff?

Senator STEWART. Yes.

Mr. DUNN. Yes, sir. But as I say, we just got those a few days ago, so we have not had time to—

Senator STEWART. In other words, the study that you have been engaged in since July—

Mr. DUNN. Has been of the New York Exchange's proposal.

Senator STEWART. Has been only of the New York Exchange's suggested changes.

Mr. DUNN. Yes.

Senator STEWART. OK. Could you describe the action the Commission took against those people who were involved in the May 1976 default?

Mr. DUNN. Yes. I could certainly do this in a general way. The Commission charged numerous individuals and organizations, on the short side and on the long side of the contract, and also the exchange itself. I think that the cases against the shorts have now been concluded with one or two exceptions, and these cases were concluded by settlement. As a result of the settlement, the Commission then ordered a cease and desist, and ordered suspensions from all trading activity of from 2 to 6 years, and rather large fines, in addition.

Senator STEWART. Fines are not very significant in the overall scheme of things, are they?

Mr. DUNN. No, but how significant is a fine of the maximum allowed by the Commission to a multimillionaire? I feel that the suspension of trading for 6 years is a much more meaningful sanction.

Senator STEWART. And you took that in some of the instances in connection with the May 1976 default?

Mr. DUNN. Yes, and in the case of one of the longs, we ordered their suspension for life.

There are, I think, three or four of those cases that are still in litigation.

Senator STEWART. Do you think the results that were achieved by those actions were satisfactory, as far as you are concerned?

Mr. DUNN. Well, it was certainly effective, completely effective, we think, in taking out of the market the people who, indications were, were the causes of trouble.

Senator STEWART. Of course, under the terms of some of these provisions, 4 years' and 6 years' suspension, by the time 1980, 1981, or 1982 rolls around, some of these people will potentially be back in the market; is that correct?

Mr. DUNN. It is possible, but some of them are old people already. [Laughter.]

Senator STEWART. I am not going to go into that.

Do you believe that the surveillance and enforcement capabilities of the New York Mercantile Exchange have been strengthened since your initial review of the exchange's activities?

Mr. DUNN. Oh, yes, sir, very materially. A sizable staff has been built up, the quality and experience of the staff has greatly improved; the nature and extent of the cooperation with the CFTC has been improved and strengthened.

Senator STEWART. In connection with the cooperation with the Commission, do you receive from the New York Mercantile Exchange all of the information that you deemed necessary to monitor the potato market?

Mr. DUNN. Yes, I think so. We not only receive information from the exchange, but we receive information directly from all of the reporting traders who have reportable positions, which is positions above a certain limit. We also receive reports directly from the brokers. And on these large traders, you see, we get reports on their activity daily.

Senator STEWART. And you think that is adequate in order to monitor the situation?

Mr. DUNN. Well, yes. Those are very complete reports.

Senator STEWART. Have you been receiving that since your involvement in the activities as a Commission, since May 1976; has that improved or stepped up since that time?

Mr. DUNN. Yes. We have certainly intensified and tightened up our surveillance activities since the problem first occurred.

Senator STEWART. A good portion of the hearing will be devoted to the new Russet potato contract that has been traded on the Chicago Mercantile Exchange since July of this year. Would you please explain the steps the Commission goes through in considering an application for contract market designation, and what the criteria for designation are?

Mr. DUNN. We normally receive applications for new contracts, and we put these applications or these proposals out for public comment. Sometimes we hold public hearings on these questions. In addition, we have our staff very carefully review the specific proposals, which include the terms and conditions of these contracts. The standards are laid down not only by statute, but also in a set of guidelines which we have established, and they include the economic purpose test and the public interest test.

We make our own independent evaluation of not only the economic purpose and the determination of whether these meet commercial criteria, but also of the nature and extent of interest in the industry for such proposals. We have to make a finding that there is a reasonable opportunity that these contracts will be used for price discovery and/or for risk management.

This is a part of the economic purpose test which we apply. The proposal is evaluated by all of our staff, but primarily by the economic staff, which has responsibility for analyzing the probable use of the proposed contract.

Senator STEWART. Are you aware of any problems in the Chicago Mercantile Exchange with the Russet contract?

Mr. DUNN. There is obviously a problem in that contract, because the level of trading is very low indeed. Just what is the problem is not so easy to determine. We have discussed this on a number of occasions with producers and handlers and processors, and also with the exchange. We are continuing to discuss this in an effort to find out—

Senator STEWART. Do you plan to make any changes or suggested changes in that contract?

Mr. DUNN. It is clear that something will have to be done to get it to trade. It is not very clear to me at the present time just exactly what needs to be done on that contract.

Senator STEWART. Well, we have some witnesses from the Chicago Mercantile Exchange.

Let me ask you, have you conducted any hearings or discussions in either Maine or Idaho in connection with this problem, as a Commission?

Mr. DUNN. Yes. We have had several meetings and hearings in Maine. I could give you the exact dates on those by going back to the records. We have had informal visits in Idaho with producers. I myself have been out there for one meeting, and our chairman was out there recently, and our staff people have also recently been out there.

Senator STEWART. It has been asserted that members of the potato industry would profit from the cessation of futures trading. Do you have any thoughts on that assertion?

Mr. DUNN. That members of the industry would profit from a cessation?

Senator STEWART. Right.

Mr. DUNN. It is difficult to be sure on such a point. I believe that an organized market such as an organized futures market brings together the largest possible number of buyers and sellers that can be brought together. In the absence of such an organized market, it is quite possible, I think, particularly in the outlying communities,

that you may have a small number of buyers, and therefore, reduced competition.

If, for instance, you had only one buyer in a smaller outlying community, he could name his own price because of the absence of competition. It is possible, it seems to me, that he might be able to profit more than if there were more competition.

Senator STEWART. But if the Commission saw fit, you could stop potatoes futures trading, couldn't you?

Mr. DUNN. Yes.

Senator STEWART. Is this one of the reasons you have not, in order to keep a market for those potatoes? Is that one of the economic—

Mr. DUNN. Up to now, it has been the opinion of the Commission that the advantages outweigh the disadvantages, that the benefits are greater than the liabilities. But we are reassessing this question.

Senator STEWART. Thank you.

[Subsequent to the hearing of November 15, 1979, the following information was submitted by the Commodity Futures Trading Commission:]

COMMODITY FUTURES TRADING COMMISSION,
Washington, D.C., December 13, 1979.

HON. DONALD W. STEWART,
Chairman, Senate Subcommittee on Agricultural Production, Marketing, and Stabilization of Prices, U.S. Senate, Washington, D.C.

DEAR CHAIRMAN STEWART: During the November 15, 1979, hearing of your Subcommittee on S. 770, you asked for information and materials concerning the Freedom of Information Act ("F.O.I.A."), 5 U.S.C. § 552(b), request made to the Commission by the State of Maine. Set forth below are the details concerning the Commission's treatment of that request. In addition, I have enclosed certain documents which you specifically requested during the hearing. Those documents are transcripts of a closed Commission meeting, which the Commission voluntarily disclosed in an attempt to resolve an F.O.I.A. lawsuit brought by the State of Maine. We request that this letter and its enclosures be included in the record of the hearing.

The Commission first received a request from the State of Maine for information concerning the March 9, 1979, declaration of emergency by the New York Mercantile Exchange in the March, April and May potato futures contract by letter dated April 29, 1979, from Sarah Redfield, Assistant Attorney General. That letter expressly stated that the information was being requested under the Freedom of Information Act. By letter dated May 10, 1979, the Commission's Office of Public Information advised Ms. Redfield that of the documents requested, some were subject to a petition for confidential treatment submitted to the Commission by the Exchange. The letter explained that the Commission's staff was reviewing the documents covered by the request, as well as other documents in the Commission's possession, in order to determine whether they could be released pursuant to the F.O.I.A., the Commodity Exchange Act, and applicable Commission regulations.¹ At that time, the Office of Public Information released two documents in its possession to the State of Maine in partial fulfillment of its request.²

After the staff completed its review of all requested documents, the Office of Public Information again wrote to Ms. Redfield on June 7, 1979, advising her of the staff's determination. The staff determined that two additional documents could be released to the State of Maine. These documents were advisory, internal agency memoranda from the Division of Trading and Markets to the Commission concern-

¹ All requests for information under the F.O.I.A. are initially processed by the staff. The Commission, itself, will generally only consider a matter if the requesting party appeals an adverse staff determination to the Commission for review. This procedure is consistent with the statutory scheme of the F.O.I.A. and is essential to efficient disposition of other Commission business. See Commission Rule 145.7(g), 17 C.F.R. § 145.7(g) (1978).

² Those documents were hand delivered to Ms. Redfield by an attorney in the Commission's Office of the General Counsel on May 9, 1979. In addition, on May 30, 1979, in response to a telephonic request, Commission staff provided Ms. Redfield with a copy of the rules of the Exchange.

ing the Commission's decision to authorize the Exchange to extend its temporary emergency action from thirty to ninety days, pursuant to Commission Rule 1.41(f), 17 C.F.R. § 1.41(f) (1979)

The staff further determined not to release minutes or transcripts of the closed Commission meetings of March 8, 9, 23 and April 3, 1979. The basis of that determination was 5 U.S.C. § 552(b)(7)(A), and Commission Rule 145.5(g), 17 C.F.R. 145.5(g) (1979), which exempts from disclosure "investigatory records compiled for law enforcement purposes" the production of which would interfere with an ongoing Commission investigation pertaining to the exchange's declaration of an emergency in the March, April, and May Round White Potato futures contracts. In addition, as indicated in the June 7, 1979 letter, the staff determined that these documents were exempt from disclosure pursuant to 5 U.S.C. § 552(b)(5), and Commission Rule 145.5(e), 17 C.F.R. § 145.5(e) (1979), as intra-agency memoranda not available by law to a party other than an agency in litigation with the Commission.

As to those documents submitted by the Exchange to the Commission that were subject to the Exchange's petition for confidential treatment, the staff determined that the documents should be released with the exception of information required to be kept confidential by Section 8(a) of the Commodity Exchange Act.³ Accordingly, in its June 7, 1979, letter the Office of Public Information informed Ms. Redfield that the relevant documents would be released after a period of five business days—the period during which the Exchange has the right, under Commission Rule 145.5(f)(1), 17 C.F.R. § 145.9(f)(1) (1979), to seek review by the Commission of the staff determination to deny the Exchange's petition for confidential treatment. The State of Maine had the opportunity during that time to seek review by the Commission of the denial by the staff of part of its request. Commission's Rule 145.7(g), 17 C.F.R. § 145.7(g) (1979).

On June 8, 1979, however, the State of Maine instituted a proceeding against the Commission, on the basis that the Commission has not complied fully with its F.O.I.A. request, in the United States District Court for the District of Maine (Civil Action No. 79-129-P). The Commission's Office of the General Counsel received a copy of the complaint on June 15, 1979. Notwithstanding the initiation of this lawsuit, the Commission continued to follow its established procedures for reviewing F.O.I.A. requests. Review by the Commission of June 7, 1979, staff determination was requested by the State of Maine by letter dated June 22, 1979. This petition sought review of the staff action in withholding from disclosure the minutes and transcripts of the closed Commission meetings of March 8, 9, 23, and April 3, 1979.⁴ In addition, the Exchange sought Commission review, by telegram dated June 14, 1979, of the staff determination to release the documents which it had submitted to the Commission, and which regarded as confidential. To facilitate its review, the Commission considered both petitions together.

On July 17, 1979, the Commission, having considered the petitions for review and the initial staff determinations, affirmed the staff's action in denying the Exchange's petition for confidentiality. Accordingly, all of the Exchange documents submitted to the Commission were ordered by the Commission to be made available to the State of Maine, with the exception of any portion of those documents which contained information the release of which is prohibited by Section 8(a) of the Act.

The Commission further decided that despite the applicability of several exemptions under the F.O.I.A. and the Government in the Sunshine Act from mandatory disclosure of the minutes and transcripts of the closed Commission meetings, and despite the fact that these minutes and transcripts reflected the Commission's deliberative processes and concerned an ongoing Commission investigation, the Commission would exercise its discretion and release portions of these minutes and transcripts. It must be emphasized that this is a decision which only the Commission could make. It is not within the staff's discretion to waive the Commission's right to protect its deliberations from disclosure. The disclosed minutes and transcripts of the March 9, 23, and April 3, 1979, meetings were edited to delete information, the release of which is prohibited by Section 8(a) of the Act.

³ Section 8(a) of the Commodity Exchange Act generally prohibits the Commission from disclosing information that would "separately disclose the business transactions or market positions of any person and trade secrets or names of customers." This information is exempt from disclosure under 5 U.S.C. § 552(b)(3) and Commission Rule 145.5(c), 17 C.F.R. § 145.5(c) (1979). Sections 8(b), 8(c) and 8(e) of the Act contain certain exceptions to this general prohibition on disclosure. None of these exceptions, however, was applicable to this request for information.

⁴ In its June 22, 1979 petition, the State of Maine for the first time requested those documents required to be prepared under the Government in the Sunshine Act when the Commission conducts a closed meeting. Those documents were provided to Ms. Redfield on July 23, 1979.

The minutes of the March 8, 1979 meeting were also released, but the transcript of that meeting was withheld because of the great frequency with which Section 8(a) information appeared. In addition, that transcript also contained a detailed discussion of an ongoing Commission enforcement investigation relating to trading in the contracts affected by the Exchange's emergency action.

Meanwhile, the litigation proceeded in the United States District Court. On July 16, 1979, the Commission, represented by the United States Department of Justice, filed its answer praying for the dismissal of the action with prejudice. At a pretrial conference, held on August 20, 1979, before U.S. Magistrate Zarr, the matters remaining in dispute were restricted to the withholding of the March 8, 1979 transcript and to portions of the April 3, 1979, transcript. All other documents which the State of Maine requested had been previously released pursuant to the Commission's decision on review. The court ordered that the Commission, which intended to file a Motion for Summary Judgment, file that Motion by October 22, 1979. At the request of the Department of Justice, that deadline was subsequently extended.

On September 27, 1979, however, the Commission on its own motion reconsidered its decision concerning the withholding in its entirety of the March 8, 1979, transcript. In an attempt to resolve the F.O.I.A. lawsuit by the State of Maine, the Commission amended its decision and instructed the staff to release that transcript in its entirety, except for information required to be withheld under Section 8(a) of the Act.⁵ On November 19, 1979, the State of Maine stipulated to a dismissal of its FOIA lawsuit against the Commission.

Thus, the Commission has released to the State of Maine all of the information in its possession concerning the Exchange's emergency action except for small portions of documents, the release of which would violate Section 8(a) of the Act, or which might interfere with an ongoing enforcement investigation. As the above chronology of events demonstrates, the decision to release the vast majority of the information which the State of Maine requested was made before the litigation was commenced.⁶ Indeed, the Commission had released several documents in partial fulfillment of the request well before the complaint was filed. Furthermore, the Commission was not required to release any information as a result of the State of Maine's lawsuit. However, in an attempt to cooperate with that State, the Commission exercised its discretion to release all the information requested except information expressly prohibited from disclosure by law or which could interfere with enforcement proceedings.

Sincerely yours,

READ P. DUNN, Jr., *Commissioner.*

Senator STEWART. Mr. William Motes, Associate Director, Food, Agriculture, and Rural Development, U.S. Department of Agriculture, accompanied by Dr. Allen Paul, Economics, Statistics, and Cooperatives Service, USDA.

Mr. MOTES. Candace Kahl is here, too; she is one of the principal authors of this. She works with Dr. Paul.

Senator STEWART. We are glad to have both of you today.

Prior to the time you testify, we received a letter from the chairman of the committee here, from Jim Williams, Assistant Secretary of Agriculture. I will just read a part of the letter into the record and submit the rest of it. I assume all of you are supporting his position this morning.

Mr. MOTES. Yes.

Senator STEWART [reading]:

This is in further response to your request of last April the 7th, for a report on S.770, to prohibit trading in potatoes futures on commodity exchanges.

The interim report of this bill was forwarded on July 2, 1979, and recommended that action on the bill be postponed until the study, then underway, was complete. The Department study is now complete. Its conclusions do not support the need for

⁵ We have attached a copy of that transcript in accordance with your request. (Retained in committee files.)

⁶ Any appreciable delay in the release of information to the State of Maine was due, in large part, to the Commission's attempt to ensure the privacy of individuals who submitted confidential information to the Commission.

a prohibition of futures trading in potatoes. As a result, the administration does not support the enactment of S.770.

I will submit the rest of it for the record.
[The letter follows:]

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, D.C., November 15, 1979.

HON. HERMAN E. TALMADGE,
Chairman, Committee on Agriculture, Nutrition, and Forestry,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in further response to your request of last April 2, for a report on S. 770, "To prohibit trading in potato futures on Commodity exchanges." An interim report of S. 770 was forwarded on July 2, 1979. It recommended that action on the bill be postponed until a study, then underway, was complete.

The bill specifically provides that no contract for the sale of potatoes for future delivery shall be made on, or subject to the rules of any board of trade in the United States. A penalty for any violation is provided.

The Department's study is now complete. Its conclusions do not support the need for a prohibition of futures trading in potatoes. As a result, the Administration does not support the enactment of S. 770.

The study concludes that while there are serious problems with the potato futures contract traded on the New York Mercantile Exchange, there is substantial evidence that these problems can be prevented or ameliorated by changes in the contract; by providing an optional method of settlement; and, by applying limits more widely on the size of individual positions held to maturity. A series of recommendations to effect these changes are presented in the Department's report entitled "Potato Futures Study," which has been made available to the Committee.

The two most serious problems identified in the study are the failure of cash and futures prices to move more closely together during the life of the contract and to converge at contract maturity, and the unusual volatility of futures prices during the period of trading when contracts are being closed out. However, the study found no adverse effect on the level of potato inventories held throughout the storage season in Maine. And, it concludes that although the Maine potato futures contract traded on the New York Mercantile Exchange is less useful for hedging purposes now than it was in the past, it is still useful, especially for longer-term hedging.

The study recommends all New York Mercantile Exchange contracts for round white potatoes be modified so that they permit delivery of potatoes from all states, provided that the potatoes meet the same grade and package requirement as Maine potatoes and that the spot prices for such potatoes normally move in close sympathy with the spot prices for Maine potatoes.

The study also recommends the consideration of a system of optional financial settlements to be provided for those who hold contracts but who do not wish to deliver or remove potatoes after the end of trading in a contract. It further recommends consideration of additional restrictions on all individual positions held to maturity. These changes would be expected to lead to better convergence of cash and future prices at contract maturity and would be expected to reduce basic risks and provide more stability to futures prices. They would be expected to significantly increase hedging potential.

Finally, the study concludes that gross abuses of futures—as exemplified by the May 1976 default experience—probably can be prevented by improving contract terms and settlements and, if need be, by imposing constraints on the size of individual positions held to maturity. Large-scale failures to make good delivery—as in March 1979—probably can be ameliorated also by changes in contract terms and settlements. With such changes, the round white contract would be expected to become a more viable instrument for risk management in the potato industry.

The Department defers to the Commodity Futures Trade Commission with regard to specific changes in trading rules; contracts; and limitations on speculative positions needed to make the potato futures contract more useful to hedgers. We have examined these issues from an economic viewpoint. That analysis found both significant problems and substantial evidence that potato futures trading fills an important economic function even now, and that the performance of the function could be significantly improved through changes such as those recommended. For these reasons, we do not support the enactment of S. 770.

The Office of Management and Budget advises that there is no objection to the presentation of this report from the standpoint of the Administration's program.

Sincerely,

JIM WILLIAMS.

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, D.C., July 2, 1979.

Hon. HERMAN E. TALMADGE,
Chairman, Committee on Agriculture, Nutrition, and Forestry,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your request of April 2, 1979, for a report on S. 770, "To prohibit trading in potato futures on commodity exchanges."

The Department recommends that action on the bill be postponed until a study we have underway is completed.

The bill specifically provides that no contract for the sale of potatoes for future delivery shall be made on or subject to the rules of any board of trade in the United States and provides a penalty for any person who violates provisions of the bill.

The Department has been directed by section 27 of the Futures Trading Act of 1978 to conduct a comprehensive study of the marketing of Irish potatoes and of the making and trading of contracts of sale for the future delivery of Irish potatoes. We expect to complete the study by October 1, 1979. Objectives of the study are to evaluate the usefulness of futures trading in Irish potatoes, including the rules and regulations and their modification pertaining to such trading issued by the Commodity Futures Trading Commission or any organized commodity exchange designated for such trading by the Commission.

Upon completion of the study, pertinent facts needed for consideration of this legislation will be available.

The Office of Management and Budget advise that there is no objection to the presentation of this report from the standpoint of the Administration's program.

Sincerely,

JIM WILLIAMS,
Acting Secretary.

Senator STEWART. You may proceed, Mr. Motes.

STATEMENT OF WILLIAM MOTES, ASSOCIATE DIRECTOR, FOOD, AGRICULTURE, AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY DR. ALLEN PAUL, AND DR. CANDACE KAHL, ECONOMICS, STATISTICS, AND COOPERATIVES SERVICE, USDA

Mr. MOTES. Mr. Chairman, my purpose today is to present the administration's views on S. 770 and to discuss with the committee a recent USDA study on potato futures trading. The authors of the study are here to answer any questions the committee may have. You have the study, and the staff has had a chance to study it. I do not want to dwell on the study at any length, but just mention a couple of highlights.

In carrying out the study, we found serious problems with potato futures contracts traded on the New York Mercantile Exchange. Two of the most serious are the failure of cash and futures prices to converge at contract maturity and the unusual volatility of futures prices during the period of trading when contracts are being closed out.

At the same time, we found no adverse effect on the level of potato inventories held throughout the storage season in Maine, and although the Maine potato futures contract traded on the New York Mercantile Exchange is less useful for hedging purposes now than it was in the past, it is still useful, especially for longer term hedging.

We believe that there is substantial evidence that these problems can be prevented or ameliorated by changes in the contracts, by providing an optional method of settlement, and by tightening the limits on the size of individual positions held to maturity.

Our study recommends that all New York Mercantile Exchange contracts for round white potatoes be modified so that they permit the delivery of potatoes from all States, provided that potatoes meet the same grade and package requirements as Maine potatoes and that spot prices for such potatoes normally move in close sympathy with the spot prices for Maine potatoes.

The study also recommends consideration of a system of optional financial settlements for those who hold contracts but who do not wish to receive or deliver potatoes after the end of the trading contract, and it recommends consideration of additional limits on all individual positions held to maturity. These changes would be expected to lead to better convergence of cash and futures prices at contract maturity and would be expected to reduce the basic risks and provide more stability to futures prices. They would be expected to increase hedging potential.

Finally, the study concludes that the gross abuses of futures, as exemplified by the May 1976 default experience, probably can be prevented by improving contract terms and settlements and, if need be, by imposing constraints on the size of individual positions held to maturity.

Large-scale failures to make good delivery, as in March 1979, probably can be ameliorated also by changes in contract terms and settlements. With such changes, the round white potato contract would be expected to become a more viable instrument for risk management in the potato industry.

The Department of Agriculture defers to the Commodity Futures Trading Commission with regard to specific changes in trading rules, contracts, and limitations on speculative positions needed to make the potato futures contract more useful to hedgers.

In summary, the Department has examined a number of issues and concerns about potato futures trading from an economic viewpoint. That analysis found both significant problems and strong evidence that potato futures trading fills an important function even now, and that the performance of the function could be significantly improved through changes such as those recommended in the USDA study.

As a result, we would prefer to see the contract and trading rules modified in an effort to deal with the problems, rather than a legislative prohibition on potato futures trading, such as contained in S. 770.

We would be happy to respond to any questions.

Senator STEWART. All right. Your report concludes that the potato market is less useful for hedging today than in the past. This is in line with the question that was asked by Senator Cohen from Maine, that there has been a decline in the yield in the market of hedges.

Would it also be your conclusion that if the New York Mercantile Exchange contract is broadened—which is one of the things Mr. Dunn indicated might happen—to permit the delivery of round

white potatoes grown in locations other than Maine, the hedging usefulness would be increased?

Dr. PAUL. That is right. I think that it would have a substantial increase. But it would probably have more effect on improving the usefulness of the March contract than it would have on improving the usefulness of the April and May contracts.

And it would improve the usefulness of all these contracts, in some years more than other years.

Senator STEWART. Would the contract place Maine—this is one of the questions Senator Cohen asked—would the expanded contract place Maine at a disadvantage in November and March contracts?

Dr. PAUL. I think I understand the import of the question. By providing for other origins to deliver their potatoes on the Maine contract, would that disadvantage the Maine grower and put him in competition with other areas? I do not think that this would be deleterious at all to the Maine grower. I think on balance, it would help improve his position, because the additional supply would make a better hedging market out of the market we now have, so that Maine growers and dealers who wish to hedge would be able to do so in a better way, with more precision than they now have.

Senator STEWART. In your report, it says that the continuation or elimination of futures trading could not produce a cure for the basic economic difficulties of the Maine potato sector. Could you expand on the basis for that statement?

Dr. PAUL. Well, futures trading does have important effects on the organization of any commodity sector in which it functions and on how enterprises are launched and who launches them and the way the enterprise is divided up. But it has far less effect on the basic conditions in a sector than the natural endowments, the weather, the geography, the available technologies, and a host of other things that determine economic opportunities and problems.

Senator STEWART. Well, are you saying there are other reasons for the difficulty that Maine is experiencing with their potato crops?

Dr. PAUL. Right. There are more fundamental reasons.

Senator STEWART. What are they?

Dr. PAUL. Well, Maine now produces an earlier maturing variety that is more attractive in many respects than some of the older varieties, but which does not store as well as the Katadins and the Kennebecs. So they have now a problem of how long they can store the potatoes from about 30 percent of their acreage now. That is one of the problems.

I am not a potato expert, but I understand there are new harvesting techniques that have a lot of advantages, but also that may bruise potatoes. The labor costs are high, but machine bruising has caused some problems in the appearance of potatoes later in the season.

Senator STEWART. You are saying that the quality of the potatoes for delivery at the end of the season might be hampered or harmed by harvesting mechanisms?

Dr. PAUL. That is my understanding.

Senator STEWART. And those might be some of the reasons for the difficulties of the Maine potato growers?

Dr. PAUL. Those are some of them; yes.

Senator STEWART. Would increased educational efforts result in better participation in the market by those people, such as hedgers, who are the potato producers, and would that net result be a desirable result if they participated more, in hedging in the market?

Dr. PAUL. Yes. I think the uses of futures markets seem to be seized by certain parts of the industry more than others. It is, after all, a fairly sophisticated and technical piece of machinery, just like an automobile, and you can get harmed by it, as well as helped.

So education is a real need. If there is an economic basis for the use of it—and there still is—why, education would help. It would help further if the hedging potential were improved, though.

Senator STEWART. You point to three characteristics of the potato futures markets in the seventies. You said the short-term hedging potential has deteriorated, which is again in line with a question that was asked by Senator Cohen; the importance of the small trader on the short side has declined; and open positions of the May contract have become even more dominant than before.

Can these three factors be changed, and if so, how? And I would add a question of my own, would that include the situation of the Maine potato grower?

Dr. PAUL. The short answer is it can be done—it is my belief it can be done—and it would help the Maine potato grower.

Senator STEWART. What would you do to change that?

Dr. PAUL. Well, I think the two positive ways to do it have been mentioned by previous witnesses. That is, to expand the number of States that can ship round white potatoes on the contract, so that there is a larger potential deliverable supply. This will help, as I indicated in answer to the first question, in some of the contract months, particularly March. It will help convergence of the cash and futures price toward maturity. And the second part of your question, would it help the small hedger, and be more attractive to him—I think it would because anything that gives more precision to hedging makes it easier for small people to get in without getting hurt, to get in and out.

However, the second thing that we propose, which requires further study, is the provision for optional financial settlements. This is a positive means of tying futures and cash together so they will converge. It would be, it seems to me, a large step toward completing the conditions that are required for improved hedging, and for attracting back the smaller hedgers.

The third part of the question, the volume of trading in the May contract—what was that again? Would it reduce it, how was that phrased?

Senator STEWART. It was said that open positions in May contracts would become even more dominant than before. Can those factors be changed?

Dr. PAUL. I am not sure that it would affect the volume, or how it would affect the volume, and whether it would be desirable to reduce the volume in the May contract.

It would be desirable to reduce the congestion toward the close in the May contract, as well as the March and the April contracts. And I think that if a workable financial settlement were installed,

it would reduce the gamesmanship that is inherent in the way the market works now. That is, people stay in to the last day and then try to get out.

Senator STEWART. And try to liquidate their positions.

Dr. PAUL. They try to liquidate their positions the last day. The figures show that for an extended period, that about 40 percent of the contracts at their highest period of use, are still open on the beginning of the last day. Now, that is very high, and higher than most markets I know of.

Senator STEWART. I have a question that might tie in with that. Is the greater lack of convergence—and this ties in with something that Senator Cohen wanted—is the greater lack of convergence of cash and futures prices during the last 2 weeks of trading in March, April, and May contracts due to traders holding rather than liquidating their positions?

Dr. PAUL. No. The lack of convergence as measured in the study leaves out the last day. It takes the 8 days prior to the last day, and this is an extended period in which you would expect there to be arbitrated between the cash and the futures—that is, if there were a profit in selling futures and delivering on it, some dealer would do it. And——

Senator STEWART. What does “arbitrated” mean?

Dr. PAUL. Well, in this case, I use the term to denote actions any dealer would take to buy cash or, if he has it on inventory——

Senator STEWART. I am going to be frank with you. I am having enough trouble with futures marketing, and you throw that kind of stuff at me——

Dr. PAUL. That is one of the difficulties of this subject. We fall into the use of short-hand expressions that not only have a clouded meaning, but they mean different things to different people—sometimes, they mean different things to the same person, I might add. [Laughter.]

Well, I simply meant there that convergence would occur in futures markets right up to the end, because there would be a profit for a dealer to simply sell futures, if the future was sufficiently above what he could get for the cash commodity he now has, so that he could cover his cost, plus his freight and any other cost, and still have a profit.

Therefore, futures should not go above cash by more than that amount. Normally functioning futures markets work that way. This market did work that way in the earlier periods. It has not worked that way since the early seventies.

There is something in the situation that prevents rational operators, dealers, from taking this profit opportunity. It just is not there, in their eyes. Therefore, you have no convergence, so that the question of whether too many speculators are causing it should be answered “No”. It is not that. If you could reduce the numbers of speculators in the market on the last day, the market still would not converge.

What you have to do is provide a larger supply of acceptable quality potatoes, then make them easily available——

Senator STEWART. Expand the contract?

Dr. PAUL. Expand the contract and perhaps provide for a financial settlement system.

Senator STEWART. Now, your suggestion of a cash settlement alternative to physical delivery to satisfy the contracts has been indicated by Senator Cohen and others, and is a very interesting proposal, and is apparently not being studied now by the CFTC, but it might in the future.

Do you have any feeling as to whether such an alternative will increase the interest and activity of speculators in the marketplace?

Dr. PAUL. I think the central thing it would do is remove some of the gamesmanship toward the end of the contracts, so that the character of speculation would change, and there would be more of an opportunity for those people who base their speculative decisions on fundamentals to operate toward the end. This would include—I will use the term “spreaders”—those people who will spread between one month and another, because when prices are more precise and converge, these people can predict more closely what prices ought to be and the price relationships. And perhaps more of those types will be in the market, and fewer people who are in there simply because there is going to be something happening the last day—even though they are not quite sure what. It will reduce the gamesmanship and take out of the market, I think, the kind of speculation that is undesirable.

Senator STEWART. Would it be fair to say that you have concluded that changes such as expanding the pool of potatoes that may be delivered against the contract is necessary and that if such changes are not made, that trading in this particular contract will be terminated by the New York Exchange? Would that be a fair statement?

Dr. PAUL. Well, if no changes are made, I would suppose the futures trading in potatoes will go the way of many commodities; it will just die from disuse. I do not know how long it will take, but it will.

Senator STEWART. Would that be good or bad for the potato growers and producers?

Dr. PAUL. Well, if there is no use for it, by definition it is good. If there is a potential use for it, and we do not take steps to seize the opportunity to change things, then it is my conclusion that it would be bad. I would add parenthetically that the operation of futures we see today did not come full-blown on the scene 100 years ago when it first started. It was an evolutionary process, and some of the things that we take for granted today, like the clearinghouse which is the core of the system, which guarantees contracts, this sort of thing was not around before futures trading was well underway, for half of its life. It evolved over a 20- or 30-year period.

Senator STEWART. What you are basically saying is that the marketplace will make a decision in connection with the potato futures, and it would be your opinion that that marketplace, rather than Congress, should make the decision?

Dr. PAUL. Yes, that is my opinion. I think the marketplace will take care of these things if they are not useful.

Senator STEWART. Do you have any other comments?

Mr. MOTES. No.

Senator STEWART. I have a couple of other questions that were asked by the Senator from Maine, but we have other witnesses. I

will submit those, and you can answer them for the record for his benefit. I appreciate it, and we will supply you with a copy of those.

Thank you for being here today.

Mr. MOTES. Dr. Paul will remain here, if other witnesses bring up other points that you would like to have him comment on.

Senator STEWART. Thank you.

[Questions asked by Senator Cohen of Allen B. Paul and answers thereto:]

Question 1. Why have the benefits to hedgers decreased in the past decade? Do you see the expanded contract as a realistic remedy to this situation?

Answer. The usefulness of potato futures for hedging depends on the close movement of cash and futures prices over time, and on their convergence at contract maturity. This has not happened in the 1970's as well as it did in the 1960's primarily because of the marked decrease in supplies of Maine grown potatoes deliverable on futures and the uncertainty of whether potatoes grading U.S. No. 1 in Maine would meet reinspection requirements in New York City. In addition to the reduction in total storage stocks, the trend toward early maturing varieties with poor keeping qualities, new harvesting methods, as well as other factors underlay the uncertainty regarding reinspections.

The proposed 15-state contract would broaden the deliverable supplies significantly and therefore would be a realistic improvement. The improvement would come mostly from making larger supplies readily available for delivery on the November and March contracts, and to a lesser extent on the April and May contracts. After March, potatoes from states such as Michigan, Wisconsin, North Dakota, and Minnesota normally do not move to New York City. (see table 34, p. 135, Potatoes Futures Study). Such stocks supply the needs of nearer terminal markets and would move to New York City only if a higher price were paid to attract them. This required price premium would constitute the squeeze potential on the NYME proposal, but it would be a smaller squeeze potential than exists in the present Maine-only contract. On these grounds, the proposal is a good one.

But there is another ground to question the proposal as a realistic remedy for the deteriorated hedging potential. It contains a provision (Exhibit B, pp. 24-27) that permits the seller who delivers potatoes that fail reinspection to require the buyer to take delivery f.o.b. shipping point, (freight allowed to N.Y.C.) with the inspection final at a 2½ percent discount. Presumably, the rationale for this modest price concession is that inspection standards would be tightened to the point where potatoes that passed this inspection in Maine or any other state would be fairly certain to pass the reinspection standards at the Hunts Point Market in New York City. But if this were so, why not allow for reinspection in New York City? (Incidentally, if tightening shipping point inspection standards removed most of the quality uncertainty from the buyer's mind, the chief block against moving to a par delivery, f.o.b. Maine contract will have been met. This would have a greater potential for augmenting deliverable supplies than the 15-state proposal based on delivery in N.Y.C.).

If the replacement provision does not adequately compensate buyers, they would enter an uncertainty discount into the price of futures, which may keep cash and futures prices from converging and may keep prices from moving in close sympathy with one another. But whether hedging potentials would be any less than now is hard to say.

Question 2. What transportation and delivery problems do you anticipate in midwestern states delivering to eastern terminal markets as specified by the NYME contract?

Answer. The proposed contract calls for par delivery in N.Y.C. by truck or rail at the seller's option. This in itself should cause no unusual problems. However, as noted in the answer to question 1, it ordinarily would be in a midwest producer's or dealer's best interest in late spring to sell potatoes locally and remove his hedge by offset rather than deliver potatoes into N.Y.C. to satisfy his short position. Only in the case of a long squeeze is it likely to be cheaper for him to deliver to satisfy his short futures position.

Question 3. How will the expanded contract affect the Maine cash price and what effects, if any, does trading have on present Maine cash prices?

Answer. The use of a contract that would augment the deliverable supply probably would have no appreciable effect on the level of Maine cash prices. Trading in the present contract appears to have no discernible effect in raising or lowering the current level of cash prices for Maine potatoes. Our study shows that annual

changes in tablestock potato prices in Maine (which has an active futures market) and Washington (representative of western states which do not have an active futures market) can be explained equally by fundamental changes in production and demand (pp. 13-20).

Question 4. Will the expanded contract place Maine at a disadvantage in November and March contracts?

Answer. No. If futures trading in potatoes were functioning properly (cash and futures prices move together throughout the life of the contract and converge at maturity), it is immaterial whether all or part of the total supply is deliverable because there would be no disadvantage by offsetting rather than delivering on a futures contract. Consequently, a contract allowing delivery of round white potatoes from fifteen states would not adversely affect Maine in the November and March contracts. If broadening the contract improves the precision of hedging, the Maine potato industry as a whole should gain rather than lose. Only those firms or individuals now capable of squeezing the futures market because of their relative control over Maine stocks would be adversely affected.

Question 5. How will the industry function in the absence of futures? Are there mechanisms which will replace futures in price formation and in bargaining with buyers and processors?

Answer. A viable futures market widens the opportunities for many firms to price products in advance of needing them as inputs or of disposing of them as outputs. The failure to have such futures trading would raise the cost of entering into and completing forward pricing agreements. This would reduce the scope of planning by the firm and raise the cost of doing business. In particular, it would deprive firms of an efficient method for reducing their exposure to the hazards of adverse changes in potato prices and interfere with enlargement and modernization of operations through attraction of outside capital on more favorable terms. Over the years, the loss of a viable futures market would influence who could survive. Presumably, it would give an advantage to those with strongest net worths and/or the most diversified enterprises.

In day-to-day bargaining over the price of potatoes, the presence of a viable futures market makes explicit the going price of potatoes for immediate and forward delivery. In the absence of futures, the larger firms would have the best access to market information by virtue of their being continuously in contact with different buyers. The smaller firms would find it costly and time-consuming to canvass the market and may have to rely on price information of a few local dealers.

Conceivably in the absence of futures, producers in a region could reduce their exposure to price declines by controlling market supplies through group action. But the scope for control would seem to be quite limited in view of the potentials for greater potato production and refrigerated storage outside of Maine. This eventually would erode any initial price advantage that could be obtained by controlling Maine potato supplies.

Senator STEWART. Stewart Smith, commissioner of agriculture, State of Maine.

STATEMENT OF STEWART SMITH, COMMISSIONER OF AGRICULTURE, STATE OF MAINE

Mr. SMITH. Mr. Chairman, I would paraphrase my remarks, which I will submit for the record.¹

Senator STEWART. Thank you. They will be made a part of the record

Mr. SMITH. I am Stewart Smith, commissioner of agriculture of the State of Maine. My background is primarily in potatoes. I was a farmer for 18 years, having used the futures market as a producer, as a potato dealer. My professional training is in agricultural economics. I was with the USDA until June 1, at which time I went to Maine and became commissioner of agriculture.

I am here today on behalf of the State, in support of S. 770. I base that support, Mr. Chairman, primarily on two questions. One is, Is potato futures trading in general beneficial to the potato industry? The second question is, Have the specific contracts and

¹ See p. 110 for the prepared statement of Mr. Smith.

contracts markets that have been used in the past been of benefit to the potato industry? I think on both of these questions, the answer is "No, they have not," and therefore, one could come to the conclusion that abolition of futures trading would be beneficial to the general public.

The first question, Is futures trading in general beneficial to the industry? is a question that really has not been addressed, and I was disheartened that Dr. Paul did not address that issue in his study.

Most economists simply look at price relationships and market impact and analyze what impact that has on users. The question of what the existence of a futures market in general has on nonusers or the industry in general has not been asked.

I would suggest that in the State of Maine, that impact has been quite negative. One of the problems we have in the industry—and Dr. Paul outlines several problems—but one of the problems we have had in the industry is that producers do not commit their potatoes to a market agent. And one of the reasons that this commitment is not made is because there is a futures market in existence, and even though the producer does not use that to hedge his own volume, he does other things that prohibit him from developing good market practices.

We are proposing an alternative market system in the State of Maine, and in fact, on December 20, we will start a series of hearings in which we propose a system which allows for establishing prices without using the futures market. Mrs. Kelley, from the Maine Potato Council, will speak to that, I think, in more detail a little later. But the Department of Agriculture is working with the Maine Potato Council in developing this alternative system.

The other general reason why futures markets impact nonusers is because of the dealer system we have in the State, the people who handle potatoes. When they are in a short position, they are inherently in a position adverse to the good of the producers who are supposed to be selling potatoes for them.

It would be naive to think that dealers who have a short position might want to influence the market in a downward direction. Obviously, this is adverse to the good of the producers whom they are supposed to be selling the potatoes for.

There is a conflict of interest and a conflict of responsibilities with respect to those dealers, and just the fact that they are dealing in futures and in the cash markets does have an adverse impact on the industry.

If one concludes that just the existence of the futures market does have this adverse impact on the industry, as farmers in the State of Maine believe, I would hope that Congress would see fit not to let the marketplace run the course, but in fact, to abolish the futures trading so that we do not have to allow this slow death.

Turning to the second question, even if we conclude that futures markets in general can be beneficial—and I do not think that case can be made clearly—but even if you could make that case, I think you have to ask a second question, and that is, Whether this particular futures contract in this particular market has been adverse to the Maine potato industry? And the answer to that clearly is "Yes," for four reasons.

First of all is the apparent inability of the New York Mercantile Exchange to operate in a manner which allows legitimate hedgers to use the contract for insurance.

Second is the demonstrated inability of the New York Mercantile Exchange's board of governors and of the Commodity Futures Trading Commission to prevent manipulation.

Third is the unwillingness and/or inability of the New York Mercantile Exchange and/or the Commodity Futures Trading Commission to respond to the concerns and needs of the potato industry.

And fourth is the fact that very few Maine farmers actually use the New York Mercantile Exchange's potato futures contract.

Now, these problems are serious. They have harmed the potato industry. And they alone are enough, I think, to argue for the case for abolition of futures trading.

First of all, we have already heard from Dr. Paul that hedges cannot now, under this existing contract and this existing market, successfully hedge potatoes. The price convergence problem, we have heard about, and we do not have to recite that.

Extreme price fluctuations, especially in the late-month contracts, are known, they are real, and they have prevented the farmers from using that market as a hedging vehicle.

The second question is that it appears that the exchange has not been able to control manipulation. We have heard of the 1976 problem, the 1979 suspension, and there appears to be in the CFTC a record of their meetings after that suspension concerning whether CFTC, that there were some price manipulations involved with that action that surrounded the 1979 suspension.

The third problem is one of lack of accountability, and I think this is a very real problem. Obviously, one of the criteria for establishing a futures market, they have to meet the criteria of accountability. The New York Mercantile Exchange has not met that criterion, I do not believe. It was obvious in the hearings in Presque Isle, Maine, after the suspension in 1979—I believe Mr. Michel Marks, who was speaking for the New York Merc at the time, was asked whether or not they consulted the Maine potato industry in that decision, and if they used their own potato committee, which they have for advisory purposes, and he replied, I assume, that he did not use them, because he did not even know the names of that potato committee. It is obvious that they do not consult with the potato industry, except possibly with their own employee, Mr. Peter Johnson, in that particular case.

They also have, as you undoubtedly know, immunity from legal actions by private individuals, and I believe that is also a serious problem in accountability. In the *National Super-Spuds v. New York Mercantile Exchange*, our case, the court ruled that private individuals could not sue the New York Mercantile Exchange; we have a current case now before the New York Mercantile Exchange with respect to that suspension.

The CFTC is supposed to represent the public with respect to how the New York Mercantile Exchange operates, and I would suggest that as you look at the record of the CFTC meetings as we have, surrounding that action by the New York Mercantile Exchange, you have to wonder who the CFTC is representing, wheth-

er it is the public and the interests in the potato industry, or whether it is, in this case, the New York Mercantile Exchange.

The fourth question is self-evident, and that is that the New York Mercantile Exchange, the contract now is not generally available for hedging for insurance purposes. And if that contract cannot be used for hedging purposes, then I would suggest that it is of not much benefit to the potato industry or anyone in general.

In fact, not many farmers in the State use the futures market for hedging purposes. One of the reasons is the financing of the margins. About 40 percent of the crop in Maine is financed by Farmers Home Administration, and they do not finance margins.

Until a few years ago, they did subordinate their interest in the crop so that the private institutions could provide that financing; they no longer do that, so about 40 percent of the crop is precluded from using a futures market, even if the exchange's contract were valid.

Other financial institutions in the State have stopped financing contracts because of the 1979 suspension.

In summary, I would say that the majority of farmers cannot use the New York Mercantile Exchange for hedging. The fact is that the New York Mercantile Exchange has proven absolutely unreliable, even for those farmers who do. I think it is clear that this committee should refuse to allow the contract to continue.

Even if that contract could be approved, even if it could be made valid, and even if it could be administered properly which it has not been in the past, there is grave doubt that a sound futures market would be advantageous to the potato industry, simply because it inhibits the potato industry from establishing a better market mechanism, whereby producers will commit their crop to a sales agent who has the responsibility for selling that to the best advantage of the producer. That would not happen until the futures market is opposed.

Senator STEWART. Thank you very much for your statement. If you will remain there, I want to get to our next witness, and then we will get back to you for questions.

Our next witness is Senator Ed Muskie, from Maine. I would say that he was not here earlier because he was waging a battle for Maine on the floor of the Senate.

It is my honor to have you here with us this morning, and I look forward to hearing from you.

STATEMENT OF HON. EDMUND S. MUSKIE, A U.S. SENATOR FROM MAINE

Senator MUSKIE. Thank you, Mr. Chairman. I apologize for not being here earlier, primarily because what I have to say is not as relevant, probably, as these witnesses who are more knowledgeable about the technicalities of the market and its impact on producers than I am; but second, because I have not listened to the testimony this morning, I do not have to worry about whether I am repetitious or irrelevant. I will just say what I have on my mind.

I was anxious to be here in order to make it clear to you, Mr. Chairman, and members of the committee, my very strong support for the position taken by Maine Agriculture Commissioner, Stewart

Smith and other people from my home State, and Aroostook County who are here, to testify in behalf of this legislation.

So Mr. Chairman, I would like to thank you and the other members of the committee for your willingness to hold a hearing on S. 770, this morning. We have had other hearings in previous years. The results have been disappointing. I hope that at long last, given the excellent case that Stewart Smith has made and that others from Maine will make, as well as Senator Church and people from Idaho, that finally we may be able to get a positive result out of these hearings and this legislation.

Today's hearing provides the people of Maine and elsewhere around the country an opportunity to present their views on the futures trading of potatoes. For the past several years, I have joined Senator Church in sponsoring this legislation. I have done so because Maine farmers have said for years that futures trading has been subject to manipulation and has created a market which does not accurately reflect actual supply and demand.

These suspicions are not unfounded. I can recite a litany of problems which have occurred over the past few years. For example, there was manipulation of the price of the May 1971 potato futures on the Chicago Mercantile Exchange; in May 1976, a major default occurred on the New York Mercantile Exchange; serious violations of the exchange's rules, as well as the violations of the Commodity Exchange Act occurred. As a result, the Commodity Futures Trading Commission had to suspend several individuals from trading.

Of course, the individual that had to absorb the economic loss was the Maine producer. The result was severe economic loss to the growers in Aroostook County. And most recently, in March of this year, the New York Mercantile Exchange's board of governors suspended trading in the April and May potato futures contract. Without question, this unprecedented halt in trading had a tremendous adverse impact on the Maine potato industry. In addition to incurring substantial losses, the industry's cherished reputation as one of the Nation's leading producers of quality potatoes was tarnished by this latest difficulty with the potato futures contract.

Equally discouraging has been the severe economic difficulties the farmers face as a result of extremely low prices on the cash market. Combined, these factors have persuaded the majority of farmers that futures trading does not serve their best interests and that other market systems must be considered.

The farmers have stated their wishes by resolution through the National Potato Council and the Maine Potato Council, that abolition of futures trading is in the best interest of the potato producers and the entire potato industry.

I am sure that testimony given before I arrived today and later will detail the overwhelming votes and referendums over the years which have shown that Maine potato farmers do not favor the trading of their commodity on the New York Mercantile Exchange.

Last year, a referendum was conducted by the Maine Potato Council, which resulted in an almost 4½-to-1 vote against trading. I want to stress that this referendum was conducted prior to the New York Mercantile Exchange's action to suspend trading in March.

Mr. Chairman, I sincerely hope this legislation will be considered on its merits and that our attention will focus on the futures trading of potatoes and not other commodities.

I know it has been a fear of representatives of other commodities that a ban on the trading of potatoes could endanger all exchange trading of futures. That is not my intention.

Rather, I believe that a well-run futures market can provide a valuable service to many industries. However, a perishable commodity such as the Maine potato cannot afford to be manipulated or subject to a situation where it has no control of its own market.

In closing, I would only add that given the performance of past potato future contracts on the New York Mercantile Exchange, coupled with an overwhelming desire by the potato growers in my State and elsewhere, that futures trading be eliminated and that S. 770 be favorably considered by this committee.

That is the end of my statement, Mr. Chairman. I have a few minutes to listen to your questions and to Commissioner Smith's answers, because I always welcome an opportunity to learn more about this subject, on which I have such firm convictions.

Senator STEWART. Thank you for your statement. We appreciate you being here today, and I will assure you that this particular piece of legislation will receive a fair and equitable hearing, and we will make it plain to the other Members of the Senate that we are only considering potato futures.

Senator MUSKIE. Thank you, Mr. Chairman.

Senator STEWART. You state that one of the reasons for the decline of the Maine potato industry is the unwillingness of the producers to commit in advance their crop to a sales agency. Why or how would this unwillingness be removed by banning potato futures trading?

Mr. SMITH. The mere existence of a futures price, Mr. Chairman, which is higher than the existing cash price is kind of an elusive promise that that is always there for the potato producer. And I think that he acts on that, he does not commit his crop, because of that promise at the end of the rainbow.

Now, some people argue that that is not a rational economic decision on the part of the producer, and I guess I would agree that that is probably true. But farmers do not operate as the perfect economic man, like the economists would like to think, and when we do our analyses, I think we should put them in their proper political and social context, and not just assume they are going to be perfect economic decisionmakers all the time.

They look at that price; it is there. And because of that, they do not make a commitment of their product that they should.

Senator STEWART. What is the evidence that the existence of futures trading and the decline of the industry are related?

Mr. SMITH. I do not think that there has been a study done on the impact of the futures market on nonusers as I have described earlier. That is my hypothesis. It has never been tested. But the very fact that for 20 years, the Maine potato industry has been in a decline, it seems obvious to me that the marketing system we have and the production system we have obviously have some problems with them, or this decline would not have happened.

One of the important aspects of that marketing system is the futures market. It cannot clearly be demonstrated that that futures market does not affect the market structure and therefore a decline of the industry. I guess I would argue, then, since that cannot be determined, we have headed for 20 years, and it is time to try a market system without the futures market.

Senator STEWART. What is the share of the Maine potato market today?

Mr. SMITH. Seven percent.

Senator STEWART. What was it prior—let us say 10 years ago, what was it?

Mr. SMITH. Twenty years ago, it was 15 percent. Ten years ago, it was somewhere in there.

Senator STEWART. Well, what has caused that decline? Are you saying that it is related—I am asking for my personal information; I want to know what has caused that decline?

Mr. SMITH. A shift in production in the Northwest; a shift to processed potatoes, french-fried potatoes, which is served probably better by the potatoes grown in the Northwest; cultural practices in the State of Maine, and the marketing structure in the State of Maine.

The State of Maine has a unique market structure. The people who sell our potatoes are not brokers who represent the interests of the potato producer or the potato packer. The people who sell the potatoes in Maine are dealers, who sell into the marketplace and then consequently purchase from packers or producers. They have an inherent interest to buy as low as they can and to sell as high as they can.

Senator STEWART. All right. Now, even if we accept your analysis that a ban on futures trading would increase the direct marketing of Maine potatoes, wouldn't there be a use of futures trading by the purchasers of the potatoes? Wouldn't that occur?

Mr. SMITH. Certainly, purchasers could use a well-run futures contract for hedging purposes. I do not argue that there are not some benefits—

Senator STEWART. Well, couldn't the producers do the same thing?

Mr. SMITH. Some producers do use the futures contract to advantage. The question is, however, Does that futures contract, by its mere existence, have an impact upon those who do not use it? Which are the vast majority of producers. I think the answer to that is it does have a disadvantage to them.

I do not argue that some producers and some dealers do not use the futures contract rather successfully; they do.

Senator STEWART. You state that very few Maine farmers actually use the New York Mercantile Exchange's potato futures contract; you made that statement in your written statement.

Yet, a July 10, 1978, study, conducted by the Social Science Research Institute, University of Maine, concluded that approximately two-thirds of all the potato growers in Maine, 68 percent, traded potato futures at one time or another. And this 68 percent planted 83 percent of all the Maine potato acreage in 1977.

Now, how do you explain this contradiction?

Mr. SMITH. The majority—

Senator STEWART. First, let me ask you, to be totally fair, do you accept the results of the study?

Mr. SMITH. Yes, I do. The majority of those contracts were not for hedging purposes. They were for speculative purposes, and they did not cover, of course, anywhere near the total volume that those producers were producing. And if that study were done today, after the 1979 suspension, those figures would be much lower.

Senator STEWART. Where did you get your figure that 40 percent of the crop was financed by the Farmers Home?

Mr. SMITH. From the State Director of the Farmers Home Administration in the State of Maine.

Senator STEWART. And so that does not allow those people who are financing that to actually hedge, in other words, if they cannot meet the margin calls.

Mr. SMITH. Basically. Some of those farmers, I assume, find other means of financing their hedge, but the vast majority of them, that other financing is not available.

Senator STEWART. Well, it is my information—and this is from staff, and I do not know that it is correct or incorrect—but it is my information that some, or the majority of the financial institutions that do finance the production of potatoes require hedging. Is that correct?

Mr. SMITH. Prior to the suspension in 1979, I would say that probably is correct.

Senator STEWART. Prior to the suspension in 1979.

Mr. SMITH. Yes. I believe that would not be correct today. There has been a vast change in the industry because of that suspension.

Senator STEWART. You apparently feel that the CFTC—and this is something that concerns me as a member of the Agriculture Committee—represents the New York Mercantile Exchange and not the potato producer in Maine; is that your opinion, and does that pretty well express the ideas and the attitudes? That concerns me.

Mr. SMITH. That concerns me, as we look at the transcripts. Incidentally, we had to sue to get the transcripts, through the Freedom of Information Act, of the CFTC, both prior to and after the suspension—

Senator STEWART. You mean you had to sue to see what action they took?

Mr. SMITH. We had to sue to get the transcripts of their discussions of what actions they would take with respect to the New York Mercantile Exchange. We did get the transcript—

Senator STEWART. What was the basis of their refusing to allow you to have the information?

Mr. SMITH. I do not have my counsel here, and I am not sure of the legal reasons.

Senator STEWART. Could you tell us, Mr. Dunn?

Mr. DUNN. I just asked the representative of our general counsel exactly what it was—

Senator STEWART. Well, who is he? Is he here?

Mr. CONNOLLY. Yes.

Senator STEWART. Introduce yourself, please.

Mr. CONNOLLY. My name is John Connolly, with the general counsel's office. The information that the commissioner of agricul-

ture references was supplied to the State of Maine under the Freedom of Information Act, not because of a lawsuit.

The State of Maine thereafter brought a reverse FOIA lawsuit, because there was certain material that we could not release by law.

Senator STEWART. Well, what is that material that you cannot release by law?

Mr. CONNOLLY. Well, that would be what we call section 8 material. It would contain names and positions of people in the market at that particular point in time.

Mr. DUNN. Confidential information on individual positions.

Senator STEWART. In the marketplace.

Mr. DUNN. Yes.

Senator STEWART. Well, did that involve any of the people who were suspended for any period of time; any of the people against whom disciplinary action was taken?

Mr. CONNOLLY. There have been no actions taken as a result of that suspension.

Senator STEWART. I am thinking of the 1976.

Mr. CONNOLLY. He is speaking to the 1979 emergency.

Senator STEWART. So there was no action taken against anyone in the marketplace as a result of the activities——

Mr. CONNOLLY. Not to this time

Senator STEWART. Is any contemplated—or is that fair to ask? Can you release that information?

Mr. CONNOLLY. Well, it is my understanding that there is an investigation, but no proceedings have been formally instituted at this point.

Mr. SMITH. I am not an attorney, and I do not know all the legal jargon and so forth——

Senator STEWART. Well, I am, but I never did any work in that area.

Mr. SMITH. So I do not know whether we brought a suit or not, but I do know that the information that was referred to was supplied to the State of Maine after our attorney met in some courtroom before some judge, and then that information was released. That may not be——

Senator STEWART. He is indicating that that is under the Freedom of Information Act, but apparently, they had to go to court to get it.

Mr. CONNOLLY. No. Again, that is not an accurate statement, Senator. I would say that perhaps 95 percent of the information that the State of Maine received was pursuant to their Freedom of Information Act request. Thereafter, they filed an FOIA lawsuit, trying to get primarily section 8 material, and we did release some more material.

Senator STEWART. What was it that you released, that 5 percent?

Mr. CONNOLLY. We released all the Commission records concerning the emergency action except——

Senator STEWART. And did you hold that information?

Mr. CONNOLLY. We withheld that information on the positions of people in the marketplace at that time.

Senator STEWART. I understand the positions of the people in the marketplace. But you withheld certain information from them that you ultimately delivered to them as a result of court action?

Mr. CONNOLLY. There were a few pages of documents provided.

Senator STEWART. What were those few pages of documents?

Mr. CONNOLLY. Those were materials that the Commission could have withheld under the Freedom of Information Act.

Senator STEWART. What did they consist of?

Mr. CONNOLLY. They consisted of confidential discussions between Commission staff and Commissioners at closed Commission meetings.

Senator MUSKIE. I am curious about that.

Senator STEWART. So am I.

Senator MUSKIE. Very curious. It seems to me that from what you have said that the tendency of the Commission is to withhold information unless you are clearly required to.

What is there in discussions between staff and Commissioners—and I deal with staff, and such discussions are intended to influence here the decisions reached by Senators—so I assume those discussions are intended to influence the decisions made by Commissioners. Why isn't that kind of discussion relevant enough to the concerns of producers that it ought to be released, without the pressures that can be generated by the Freedom of Information Act? And what do you mean when you say that you released information under the Freedom of Information Act before suit was brought? The Freedom of Information Act is not self-executed, so in what way did you release information under the Freedom of Information Act before suit was brought?

Mr. CONNOLLY. There was a request made by the State of Maine under the Freedom of Information Act.

Senator MUSKIE. Exactly. So that even though they had not actually gone to court, if the Freedom of Information Act had not existed, you would not have released that information. Am I correct?

Mr. CONNOLLY. I do not know whether or not that would be accurate.

Senator MUSKIE. Well, I am drawing that conclusion on the basis of your statement. You said because the State of Maine requested this information under the Freedom of Information Act, you released it. The implication is that if the Freedom of Information Act had not existed, you would not have released it, even though the State had requested it—or did you intend to convey that impression?

Mr. CONNOLLY. I think the Commission is of the view, Senator, that all materials that we can release are generally released to the public. The only materials we withhold are generally those materials that we are required by law to withhold, or materials such as discussions between Commissioners and staff people that reflect a possible enforcement proceeding.

Senator MUSKIE. Well, as I understand what you have said, there are three categories of information involved in this matter: (1) that involving the status of individuals; (2) discussions between Commissioners and staff and (3) some other information, which you said

you released because the State of Maine made the request under the Freedom of Information Act.

Now, I am interested in that category of information, as well as the second one, but that one particularly, because you do not suggest that that information was such that it should have been denied in any case. The indication here is that that information should have been freely available without restraint or inhibition, to the State of Maine, but that you did not release even that, except that it was required under the Freedom of Information Act. Am I right? You said it. I am not throwing the accusation at you; you said it.

Mr. CONNOLLY. Well, that is difficult to respond to. I—

Senator MUSKIE. Well, why is it difficult to respond to? It was not difficult for you to make the statement.

Mr. DUNN. The only request they made, as I understand it, was under the Freedom of Information Act.

Mr. CONNOLLY. That was the only request we received. We have a provision—

Senator MUSKIE. But why was it necessary for them to resort to the Freedom of Information Act?

Mr. CONNOLLY. Mr. Senator, I do not think it would have been necessary. We have a provision under our act that provides that the Commission should cooperate with the various State and Federal agencies, for instance. If the State of Maine had come to the Commission as a sovereign State and requested this information, they would have received all the information they received, probably, under the FOIA. But they chose to use the FOIA instead.

Senator MUSKIE. Well, I can understand why, because over the years that I have been exposed to this issue, the Commission has not been all that forthcoming. Whether or not they were in this case, I am trying to elicit from you. But you in your statement said that you responded because the request was made under the Freedom of Information Act, and I suspect that was an accurate statement, from which you are now trying to retreat. That is my impression.

Senator STEWART. Could I have a copy of the information, on that 5 percent of the information that you provided—

Senator MUSKIE. Mr. Chairman, could I ask another question? I understand that the State attorney general's department requested this information several times before the request was made under the Freedom of Information Act. Do you deny that?

Mr. CONNOLLY. That is not my understanding.

Senator MUSKIE. Well, we can run that down, so you had better be careful about your answer to it.

Mr. CONNOLLY. Well, from my own personal knowledge and information, that is not my understanding.

Senator MUSKIE. Well, we will check that one out.

Senator STEWART. It was my understanding—and let me clarify this, because I do not want to misstate, but let me clarify this. My understanding is that you gave them certain information, and then they had to get other information, which you later released to them as a result of court action. Is that correct?

Mr. DUNN. Yes, Senator.

Mr. CONNOLLY. Yes, it is, Senator.

Senator STEWART. All right. I want that separate information. I want copies of it.¹

Thank you. That is all the questions I have.

Mr. SMITH. Thank you, Mr. Chairman.

Senator STEWART. Our next witness is Michel Marks, Chairman of the Board of Governors, New York Mercantile Exchange. Please proceed, gentlemen.

STATEMENT OF MICHEL MARKS, CHAIRMAN, BOARD OF GOVERNORS, NEW YORK MERCANTILE EXCHANGE, ACCOMPANIED BY HOWARD GABLER, ACTING PRESIDENT, NEW YORK MERCANTILE EXCHANGE

Mr. MARKS. My name is Michel Marks.² I am chairman of the board of governors of the New York Mercantile Exchange. I am accompanied by Howard Gabler, who is acting president of the exchange.

We thank the chairman for this opportunity to discuss S. 770.

For well over a century, the New York Mercantile Exchange has served the agricultural, industrial, marketing, and investment communities by maintaining a futures market for commodities.

The exchange itself does not participate in trading. Its function is only to provide the physical marketplace and to ensure that the trading process is open, fair, and orderly.

Potatoes are one of the products traded on the exchange.

The purpose of futures trading itself is well documented. Price risk is a reality of the free market, and futures enable growers, shippers, and merchants to reduce that risk. Yet, despite the evidence pointing to these benefits, there have been repeated attempts to ban potato futures. Various charges have been made and opinion polls, although of doubtful objectivity, have shown antimarket sentiments, based upon the belief that speculators are undermining prices and that if the futures market did not exist, prices would be higher.

Representatives of potato associations have cast the blame for the economic ills of the industry on futures trading. However, there are clear indications that the problems of the potato industry originated elsewhere.

The call for banning of a free market institution is a serious matter. I would like to briefly consider some major evidence.

First: Argument—Maine's competitive position in the potato industry has declined due primarily to the existence of the futures market.

Although the Maine potato industry has suffered setbacks in recent years, futures trading has not been the cause. A recent USDA study clearly indicates that increased output of the other major producing regions, due to population shifts, different growing conditions, and the production of preferred potato varieties have largely contributed to the problems faced by the Maine industry.

Despite this, the average price received by Maine farmers compares favorably with the U.S. average.

Second: Few growers hedge on the futures market, and those who do are often unsuccessful.

¹ See p. 16.

² See p. 114 for the prepared statement of Mr. Marks.

The futures market is used by many small- and medium-sized farmers, as well as by large commercial growers. A 1978 survey by the University of Maine confirms that 68 percent of Maine's farmers have used futures.

Further, the Commodity Futures Trading Commission commitment of trader reports reflect substantial use by hedgers. Many growers use the market indirectly through dealers and financing institutions. Their creditors then protect themselves by hedging in the futures market. Without the protection of the futures market, such sales and credit would either be unavailable or much more expensive to the growers.

Third: Perishable commodities like potatoes are unsuited to futures trading.

No proof has been presented. On the contrary, the anticipatory pricing and hedging functions of a futures market may be even more important for a perishable than for a nonperishable commodity, because existing supplies must be rationed to, but not beyond, the end of the marketing year.

Fourth: Futures trading causes disorderly marketing, as growers are persuaded to hold their crop for spring.

The futures market did not establish the potato marketing season, but rather, adapted to it. Maine has the ability due to its geographic location to hold potatoes longer into spring than some of its competitors and thus can take advantage of seasonal price rises which often occur in the spring.

However, arguments that Maine growers are holding increasingly greater numbers of potatoes into spring are not warranted. Maine marketings are being conducted on an orderly basis and the percentage of marketings in the late spring months has actually been declining.

Fifth: Speculators cause erratic and unwarranted price movements making it impossible to hedge potatoes.

Potato prices are volatile as a result of the inherent nature of the potato market. The potato industry has long been plagued by the classical boom-or-bust price-production response cycle: Low prices cause less acreage to be planted, which in turn causes a short crop and high prices, encouraging increased acreage which brings a surplus crop and low prices. For these reasons, potatoes have always been an uncertain source of income.

The futures market only mirrors the volatility of the underlying cash market. Price volatility is really being confused with price visibility.

Sixth: The potato futures market is populated by gamblers who know nothing about the potato industry.

A gambler assumes an artificial risk created for his amusement, whereas a speculator assumes a naturally existing economic risk and attempts to reduce that risk by making reasoned forecasts of conditions in the future. Speculators in the potato market provide a liquid market in which hedges can be placed at profitable prices.

Seventh: Speculators spread rumors which help them to manipulate prices.

A large central market is the most efficient means of assimilating information. Traders in futures markets need accurate information, and rumors are soon discredited by facts.

The broader the market, the better the information.

Some of these same arguments were leveled against onion futures in 1958, resulting in the congressional ban on that market. However, subsequent studies have shown that futures had no adverse effects on the onion industry and that the ban on futures trading actually caused greater price risk for those in the industry who previously had a mechanism for transferring that risk to others.

The recent USDA study on the impact of futures trading on the potato industry also invalidates such charges and explicitly states that the abolition of futures trading would not provide the solution to the underlying economic problem of the Maine potato industry.

But what can be done now?

The New York Mercantile Exchange recognizes the declining viability of a Maine only potato contract. When the Maine potato futures contract was initiated at the exchange nearly 40 years ago, Maine produced approximately from 35 to 40 percent of the entire U.S. fall potato output. Now, Maine accounts for less than 10 percent of that crop.

Two changes have been made under the expanded contract. Delivery of fall-harvested round white potato varieties grown throughout the Eastern and Central States will be allowed and will result in a significant increase in deliverable supply.

Also, the delivery mechanism has been modified, and a new provision for replacement delivery has been added. These provisions will provide a closer relationship between cash and futures prices through the entire term of the contract, further facilitating hedging.

The revised contract was submitted to the Commodity Futures Trading Commission in July. Further, recommendations contained in the USDA report are also being carefully studied for further possible improvements in the contract.

Senator STEWART. By whom?

Mr. MARKS. Those recommendations will be considered by the potato advisory committee of the exchange.

Senator STEWART. Is there anybody from Maine on that committee?

Mr. MARKS. Yes, there are about four or five, Senator, from the State of Maine, including the chairman of the committee.

Senator STEWART. Are they potato producers or potato purchasers or potato sellers—what are they?

Mr. MARKS. They are dealers and producers.

Senator STEWART. And out of the four, how many are producers and how many are dealers?

Mr. MARKS. Senator, I am not sure exactly.

Senator STEWART. Could you get that for the record?

Mr. MARKS. Yes.

[The following information was subsequently submitted by Mr. Marks:]

NEW YORK MERCANTILE EXCHANGE, POTATO ADVISORY COMMITTEE

Brian Ketchum, Chairman, State Potato Sales, Inc., Box 401, Mars Hill, Maine 04578—shipper and dealer owner, Commodity Trader Corporation.

Willard C. Doyen, Mapleton, Maine 04578—grower.

Sam Fishberg, Sam Fishberg & Co., 1790 East 92nd St., Brooklyn, N.Y. 11236—produce business.

Clifford Foster, Main Street, Sagaponack, N.Y. 11962—grower and shipper.

Leon Grappel, Four World Trade Center, Box 636, New York, N.Y. 10048—floor broker.

K. Richard Irving, Maine Potato Growers, Inc., 56 Parsons Street, Presque Isle, Maine 04769—General Manager, Maine Potato Growers, Inc., a cooperative.

Marlee-Jo Jacobson, 20 East 9th Street, New York, N.Y. 10003—floor broker, produce business.

David Laiken, Box 660, Four World Trade Center, New York, N.Y. 10048—floor broker.

Harvey Mach, Mach Farms, Inc., Rt. 4, Box 15, Antigo, Wis. 54409—grower, shipper and truck broker.

Edward J. Otero, Merrill Lynch Pierce, Fenner & Smith, 165 Broadway, New York, N.Y. 10080—potato specialist, Merrill Lynch.

Henry A. Pollak, Box 690, Four World Trade Center, New York, N.Y. 10048—floor broker, produce business.

Robert Reardon, Box 667, Four World Trade Center, New York, N.Y. 10048—floor broker, produce business.

Donald C. Silver, MFX Commodities Inc., P.O. Box 773, Presque Isle, Maine 04769—grower, shipper, dealer and commodity broker with MFX, Inc.

Carl R. Webber, Morrison Road, Mapleton, Maine 04757—grower and President, Maine Potato Sales Association.

Mr. MARKS. In addition, the exchange has taken steps to give the potato industry a greater role in the review and management of the potato contract.

Senator STEWART. How?

Mr. MARKS. This potato advisory committee was reconstituted earlier this year.

Senator STEWART. When was it reconstituted?

Mr. MARKS. In May or June, I believe.

Senator STEWART. Of this year?

Mr. MARKS. Of this year, that is right.

Senator STEWART. Was that after they suspended the trading of the contract?

Mr. MARKS. Yes, it was.

Senator STEWART. What did that come as a result of? Your interest in providing greater input by the potato producers or the suspension of the contract?

Mr. MARKS. Senator, I have been chairman of the exchange for 10 months—

Senator STEWART. Could Mr. Gabler speak to that?

Mr. MARKS [continuing]. May I finish—3 months into my office as chairman of the exchange, we were faced with a serious problem, and in responding to the seriousness of the problem, we took action.

I am determined to see that the exchange recognizes its responsibility as a public institution, and the expansion of this potato advisory committee is a major step in securing that.

Senator STEWART. Did you do that? Was that your action?

Mr. MARKS. Yes, it was. It was an action of the chairman of the board of governors of the exchange.

Senator STEWART. And your effort was to improve the confidence of those who produce the potatoes in the contract itself?

Mr. MARKS. Precisely, yes, it is.

Senator STEWART. What changes did you make in that advisory board?

Mr. MARKS. The prior chairman of the committee was a member of the board of governors.

Senator STEWART. Do you mean the chairman of the potato advisory committee was a member of the board of governors of the exchange?

Mr. MARKS. That is right. And the current chairman is a member of the Maine potato community.

Senator STEWART. What is he; is he a producer or a dealer?

Mr. MARKS. I believe he would be classified as a dealer, but I might be mistaken.

Mr. SILVER No. He is a——

Senator STEWART. Who are you?

Mr. SILVER. My name is Don Silver. I am from Maine. I am sorry, Senator.

Senator STEWART. OK, Don.

Mr. SILVER. He is a farmer dealer who now has a brokerage office. He is associated with Sinclair out of Idaho.

Senator STEWART. A brokerage office that does what—deals in——

Mr. SILVER. In commodities.

Senator STEWART. He is the chairman of your potato advisory committee.

Mr. MARKS. Yes, he is.

Senator STEWART. Who else is on that committee?

Mr. MARKS. There are, in addition, four other men from the Maine potato industry; one from the Wisconsin potato industry, one from the Long Island potato industry.

Senator STEWART. Do you think you could submit those for the record?

Mr. MARKS. Yes, we could.

Senator STEWART. Do you want to do that now?

Mr. MARKS. Yes [handing document to Senator Stewart].¹

Senator STEWART. Mr. Willard Doyen, who is a farmer and shipper; another fellow here who is a dealer, a farmer grower, and I cannot read that name—it looks like Ketchum——

Mr. MARKS. Ketchum. Brian Ketchum is the chairman of the committee.

Senator STEWART. How big is the committee?

Mr. MARKS. The committee has 14 members.

Senator STEWART. So 5 out of 14 people are involved in this committee, are related to the Maine potato grower.

Mr. MARKS. Yes.

Senator STEWART. What is the current daily volume of the potato contracts traded on your exchange; do you have any idea?

Mr. MARKS. Approximately 20 to 25 percent, I believe.

Senator STEWART. How does this compare to the past trading volume?

Mr. MARKS. I believe the percentage for the last 5 years is 60 percent.

Senator STEWART. What would be the effect on the exchange if you were to ban the trading of potato futures?

Mr. MARKS. The effect would be significant. The exchange, as I view it, is a quasi-public institution. We have many publics that we

¹ See p. 40.

must be responsible to—the brokerage community, the traders and members of the exchange, the potato industry that we serve, and ultimately, the consumer. Any banning of potato futures trading would have a significant impact on those groups and deprive the potato farmer of a hedging opportunity, and possibly have a rippling effect—

Senator STEWART. Now, Mr. Smith, who is from Maine, says that his farmers do not hedge. How do you answer that? Forty percent of the crop is financed by Farmers Home, and they do not allow it. Of course, they could, perhaps, hedge in other methods or manners.

He does not dispute the fact that 68 percent have hedged, that grew about 83 percent of the crop. He says that has changed since 1979. Let's don't argue like two young lawyers and not meet the middle and get these points addressed; let's get to the problem.

How do you answer that? Have you got a survey of some kind that indicates otherwise?

Are the Maine potato farmers hedging?

Mr. MARKS. All of our records indicate that they are.

Senator STEWART. Speculatively, or in an effort to—

Mr. MARKS. No, on a hedging basis. And I believe the CFTC keeps records showing the percentage of hedging interests and speculative interests.

Senator STEWART. And we can get that?

Mr. MARKS. Yes.

Senator STEWART. OK. I want that for the record, so as I said, we will hold it open for a week, and Mr. Dunn, if you could provide that for us—and I do not want to go to court. I would just like to have the information.

And I want to say, in fairness to you, we are going to find out before the hearing is over exactly what that situation was, because I understand from staff that you provided that information, and I want to be fair. So we are going to find out about that.

Mr. MARKS. Senator, I understand that as part of our submission, a portion of those CFTC records have been submitted.

Senator STEWART. That would indicate the percentage of the hedging?

Mr. MARKS. That is correct.

Senator STEWART. Do you have any idea as to how many were?

Mr. MARKS. I believe it is 30 to 40 percent.

Senator STEWART. Well, 30 to 40 percent of what?

Mr. MARKS. Of the total positions held in the market, 30 to 40 percent are known to be held on a hedging basis.

Senator STEWART. Do you know what percentage of that would be held by Maine farmers?

Mr. MARKS. The exchange does not keep records of individual traders.

Senator STEWART. You indicated in your statement that the difficulties with the Maine potato growers was that they had lost a large-size share of the market, and that there were other reasons for the economic decline in that area.

We have heard testimony here today, and you have indicated that you had a crisis there, at your exchange. Would it be fair to say that, even though there might not be some economic correlation, you have had some difficulties with regard to this particular

contract, which might cause or foster a lack of confidence in that contract on the part of the producers?

Now, are you saying that that is the farmers there in Maine, or the producers' problem, or can you be fair with us and admit that that there might be some problems with that contract?

Mr. MARKS. We have submitted, as prior testimony has indicated, an expanded contract, that expands the supply of the round white potato—

Senator STEWART. But that is because of difficulties that you had with the contract?

Mr. MARKS. No, it is not. The exchange has been working on an expanded contract since, I believe, the end of last year.

Senator STEWART. Are you saying that the difficulties that were had in 1979 with the contract and the difficulties in May 1976 with the contract, did not have an adverse impact on the economic well-being of the farmers in the State of Maine or Idaho?

Mr. MARKS. I do not know.

Senator STEWART. You do not know? You do not have any idea?

Mr. MARKS. I believe that—

Senator STEWART. I mean, they have testified here today that it did. The Senator from Maine testified that it did.

Mr. MARKS. Well, Senator, the purpose of a futures exchange is to offer futures contracts that give to those people in the particular industries an opportunity for hedging and for price discovery.

We feel that this new contract will increase the viability of potato futures and increase the opportunities offered to the potato industry.

Senator STEWART. Do you think, if the entire market is functioning properly, that the people who are producing the potatoes, as well as the dealers, as well as those who are dealing in the futures, are going to be benefited?

Mr. MARKS. Yes, absolutely.

Senator STEWART. Do you think the market was functioning properly in May of 1976?

Mr. MARKS. [pause]. Senator, I was not on the board of governors at that time—

Senator STEWART. I am not asking you whether you were on the board of governors or not. I am asking you whether or not you, as the chairman of the board of governors, think the market was operating properly in May 1976.

Mr. MARKS. Yes, as far as I know, it was, and those individuals that were involved—

Senator STEWART. Well, who were those people who were suspended from trading? Were they not operating within the market in May of 1976?

Mr. MARKS. No, they were not.

Senator STEWART. They were not operating within the market in 1976.

Mr. MARKS. Well, they were operating in the market, but illegally.

Senator STEWART. Then, apparently, there was some difficulty with the market in May 1976.

Mr. MARKS. No. I believe that the Commission suspended those traders for improper actions in the market.

Senator STEWART. What did you all do about it? Is that not a fair question to put to you? I mean, are you not familiar——

Mr. MARKS. I am not that familiar, but I do know that the exchange made additional changes in the contract.

Senator STEWART. Well, the exchange was fined \$50,000 by the CFTC for not carrying out proper enforcement conditions. Do you not see an obligation on the part of the board of governors to make sure that this kind of trading does not take place——

Mr. MARKS. Absolutely. That is why——

Senator STEWART [continuing]. And proper enforcement and surveillance activities?

Mr. MARKS. Absolutely. That is my primary obligation to the exchange, and two things have been done. A control committee of the board of governors was established shortly after——

Senator STEWART. Was that not in place prior to that time?

Mr. MARKS. It was not in place prior to 1976, no.

Senator STEWART. And what was the other thing that you did?

Mr. MARKS. The other thing was the increased responsibility given to the potato committee this year, to increase its input to the board.

Senator STEWART. Now, did that occur after the situation in May 1979?

Mr. MARKS. Yes, it did.

Senator STEWART. In other words, the first instance in May of 1976, you gave the board of governors more supervisory and enforcement authority; is that correct?

Mr. MARKS. That is correct.

Senator STEWART. All right. Then, after this instance in May 1979, you gave the potato committee more surveillance or enforcement authority or authority in this particular area?

Mr. MARKS. Yes. We broadened the representation on that committee to make the information available to the board from that committee.

Senator STEWART. I am going to ask you this question again, because I want to know how you feel about it. Frankly, I am not real pleased with the answer you gave me the first time, and you can give me the same answer the second time if you desire to do so. But I think some of these things have to do with the confidence of the people from Maine with regard to the potato futures contract.

Do you think the market was operating properly, or you all were operating that market properly, in May 1976—and I know you were not there, and I know you were not chairing the board of governors, but let us just say the New York Mercantile Exchange—do you think it was operating properly?

Mr. MARKS. Senator, I do not know for a fact, but I do know that what has been done since has been in the best interest of self-regulation of the market and in the best interest of the potato futures industry.

Senator STEWART. I am asking you if you felt like that situation was a proper type situation to exist in May 1976.

Mr. MARKS. Senator, I do not know enough about the situation to comment on it.

Senator STEWART. What about May 1979?

Mr. MARKS. In May 1979, yes, I believe the exchange was, absolutely.

Senator STEWART. Then why did you make the changes in the potato committee's efforts after that, if you felt like everything was all right prior to that?

Mr. MARKS. We feel that our responsibilities are continuing to grow, as the Government takes a greater role in the regulation of the exchanges, so the exchange must also take a greater role, too, and we are continuously modifying and amending and growing to meet those responsibilities.

Senator STEWART. Don't you think if you make those changes, that there would be less inclination on the part of the Government to do that?

Mr. MARKS. Absolutely.

Senator STEWART. I am quite sure some of these potato growers and some of these other folks would not like to be here; they would rather be back doing their work. And I am quite confident that you would rather be back in New York at the exchange.

Mr. MARKS. The action that the exchange took in March 1979 was in the best traditions of self-regulation by the exchange. The exchange acted on its own accord, without any Government participation.

Senator STEWART. Don't you think that that activity is not only in the best interest of the exchange, and if you have the confidence of the people that are producing these potatoes, it would be in your best interest, too? Don't you think that is reasonable?

Mr. MARKS. As I said before, Senator, the exchange is a quasi-public institution, and our public includes not just the members, but the members of the potato industry and the members of the American public that use our markets. And everything that we do is geared toward that. And I am determined to make sure that the exchange continues to meet those responsibilities.

Senator STEWART. I get the impression from some of the testimony that they do not like you right now in certain areas of the potato population in Maine.

Mr. MARKS. I get that impression, too.

Senator STEWART. And it may be that you are providing a much-needed service to those people. I had some cattle farmers who did not like another exchange in the State of Alabama, until they went out there and talked to them, and now they are using that exchange to hedge their production. They are making money and benefiting, but the exchange carried them out there, and they talked to them, and we will continue in that. I went out there to the Midwest to see that exchange and tried to find out how we could get some of that money down in Alabama. So that is all I am saying. That is the only reason I was asking the questions I was asking.

I have some other questions, but we have some other witnesses. I appreciate you being here today.

Mr. MARKS. Thank you, Mr. Chairman.

Senator STEWART. Dr. Roger Gray, Stanford Food Research Institute, Stanford, Calif.

Please proceed with your testimony.

STATEMENT OF DR. ROGER GRAY, FOOD RESEARCH
INSTITUTE, STANFORD UNIVERSITY

Dr. GRAY. Thank you, Mr. Chairman. I have a brief statement which I would like to read for the record, and then I would be glad to answer any questions.¹

I am Roger Gray, professor and economist in the Food Research Institute at Stanford University. I am appearing before you at the request of and at the expense of the New York Mercantile Exchange.

I share with some of the people here, and with Senator Muskie, who was here, a sense of *deja vu* on this occasion, since I testified in opposition to Senator Muskie's bill S. 332, in 1963 and have subsequently in 1966 and in 1972, opposed other efforts to ban potato futures trading.

My first study of potato marketing problems was my doctoral dissertation, completed in 1952, and I have subsequently published several studies dealing with futures trading in potatoes and onions, as well as numerous studies relating to futures trading in other commodities.

I have attached a copy of my curriculum vitae, because it exhibits the extraordinary focus upon analysis of futures market performance in my research and consulting work over the past 25 years.

I would urge you to refer to my earlier statements on S. 332 and H.R. 6006, in 1966, and H.R. 7287 in 1972, in order to confirm that my conclusions are based upon analyses of market performance and that these met and refuted the most frequent allegation heard against the potato futures market.

My most recent published study of this market was entitled, "The Futures Market for Maine Potatoes; An Appraisal," published in 1972.

Since 1972, there has been a major convulsion in commodity prices, as well as in cost of production, and continued shifts in areas of potato production and in potato consumption patterns.

Senator STEWART. Well, let's get to the heart of the matter. Are those some of the reasons for the difficulties that are experienced by the Maine potato growers?

Dr. GRAY. Yes, I think so.

Senator STEWART. Would you say that their difficulties are unrelated to the futures contract on the New York Mercantile Exchange, or there is some relationship?

Dr. GRAY. As a general matter, I would say that their difficulties are unrelated, although the episodes that have been focused on here, both the abuse of the May 1976 contract and the curtailment of trading in March 1979, in the April and May contracts, I think have probably had some adverse effects, independently, on the growers.

Senator STEWART. On the Maine farmers or producers?

Dr. GRAY. Yes.

Senator STEWART. So you would disagree with the statement—well, I do not know whether he made the statement that it did not

¹ See p. 129 for the prepared statement of Dr. Gray.

have any effect; he just said he did not know—but you would think that it might have some relation.

Dr. GRAY. I think that those two episodes have had some effect on growers, yes.

Senator STEWART. There is a news clipping I was handed by staff, in which Earl Roberts, who is a former member of the New York Mercantile Exchange, stated in a public statement that was reported in the press that the exchange governors are also buyers and sellers of potatoes, and that sellers made a hellish profit from the 1979 suspension of trading; that there was a conspiracy between buyers and inspection personnel to prevent delivery.

What are your views about that statement?

Dr. GRAY. I am not aware at all, Senator, of what the positions held by any groups of people were in terms of that suspension.

Senator STEWART. Would there be a possibility that under that suspension, somebody could make a pretty good profit?

Dr. GRAY. When I spoke of the impact upon growers, to the extent that growers had hedge positions, and if this gentleman is correct, that the shorts benefited, that of course would benefit growers, who would be mainly short in the market.

On the other hand, my impression has been—and I have not made an independent study of this relationship—my impression has been that following the suspension that the growers, at least for a period of time, having lost this market, found themselves in a potato market that was, to a certain extent, inoperative, and that in itself would have harmed growers' interests.

Senator STEWART. Mr. Dunn, what is your response to that statement? Is that a fair statement for somebody to make? That is a pretty damaging piece of business.

Mr. DUNN. It is difficult to accept that statement without some evidence to support it.

Senator STEWART. There is no evidence that you all found of that at this time?

Mr. DUNN. No. We do not have evidence on the positions of individuals. I think Dr. Gray had indicated that if a producer with a short position in the market had physical potatoes, and delivered them at the settlement price, the settlement price was probably a little higher than at the time he put those potatoes in storage.

Senator STEWART. He is talking about the exchange governors here, are buyers and sellers of potatoes, and that the sellers made a profit.

Mr. DUNN. Yes. Well, I should say that the act of suspension is under investigation by—the act of suspension by the exchange—is under investigation by the CFTC currently.

Senator STEWART. I see, so you are not at liberty to testify to that.

What about this assertion that only Maine, and to a lesser degree, Minnesota and North Dakota, usually have round white potato supplies left during April and May, the heaviest months of trading on the New York Exchange.

Is that correct? Are those the heaviest months? I am not asking you if it is correct about the potatoes, because I assume that it is.

Dr. GRAY. Well, I assume, Senator, that both parts of that statement are correct. I would only go on to add—

Senator STEWART. It is further asserted that even if the new contract is approved, the contract would be kept narrow for the benefit of speculators. What would your response be to that?

Dr. GRAY. Well, I would certainly hope that that is not the case. I have looked over the new contract. I think the new contract, by endeavoring to widen the delivery capabilities, is certainly moving in the right direction, and that is not something that is going to benefit speculators.

On the other hand, to go back to the earlier statement, Senator, if I may, to the extent that potatoes from the other areas become deliverable against this contract, I would expect that to encourage more holding of potatoes later in the season, because they could be hedged.

Now, I think it is virtually true that so long as the price relationship remains close between those from other areas and Maine, that they are hedgeable anyway. But I think that the evidence shows that most of the hedging that has ever come into this market has come from the State of Maine, very little from other areas. And I would expect hedging from other areas to be encouraged if the delivery capability is expanded.

Senator STEWART. Have you ever given any thought to the suggestion made by Dr. Paul, about the cash settlement alternative to delivery?

Dr. GRAY. Yes, I have. I have read that proposal.

Senator STEWART. What do you think of it?

Dr. GRAY. I think it is ingenious. My concern would be whether the cash price basis upon which this settlement would be based really represents a sufficiently broad and liquid market.

I may say I agree with Mr. Dunn that futures markets are for the purpose of price discovery and for hedging. There are instances in which some of our newer futures markets have been formed for financial instruments, for the metals, for example; where I think the existing cash market was already doing an adequate job of price discovery, and hence, basically, the purpose of the futures market becomes one of hedging.

Now, if we are content that the price discovery being done in these cash markets, to which Dr. Paul would link this settlement procedure, is being adequately done, then I think it is a most ingenious proposal. It is not historically unprecedented. The Liverpool grain exchanges, wheat and cotton exchanges, used to have a settlement procedure, and you have some sort of comparable situation even in cotton, where committees determine price differentials.

The most ingenious part that I find of the procedure recommended by Paul et al. is the procedure whereby they would invoke a penalty, if you will, against the side least willing to either accept or make delivery. And I think that would help to validate the cash market prices that they are linking in here.

I think this does need to be explored further. I would be very interested in how the CFTC reacts to this after they study it.

My own feeling would be perhaps to try first to broaden the delivery capabilities in this contract along the lines of the exchange proposal; see if that first satisfies the CFTC, and see if it works better. And if not, it seems to me that some sort of settle-

ment arrangement such as they have proposed might be quite viable.

Senator STEWART. Would the total banning of the potato futures contract help or harm the potato producer? What is your opinion?

Dr. GRAY. Certainly, it would harm to the potato producer who has made good hedging use of this market, as many of them have over the years. They would be deprived of an excellent marketing mechanism.

I have not at all been convinced that the existence of the market harms those who do not use it. I do not accept the arguments along that line. I have never seen any evidence that it harms those who do not use it. So I would have to say on balance, it would do harm to potato producers, although obviously, it is not going to do any harm to those who do not use it or do not pay attention to it.

Senator STEWART. So in other words, if they do not use it now for hedging purposes, if we ban the potato futures contract, it would not do any harm to them?

Dr. GRAY. It may be—I might want to modify my answer to that, Senator. I am sorry. I am concerned that prior to the existence of the potato futures market, we did have some considerable evidence that the market was so fragmented before you developed the centralized market that the growers were in a position to be taken advantage of—

Senator STEWART. By whom?

Dr. GRAY [continuing]. By dealers in many areas where they did not—

Senator STEWART. Well, they are still claiming that is taking place, Dr. Gray.

Dr. GRAY. Well, I certainly think it is less possible today, when the grower has both direct access to hedging on the futures market, and when the grower also knows that the dealer is hedging on futures and indirectly bringing into the futures market. It simply extends the competition and extends the price information available to the grower.

Senator STEWART. It makes the market more competitive?

Dr. GRAY. It makes it more competitive. I am concerned that if you take the market away, that some of the growers who have not used the market will be greatly disillusioned to learn that not only does this not help them, but they may find that they have been even indirectly benefited by it, though they did not use it, because the price discovery process, I think, has been fairer to them with this market in place.

Senator STEWART. Well, then, you would say the price discovery mechanism would be fairer than what, perhaps, the Commissioner of Agriculture Stewart Smith, from the State of Maine, is suggesting, that they set their own policy and establish their own marketing mechanism and price-setting mechanism in Maine.

Dr. GRAY. I do not know any of the details of the plan that he may have in mind, and since I have not read it, perhaps I should not comment upon it, other than the way you have just characterized it, Senator. If it is their proposal to get together as a group of producers and establish the prices for Maine potatoes, I am afraid that this is whistling in the graveyard. Maine has been a declining potato producer relative to other areas of the country. They have

got to be in competition with other producing areas. If they endeavor to hold their prices to a level satisfactory to them, I am afraid that they will find that the other areas will make even more rapid inroads on their potato enterprise.

Senator STEWART. Why is the Chicago contract not traded anymore?

Dr. GRAY. I have not made a study of that, and I think I perhaps should not comment on it. It is not uncommon for relatively new contracts not to catch on in a hurry.

Senator STEWART. Our next witness might be able to comment on that.

I thank you for being here today.

Dr. GRAY. Thank you for the opportunity to be here.

Senator STEWART. Clayton Yeutter, president, Chicago Mercantile Exchange, Chicago, Ill., is our next witness.

STATEMENT OF CLAYTON YEUTTER, PRESIDENT, CHICAGO MERCANTILE EXCHANGE, ACCOMPANIED BY BILL KOKONTIS, AGRICULTURAL ECONOMIST, CHICAGO MERCANTILE EXCHANGE

Mr. YEUTTER. Thank you, Mr. Chairman. It is nice to be back again. I have with me Bill Kokontis, who is a member of our research staff, an agricultural economist, and I brought Mr. Kokontis along in case there are some technical or historical questions which go beyond my tenure here at the exchange.

I will submit a statement for the record,¹ as well, Senator Stewart, and not bother to cover it right now. I would like to make a few comments on some of the statements that were made earlier and then just generally summarize my reactions to the issues that have been raised here.

In a nutshell, Senator, I would like to simply say that I would summarize this as being the right problem and the wrong solution. There is no question that there are some issues here that merit attention. And I empathize with many of the people in this room who are being critical of futures trading in potatoes as that trading has been conducted through the years, not only on the New York Mercantile Exchange, but some years back, perhaps on our exchange, as well. That experience precedes me, so I cannot be very sanguine with respect to that evaluation. But nevertheless, I am well aware of some of the criticism that has existed of our earlier contracts. That being the case, Senator Stewart, I can sympathize with the view of some who would simply say, "Gee, we have had these problems for 20 years. Why not just throw up our hands in horror and say wouldn't we be better off just to abandon the entire mechanism."

And I simply say I think that is wrong, and wrong from their standpoint. And I would hope that does not take place.

From our standpoint, Senator Stewart, at the Chicago Mercantile Exchange, it is not an issue of major significance. As you know, we are going to trade more than 20 million contracts in a whole variety of commodities in 1979 dollar value well over \$1 trillion. And whether or not we trade potatoes among that group of contracts is not all that relevant.

¹ See p. 130 for the prepared statement of Mr. Yeutter.

But I would be very distressed if this legislation were to become law, Senator Stewart, just because of the principle that this involves. It is a "throw the baby out with the bath water" reaction to the problem, and I just do not think that is a proper reaction.

I would like to say just a word about our existing contract because a couple of questions have already been raised about it this morning, and then I would like to talk more generally about the issues that have been surfaced.

I had some reservations when we launched our revised contract in July, as to whether it would generate immediate liquidity; and regrettably, those reservations proved to be accurate. To a considerable degree, they simply reflect our own success. We are being victimized by our own success in other areas, simply meaning that our members are hesitant to go into the pit to trade a low-volume item, a new contract like potatoes, when they can trade other contracts of enormous volume and liquidity—cattle, hogs, pork bellies, and one can name a half-dozen others. So why spend any time in the potato pit if you can make a whole lot more money trading in any one of the dozen other commodities.

As a consequence of that, we have decided that we are going to have to make some changes in our membership situation, providing either some carrots or some sticks, to move people into pits of low-volume items like potatoes. We expect to do that relatively soon, and hopefully, that will generate the in-house liquidity that will provide a better market than for people out in the country to use, both on the long side and the short side, or at least it is going to give them the prerogative, and whether they then use it or not is up to them. The liquidity, hopefully, will be there, and if it is there, it is going to be up to them to take advantage of it if they wish. If they do not, then, as Dr. Paul indicates, it will die a death of its own, and there is no point in keeping it going.

Now, the basic question is why have potato futures? You raised that this morning on a number of occasions, and it was Mr. Smith who said a little bit earlier that one cannot successfully hedge on the Maine contract. Senator Stewart, that is just dead wrong. That is not an accurate statement.

Mr. Smith quoted Dr. Paul as having come to that conclusion in this study, and that is not the conclusion of the Paul study, and I just read it through last night. One can hedge successfully on the Maine contract, perhaps not as readily in terms of basis risk as one could before, some years back. That was one of the conclusions of the Paul study. But to suggest that one cannot put on an effective hedge on that contract or our contract is just dead wrong.

Any time one deals with a volatile commodity, there is an opportunity to hedge risk. That is the whole heart of the matter. And potatoes are a volatile commodity. In my judgment, they are going to continue to be volatile for a long time to come.

Senator STEWART. All right. Now, let us say I am a potato producer in Maine, and I am raising a crop. How would I do it, just mechanically. Explain it so my daughter, Priscilla, would understand it—she is smarter than I am.

Mr. YEUTTER. All right. Well, one would simply put on—producer puts on what is called the sell hedge, Senator Stewart, meaning that that producer, if he is convinced that he can lock in a satisfac-

tory level of profit on potatoes—let us say \$12 per hundred—if he can find \$12 per hundred up on the board at the New York Mercantile Exchange, or if he is trading Russet potatoes on our exchange, he can simply pick up his telephone, call his broker, have the broker relay an order to the floor of the exchange and say, “I would like to sell x amount of potato contracts, futures contracts, at \$12 per hundred.”

Senator STEWART. What happens if the cash price goes above that at the time of delivery; what does he do?

Mr. YEUTTER. That producer, once he has executed that contract, has locked in \$12 as his price. If, now, the cash price rises beyond \$12, he will have to buy his futures contract back at the time he sells on the cash market, at something higher than \$12, so he will lose money—say \$14—he will lose \$2 a hundred on his futures contract, but he will sell his cash potatoes for \$14 rather than \$12, so he will make the same amount of money. He will have locked in \$12.

If, on the other hand, the cash price goes down, and he must take \$10 in the cash market, he still receives a total of \$12 because he will make a profit on his futures contract of \$2 a hundred, so he will still end up with \$12.

If the cash market goes up, he gains on the cash side, and loses on the futures. If the cash market goes down, he—

Senator STEWART. Those options are available to him.

Mr. YEUTTER. To anyone who wishes to participate in the market.

Senator STEWART. What if he did not have that market, what options would be available to him?

Mr. YEUTTER. Then he is at the mercy of the cash market, Senator Stewart, and that means, in essence, he is a speculator. And in those commodities where futures markets are not available today, one has no choice except to take one's chance in the cash market.

Now, again, life is not quite that simple, and in some commodities—cotton, for example, which is grown down in your State—there are forward contracting arrangements available in the cash market, so he can get some protection. But that does not provide him the flexibility that he has with the futures contract. And certainly, futures is a marketing mechanism that gives him a lot more flexibility in selling his product than he would otherwise have.

OK. Just to go on to illustrate that point, Senator, to use our market, the product is now traded on our market. Going back to 1974-75, which was an especially volatile year, potatoes, the product that we trade, we were at a high of \$13 a hundred that year, and at a low of \$5¼. Well, a potato grower is obviously a whole lot better off if he hedges at \$13 than he is if he sells at a cash market of \$5¼.

Coming closer with a little less volatility, but still a significant amount of volatility, just this last crop year, 1978-79, those same products were at a high of about \$10.50 and a low of about \$7.50. And, again, it sure makes a lot more sense to hedge in at \$10.50 than it does to sell on the cash market at \$7.50. Those were hedging opportunities that people could have taken advantage of.

Senator STEWART. How many folks do you have who are potato producers out of the folks who are hedging? Do you have any hedging in the potato market?

Mr. YEUTTER. Yes, there are some. Now, our volumes at the moment, as was indicated, Senator Stewart, are so low that the numbers are really not of any great relevance.

There are people who are hedging—there will be some of those hedgers who will be testifying before you later today.

Now, first of all, let me say that I have given you an oversimplified answer. It is obviously more complicated than that to put on hedges. The question is whether one can meet the product specifications and all these sorts of things. And you will find people who will testify today that they are not satisfied with the product specifications on either our market or the New York market, and they may be right.

Now, ordinarily, the longs feel that the specifications are tilted toward the shorts, and the shorts feel that the specifications are tilted toward the longs. And every exchange has to attempt to balance the interests of both shorts and longs so that one gets a good mix of hedgers on both sides of the market, as well as the speculators. That is a delicate task, and we do not always do it well, and we probably could have done it better in both of these exchanges down through the years. And I hope that we will make some changes in both contracts as time passes, to make them more attractive to hedgers on both the long and short side of the market.

Now, aside from that, I would like to make some comments on some of the specific problems that have been enunciated here, and how we would handle those kinds of problems on the Chicago Mercantile Exchange.

I do not want to make any comments about anyone else's market; that is not my prerogative to do so. But I would like to respond with respect to how we handle these kinds of compliance problems or manipulation sorts of issues on the exchange, on all our commodities, not just potatoes, but cattle, hogs, Treasury bills, or any other commodity with which we deal.

And I would preface that by saying that 99 percent of the problems that occur on any futures market in any commodity relate to the delivery month. If we can solve those kinds of problems in all commodities, we will have a lot more relevant product available to anybody who wants to use it. And that is what has been bothering the potato industry for a long period of time. Deliverable supply is an issue that has been raised here. What about having too small a deliverable supply so that people get into a bind—the shorts get into a bind in delivering as the product phases out.

Well, there are really two answers to that. First of all, if the absolute deliverable supply is going down, down, down through the years, then one needs to change the contract specs to raise the basic deliverable supply. We have just gone through this in lumber, as an example, and we have a change now pending at the CFTC to significantly increase our deliverable supply in lumber for that very reason, to respond to that problem. But that is only part of the answer.

Irrespective of whether one makes contract changes, one must always monitor deliverable supply as it relates to open interest in

the last days of trading. And if the deliverable supply, for whatever reasons, is smaller than has ordinarily been the case, then it is the obligation of the exchange to make sure that those open interest numbers go down, down, down in the last 3 weeks, 2 weeks, 1 week.

Senator STEWART. How do you do that?

Mr. YEUTTER. Well, you do it by twisting a few arms, if necessary. Let me tell you how we do it. We begin to monitor that open interest intensely, starting, perhaps, 6 weeks before the end of trading in a particular month. As we go down to perhaps 4 months before the end of the trading, it really gets to be intense. We do it to a much greater degree with computers than anybody else in the industry does. It is a very advanced monitoring technique. But beyond that, we begin to have lots of conversations with participants in the market as we go down, finding out their intentions—both hedgers and speculators. And as we go down 2 weeks, 1 week, 5, 4, 3, 2, 1 trading days, we constantly appraise the relationship between deliverable supply as we see it and the open interest that prevails. And if we think the open interest is too big to match up with that deliverable supply, we tell people that it is time to get out of the market. Now, we tell them that very calmly initially, and then we tell them that a bit more aggressively as we go down the line, and if it calls for a meeting of the business committee and the business committee tells them that, we do it that way, as well. It is not too difficult, Senator Stewart, to make sure that those match up properly. That is just simply an execution of an effective compliance program.

There is no reason to have erratic trading on the final day, with a very high percentage of open interests still remaining and with the market simply losing any relationship to supply-demand fundamentals at that point. It should not happen.

Senator STEWART. You have raised a question, and I am going to ask you one myself. Now, if they had done a better job of making sure that this kind of situation existed on the New York Mercantile Exchange, would they have had less erratic trading in the latter days of, say, May 1976 or May 1979? Is that part of the problem, lack of supervision of the marketplace, or are you free to comment on that?

Mr. YEUTTER. Well, Senator, I very much hesitate to comment on the operations of a fellow exchange, if, for no other reason, because they obviously are much closer to the situation than I. I am not privy to the conversations and discussions that took place either in 1976 or in 1979, so I cannot really evaluate that issue or why the open interest remained as high as it did, and these kinds of things.

All I can really do is illustrate for you how we do it.

Senator STEWART. Well, let us say for the sake of a hypothetical, you have a suspension of trading on a certain exchange in the latter part of the time that the crop was to be delivered. Would you say that that could, perhaps, be related to the manner in which the exchange operated, or would that be totally unrelated? Could there be some connection there?

Mr. YEUTTER. Well, again, Senator, I am not privy to all of the historical facts in that particular case, and I know that there were some very serious concerns about deliverable supply that occurred very quickly.

It may have been difficult to estimate what was going to occur in terms of lack of deliverability of supply. So I hesitate to be critical.

Senator STEWART. Don't you think, though, that as far as a proper mechanism for supervising the markets in place, that those who produce the product have a greater degree of confidence in that marketplace? Don't you think that that is one of your obligations as a quasipublic institution?

Mr. YEUTTER. Well, sir—

Senator STEWART. I mean, I get a little tired of folks "minueting" around these obligations and responsibilities. I have mine, and I think they have theirs. And these people apparently have some concerns.

Mr. YEUTTER. I would respond in this way, Senator, that it is incumbent upon all of us involved in this regulatory process—meaning the CFTC and all of the exchanges; ourselves, as well as other exchanges—it is incumbent upon us to know what is going on in the marketplace and to respond to whatever those facts happen to be.

And we have a lot of tools in that self-regulatory kit. We have the tools that I have been talking about. We can put limitations on the size of positions held by hedgers, the size of positions held by speculators. We can increase margin deposits.

There are a lot of actions that can be taken in those final days of trading, if and when those become necessary. That is simply a question of making sure that the markets phase out of a given delivery month in a smooth fashion. And if I again can use lumber as an example, because here is one where we have had some very delicate deliverable supply problems in recent months. Those contracts, Senator Stewart, have been closing out in recent months very smoothly.

Senator STEWART. Is that because of actions that you took in connection with that, yourself?

Mr. YEUTTER. Well, it is because of actions that have been taken by the exchanges.

Senator STEWART. By the exchanges?

Mr. YEUTTER. Absolutely, absolutely.

Now, just a couple more comments in that arena. I want to respond to a couple of contentions that were made this morning, one by Senator Church, that these markets are easy to manipulate. I want the record to show that our markets are not easy to manipulate, and I can assure you, Senator, that they are not, or if anyone tries, that that will be dealt with personally.

Senator STEWART. Now, let us clarify one thing. You are talking about your exchange?

Mr. YEUTTER. Yes, sir.

Senator STEWART. All right. Would there, for the sake of a hypothetical, be a possibility of establishing one where you could manipulate a market?

Mr. YEUTTER. Well, it is always theoretically possible, Senator, to manipulate any market. And even with very strong compliance programs, as we feel we have, there is a temptation always in existence for people to cheat. It is not a perfect world, as you well know, and from time to time, people do try to manipulate markets, and they will probably try on our exchange at some time in the

future on some product, not necessarily potatoes; it could be some other product.

I am confident, Senator, that if and when that occurs, we will one, discover it, and two, deal with it very harshly.

Senator Church also indicated this morning that he looked upon futures trading in potatoes as legalized gambling, and I wanted to take issue with that, because I do not consider futures trading to be in that category at all. In my opinion, Senator, it performs a very valuable economic function and should be recognized as such.

Also, there has been some commentary here about the effect on nonusers, and I would like to make just one comment on that. I agree with Dr. Gray that there is no evidence that there has been any significant adverse effect of any futures contract on nonusers. This is not to suggest that there is no relationship between users and nonusers, because there clearly is. It is an allegation that comes to me a lot of times, especially in questions after speeches, aren't futures markets driving the cash market down or driving the cash market up.

What usually happens, Senator, is that when the futures markets show a bearish price situation with the numbers going down on into the next 6 or 12 months, the allegation is that they are pulling cash prices down. Perhaps they are to some degree, because obviously, the psychology is bearish, and people operating the cash market are not likely to bid with enthusiasm for a product if the futures market is bearish.

But exactly the opposite occurs when the futures market is bullish. If the prices go like this out into the future, then there is clearly some psychological upswing in the cash market.

Generally speaking, Senator, growers would like to ban the futures market when it has a bearish outlook and then reinstate it when it has a bullish outlook. But we really cannot have it both ways.

If there is an impact, it is going to be sometimes positive and sometimes negative, and overall, I think it is a marketing tool that ought to be there.

As you know, I have been a user of futures markets for many years in my own farming and livestock operations, and I cannot use those operations now because of my present position, and I would feel very lost in any major commodity if that tool and technique were not available. People just have to learn how to use it. It may not always be perfect, but I would rather put on an imperfect hedge, Senator Stewart, than to have no hedge at all.

Now, if everybody in the potato industry has net worth statements that are sufficiently large that price volatility is of no relevance, that they can accept the price risk no matter what it is, and if they lose a million dollars this year, they can all just shrug their shoulders and say, "Well, so be it; I will make a million back next year," then there probably is not any great economic rationale for a futures market, and it might as well die. It will probably die on its own; I do not think the Senate needs to legislate it out of existence.

I doubt that that is the case. I am not that familiar with potato growers, because I am not a potato grower. But I doubt that every potato grower, either in this room or in this country is just rolling

with money and can tolerate that kind of price risk. And if that is not the case, if price risks are of concern to them, then they one, ought to have a mechanism available where they can shift that risk, and two, they ought to use it. That is really the essence of my testimony, Senator.

Senator STEWART. Mr. Yeutter, I thank you very much for your testimony, and you, too, sir, for being here today. There may be some other questions as we move along.

I would like, if we possibly could to take a short break right now, because a vote has got to take place, and I have got to find out what my position is in that market.

We will be back in about 5 minutes.

[Short recess.]

Senator STEWART. Let us come to order.

The next witness is Lloyd Schmidt, representing the Red River Valley Potato Growers' Association.

Mr. Schmidt, would you go ahead and proceed with your testimony. And again, let us try to make it as brief as possible, so we can ask you some questions.

STATEMENT OF LLOYD SCHMIDT, EXECUTIVE VICE PRESIDENT, RED RIVER VALLEY POTATO GROWERS' ASSOCIATION

Mr. SCHMIDT. Thank you, Senator Stewart, and members.¹

My name is Lloyd Schmidt. I am the executive vice president of the Red River Valley Potato Growers' Association, located in East Grand Forks, Minn.

This association represents 950 potato growers in the northwest region of Minnesota and the entire State of North Dakota.

We produce about 95 percent of all potatoes grown in those two States. Our production is approximately 3 billion pounds of potatoes per year.

I am here today to express the strong support of the Red River Valley Association for S. 770. Our association for many years has supported the efforts of the Maine potato growers, as they have attempted to obtain the elimination of futures trading on potatoes.

Although potatoes from the Red River Valley have not been used for trading on the futures board, we have supported growers from the State of Maine because of the manner in which they have been used for the benefit of the traders, or probably more specific, the speculators.

Although this in itself would be reason enough for us to support S. 770, we find ourselves much more serious in our efforts to obtain the elimination. The reason for this seriousness is the proposal which was submitted by the New York Mercantile Exchange to the Commodity Futures Trading Commission—

Senator STEWART. Are you talking about the expansion of the contract?

Mr. SCHMIDT. The expansion of the contract.

Senator STEWART. You do not want that to cover your Minnesota potatoes?

Mr. SCHMIDT. No, sir, we do not. We have relayed our feelings on that matter to the Commodity Futures Trading Commission, as

¹ See p. 132 for the prepared statement of Mr. Schmidt.

have the commissioners of agriculture, both from North Dakota and Minnesota.

Senator STEWART. How do you market your potatoes now?

Mr. SCHMIDT. On round whites, which would be the matter of the contract here, it is strictly a processed market that we go to.

Senator STEWART. How volatile has the market been over the past 5 years?

Mr. SCHMIDT. About as volatile as you could expect it to be, I guess. It has had its ups and downs. Most of our potatoes right now, on the round white contracts, or on the round white potatoes, are preseason contracted.

Senator STEWART. Forward?

Mr. SCHMIDT. Right, only in our case, the grower, after the association has negotiated the contract, will go to the user, the man who manufactures potato chips or french fries or whatever, and make his contract directly with him. And they will have specific periods of time that they have to deliver those potatoes, so many in November, so many in December, and the price goes up accordingly, and this is all done preseason, on about 60 percent of our potatoes. The other 40 percent, the growers as well as the receivers play the market and see what happens.

Senator STEWART. Let me ask you this, then. In the past 5 years, you have indicated that the market has been very volatile. Have there been several boom-or-bust cycles, as previous witnesses have indicated?

Mr. SCHMIDT. The closest we have had to a bust was last year, and it was strictly our own fault. We cannot accuse Mother Nature of it. We just grew too many potatoes, and it was our problem, and one of those that we had to work out.

Senator STEWART. Yes. We could not sell ours from Sand Mountain.

Mr. SCHMIDT. That is right. It was just a bad year. It was the worst we have had in a long time.

Senator STEWART. But you feel that the marketing device that would be offered you on the futures contract that they are talking about would just not be to your benefit?

Mr. SCHMIDT. No. The way things are in the valley right now, it could not even be used, because the storages that we have are bulk storages. We do not have packing facilities with them. They are strictly for the processed market, and we are not in the fresh market as far as white potatoes are concerned.

Senator STEWART. Well, would that market be unavailable to you if they included you?

Mr. SCHMIDT. The way it is right now, I would have to say yes, unless a particular grower, if he wanted to make a legitimate hedge, he is going to have to make arrangements with somebody to pack out those potatoes, because he does not have those.

Senator STEWART. I do not know anything about potato futures, but with the markets that you now have, would the processors be unavailable to you if they included you under the contract?

Mr. SCHMIDT. With our present——

Senator STEWART. Yes. With your present arrangement, would you be divorced from that?

Mr. SCHMIDT. No.

Senator STEWART. Well, how would he purchase it?

Mr. SCHMIDT. If they started including round white potatoes, it can only hurt us if the speculators start taking over on this thing.

Senator STEWART. In other words, if they start setting the price?

Mr. SCHMIDT. Yes. There can be a legitimate hedge on round white potatoes out of there right now because of the packing facilities; we just do not have them. So everything that was done out of there would have to be done on a speculation basis, as far as I can tell anyway, and I am not an expert on futures trading, to say the least.

Senator STEWART. Well, that might be an unfair question to ask of you.

Mr. DUNN, could you respond to that? This gentleman has raised what I think is a legitimate question. Would this market be unavailable to him in the event he was included under the contract—the market they presently have, how they presently process the potatoes?

Mr. DUNN. I thought I understood him to say that the present markets would continue to be available to him——

Senator STEWART. Well, would this have any effect on the market?

Mr. DUNN. The price might be unreasonably depressed by action of speculators in that market. That is what I thought I understood him to say.

Mr. SCHMIDT. Right.

Mr. DUNN. Is that correct?

Mr. SCHMIDT. Yes.

Senator STEWART. The effect that you are worried about with the expanded futures contract would be on the price and not on the market.

Mr. SCHMIDT. It would not affect the present market that we go to with our round whites, because these people all process these potatoes into potato chips, or french fries, or whatever.

Senator STEWART. You do not see any benefit at all in expanding the contract to cover your potatoes?

Mr. SCHMIDT. None whatsoever.

Senator STEWART. You are totally opposed?

Mr. SCHMIDT. We are opposed to it, very definitely.

Senator STEWART. Do you have any other comments to make?

Mr. SCHMIDT. No. I think we have covered everything in just the question and answer period, sir; everything that I had written here, we have talked about.

Senator STEWART. In that case, I believe I will start having question and answer periods. Your full statement, Mr. Schmidt, will be included, and I deeply appreciate your being here today. I will tell your Senator you came. I want you to know that he is working hard for your State somewhere else, and that is the reason he is not back here.

Carl Webber, chairman of the Maine Potato Sales Association, Mapleton, Maine.

STATEMENT OF CARL WEBBER, CHAIRMAN, MAINE POTATO
SALES ASSOCIATION

Mr. WEBBER. My name is Carl Webber. I live and work in a small farming community in Mapleton, Maine. I have been involved in farming and marketing sales all of my life. I am employed by Lovley Farms, of Mapleton, Maine. Our company is a relatively large producer of potatoes. We also operate a sales office through which we market our production and production of others.

I am also president of the Maine Potato Sales Association, whose membership includes people and firms who convert an estimated 70 to 80 percent of the fresh potato sales portion of the Maine crop to cash each year. Our organization supports futures trading of potatoes under a proper contract, responsibly managed and enforced.

The New York Mercantile Exchange has for many years offered potato growers a valuable hedging device, a price insurance against the risk of market decline. Good, bad, or indifferent, these hedging opportunities have been available every day to the grower in Maine at publicly stated prices.

Production credit institutions and local county banks have routinely financed hedging operations in connection with production loans made to growers. In fact, some institutions have adequately—

Senator STEWART. What about Farmers Home?

Mr. WEBBER. Farmers Home, I do not know for sure, because I am not connected with them, sir. But I know production credit does, or local banks do. They have in the past, up until this year, due to the problems, they have for some, to a certain degree.

Senator STEWART. Would you say that due to the problems in the spring of 1979, they did not, or they are not doing that?

Mr. WEBBER. There is not the percentage compared to what they had in the past.

Senator STEWART. Have you ever hedged?

Mr. WEBBER. Yes, I have, sir.

Senator STEWART. Have you found it beneficial as far as your production is concerned?

Mr. WEBBER. Very much so.

Senator STEWART. Do you think the expanded contract would adversely affect the Maine potatoes, or give you a bigger market, a more stable market, and prevent some of the problems from occurring that occurred in May 1979?

Mr. WEBBER. No, I do not believe it will help the Maine industry as far as the April and May deliveries are concerned, because I think—

Senator STEWART. What is the problem there? I have been sitting here and have heard a lot of witnesses testify. What is the problem with the April and May deliveries of the Maine potato crop?

Mr. WEBBER. Well, a lot of it, you have got to go back and look at the different culture practices that have taken place, the changes over the past 20 years.

Senator STEWART. What are some of those?

Mr. WEBBER. Some of them are the mechanical harvesting, which normally used to be done by hand, small harvesters, small diggers—

Senator STEWART. So mechanical harvesting has damaged the potatoes?

Mr. WEBBER. To some degree.

Senator STEWART. And they are not accepted on delivery; is that it?

Mr. WEBBER. This could be some of your problem when it comes to bruising and whatnot; your change of your chemistry of your soils and whatnot would have an effect on it; and your seed strains and whatnot can have an effect on it; and your storage conditions can have an effect on it. We have changed some of our storage facilities in Maine considerably over the past year.

Senator STEWART. Obviously, there was some difficulty with the Maine potatoes in the delivery process. Are those the things that you have listed that might create that problem?

Mr. WEBBER. Yes. The delivery process, the contract requires a U.S. No. 1, 2- to 4-inch, size A.

Senator STEWART. And they did not meet that specification?

Mr. WEBBER. Right.

Senator STEWART. And so as a result of that—is that what caused the suspension of the trading in the spring of last year?

Mr. WEBBER. This is what the New York Mercantile felt, that the quality in Maine that was left there, the stock on hand, was not of adequate quality, yes.

Senator STEWART. Did the farmers suffer as a result of that pretty bad economic downturn?

Mr. WEBBER. I have no proof to that effect, sir.

Senator STEWART. Well, the Senator from Maine indicated it did earlier, and I just wondered—

Mr. WEBBER. Well, how can you know when the price and the supply and demand continue the same before and after the board?

Senator STEWART. So you support the continuation of the trading of the potato futures by the New York Merc?

Mr. WEBBER. Yes. For example, one of the reasons is that a great amount of our dealers, at least a lot of the farmers, do not directly use the board. We, as dealers, buy futures contracts under an agreement contract stating that they will put the potatoes in any size bag, and we will protect our investment as shippers, as dealers, and hedge these on the board.

Senator STEWART. So are you saying that that indirectly benefits producers.

Mr. WEBBER. Indirectly.

Senator STEWART. Do you agree with objections that have been raised by the producers and farmers in Maine and in Idaho and elsewhere that the trading of potato futures has to do with a lack of confidence in the New York Mercantile Exchange?

Mr. WEBBER. Somewhat.

Senator STEWART. Do you think that the activities that occurred in May 1976 and May 1979 had something to do with that?

Mr. WEBBER. Yes.

Senator STEWART. Do you think the corrective actions that were taken by the New York Mercantile Exchange after those things would be something that would help and assist in restoring confidence in the exchange?

Mr. WEBBER. Yes. I feel if they continue working toward and trying to keep better communications between the farming community of Maine and the people who are hedging their commodity on there—

Senator STEWART. Has it been poor communications between them?

Mr. WEBBER. It has somewhat in the past. Of course, when your product is the grade, standard, that is required, then you do not have the problem. It does not exist.

Senator STEWART. You do not have the problem if it is a deliverable product.

Mr. WEBBER. Right. We are proving it right now. We are delivering potatoes and they are receiving them—in November.

Senator STEWART. You mean, in connection with the trading of futures, some have been delivered in November? They were received?

Mr. WEBBER. They were accepted.

Senator STEWART. The operation is smooth?

Mr. WEBBER. But also, the commodity itself is in good shape.

Senator STEWART. Do you have any other comments you want to share with us?

Mr. WEBBER. No, other than that I would recommend to your committee that we feel negative on this reform and on this bill.

Senator STEWART. Thank you very much for being here. We appreciate it very much. We will make your full statement a part of the record.¹

Mr. WEBBER. Thank you.

Senator STEWART. Our next panel of witnesses includes: Reynald Soucy, of Fort Kent, Maine; Melford Sjostedt, Stockholm, Maine; Ray Lamoreau, Caribou, Maine; and Don Silver, MFX Commodities, Presque Isle, Maine.

Gentlemen, if you would, I hate to limit you, but we have four more panels after this one, and I want to give everybody the opportunity to be heard. So please make as brief a summary of your testimony as you possibly can, and I will appreciate it.

Of course, I am going to go on through the dinner hour, to attempt to give everybody the opportunity to testify, because we might have some who have planes to catch, and I want to give you the opportunity to testify and not have to rush out to National or Dulles or wherever you are leaving from.

Please proceed now with your statements.

STATEMENT OF DON SILVER, VICE PRESIDENT, MAINE FARMERS EXCHANGE, INC., PRESQUE ISLE, MAINE

Mr. SILVER. My name is Don Silver, and I was up at 6 this morning, reducing my testimony to 5 minutes, because it is very difficult for me to talk that short a time.²

Senator STEWART. You ought to run for the Senate. [Laughter.]

Mr. SILVER. I am with Maine Farmers Exchange, which is one of the largest dealers of fresh potatoes in the State of Maine, and we recently celebrated our 20th anniversary. In addition, the company is MFX Commodities, which is a Futures Commission Merchant,

¹ See p. 133 for the prepared statement of Mr. Webber.

² See p. 135 for the prepared statement of Mr. Silver.

dealing not only in potatoes, but in all commodities. And also, we have another company, called Green Thumb Farms, which grows 600 acres.

The purpose of my being here is strictly, are we in favor or against futures trading. In circling over Boston, I was reading an article on the plane about turkey producers complaining about the below cost of production price that they are receiving. And it is interesting to note that the turkey producer does not have a futures trading market or a trading vehicle available to him to pass on the blame for low prices.

So my question is, Is the elimination of a futures market the answer to our potato industry's ills? That is, low prices—and our firms say no.

Our firms are opposed to the elimination of futures trading for very simple reasons. Our industry—and I talk as an industry, not only the Maine potato industry—cannot afford to lose another important market for the protection of their investment, which is very high.

Growers—that is nationwide again, particularly in Maine—will be disadvantaged when negotiating with preseason contracts with anyone, whether it be dealer, processor, or what have you.

In the past, the futures prices—that is, of New York Mercantile Exchange—has offered the only profit at one time or another that our growers and other growers, by utilizing a cross-hedge available to the grower or the farmer, the family farmer.

Financial institutions need the futures market to protect their loans—that is, to convert potatoes to cash. At one point our companies stress, and we have said it time and time again, no person or any segment of the industry is forced under gun to trade futures. Trading is voluntary, not mandatory. If the thing is no damn good, it will die a natural death.

And we have growers—and it is available to the Senator and this committee—those growers that have used the mercantile properly have obtained a profit, and this year, it was an exceptionally good profit.

Basically, the six reasons just stated are why our firms are opposed to the Muskie-Church bill. However, let us talk about some of the misstatements, some of the polls taken, and most recently by my friend and adversary—but a friendly one, I might add—Dorothy Kelley. The poll released by the Maine Potato Council states 81 percent—and our friend, Senator Muskie, said the same thing—against futures trading.

Not so, say we, as one looks at the overall poll. A little over 50 percent voted, and out of that 50 percent, 25 percent were in favor of futures trading.

No matter how one interprets—and this is our opinion—it does not accurately reflect the true sentiment—

Senator STEWART. That is how I got elected to the Senate; 50 percent of the people voted, and I got a little over 25 percent of the vote.

Mr. SILVER. Well, Senator, I guess the old statement is that, "Figures lie, and lies figure," something like that. But it certainly does not reflect the industry. Maybe it reflects the council's feeling. And we have already heard—I will not go into this—you are well

familiar with it—the SSR research. That was completed in July and says that over 52 percent were using it, so I will not go into that.

Another study which we are familiar with, authorized by Congress and sponsored by Senator Cohen—and I quote very simply from the study by Dr. Paul—and I do not agree with all parts of Dr. Paul's, and I have told him so—but to quote from the report: "Neither the continuation or the elimination of futures trading would produce a cure for the basic economic difficulties of the Maine potato sector." In other words, Maine should clean up its own act before coming down and taking your time and everybody else's time.

I mention just two studies which are favorable. In the past, there have been many more, Senator, and they always come to the same conclusion, always favorable. It is just a shame that we continue to waste your valuable time, my time and your money and our money, to prove once again that the futures market is a necessity to a profitable potato industry, not only in Maine.

In closing, I would personally like to invite you and your committee to Maine to see first hand for yourself—I am sure I could get help from Dorothy—to invite you to talk to these growers and find out first hand the pros and cons before you place your vote on this very, very important bill to our industry.

Senator STEWART. I deeply appreciate the invitation. We may come, but it may be sometime after the windfall profits tax and SALT II Treaty and a few other things.

I do not mean to indicate that this is not important, but I am afraid we are going to be here until December 24. I think the majority leader plans to have a Christmas tree in the Rotunda. [Laughter.]

Let me say one other thing. I did not mean to indicate that we would not take the time to hear you out; we will. I have this attitude about it. This matter may not seem to be important to the overall scheme of things, but I have always felt that if a problem is important to constituents of mine—and in some respects, you are, because I represent, as a Member of the Senate, the entire country on certain issues, and this is one that would be in that category. I will stay here as long as you want to discuss the issue. So do not ever apologize for taking anybody's time and anybody's money. You have a perfect right; that is the way this Government operates. And I think all of you ought to know that I feel that way.

Next witness.

STATEMENT OF REYNALD SOUCY, FORT KENT, MAINE

Mr. Soucy. Mr. Chairman, I am a potato farmer from Fort Kent, Maine. My name is Reynald Soucy, and I have been farming since 1961.

Just after I received my bachelor's degree in agricultural sciences from the University of Maine, I began farming. I started with 15 acres and now farm around 300.

A seed farmer's crop obviously is sold to other farmers for replanting. But what may seem like a simple business process is not. A seed farmer bears the same risks as fresh market farmers, and the futures market helps me in marketing my seed crop.

I use the futures market for my seed in three ways. First, negotiations for the price of the seed begin when the price is quoted on the potato futures market, and from the futures price, we can determine the final price for the seed depending on the variety, generation, and Florida test results.

Second, if demand for the seed shipping season is dull and I want to cover my costs, I hedge my crop in the late March and April months and lift my hedges as I begin to get some calls for seed in the winter months.

Finally, if the seed business turns out to be less money for some varieties than my hedges on the futures market, I might decide to pick out the sunburned and deliver on the exchange. For me, the futures market provides marketing flexibility that I cannot do without.

In addition to my seed farming business, I am also a potato dealer. Here again, the futures market is an integral part of my operation.

In a highly unpredictable commodity like potatoes, I cannot afford to go too far out on a limb financially, so I use the futures market to transfer some of my risks when I contract with a farmer. As soon as the farmer and I reach an agreement on price, then I go to the market and hedge the contract. It works like this.

A farmer will come to me and want to sell some potatoes. We sit down and discuss a price, using the cash and futures market prices as our guidelines. We both have the same amount of information. No one has any advantage over the other. We both know the crop's quality and acreage yield, and we both have access to present and future price information.

When we finally agree on a price, and when we both make commitments, I immediately turn to the futures market and hedge the contract. That way, I can be assured that if the price begins to jump around in the cash market, I will have my price locked in.

With the futures market, I will accept some of the risk the farmer wants to give up, and I will shift some of that risk to the futures market. By doing that, the farmer is sure of his price and I am sure of my price through my hedge.

Without the futures market, I will not take those risks, and I probably will not contract with farmers. And if I drop my brokerage business, all the risks rest on the farmer's shoulders. I think that would be unfair to the farmer. A farmer takes on enough risks when he puts his seed in the ground. Why take away a market that reduces some of these risks?

As a seed potato farmer and as a potato dealer, I oppose this bill for the above reasons. S. 770 would destroy the way I have been doing business for the last two decades.

If you have any questions, I would be glad to answer them.

Senator STEWART. Thank you for your testimony.

Next witness.

STATEMENT OF RAY LAMOREAU, CARIBOU, MAINE

Mr. LAMOREAU. Mr. Senator, my name is Ray Lamoreau.¹ I have been farming in Presque Isle, Maine, for 25 years. I grow about 750 acres of potatoes primarily for processing. I do pack some at differ-

¹ See p. 136 for the prepared statement of Mr. Lamoreau.

ent times of the year, but my major emphasis is on the processing markets.

I have been using the futures market for over 20 years. I would like to list three benefits I feel that futures trading offers in my potato-growing enterprise.

One, when I negotiate for preseason contracts with the one or two processors I do business with, I use the futures market as a guide for price.

Two, the futures market provides immediate market sensitivity. There are a lot of times when I am out in the field when I am not abreast of the market. Certain conditions will change concerning the potato market, which I would not know unless I could call and find out the price on the exchange.

Senator STEWART. Let me ask you something in connection with that.

What you are telling me is that this is a market, or a pricing device, which you use to put you in a somewhat similar position to the person that you are dealing with, the processor, or whoever. Is that what you are saying?

Mr. LAMOREAU. Yes, I am.

Senator STEWART. And without this mechanism, are you telling me that it would be difficult to use as an individual farmer to make that assessment of the market?

Mr. LAMOREAU. I would know what I would want for a price, to cover cost of production plus a small profit. But when I negotiate with the processor, I can look at the price on the exchange and say that I either get near this price, or I will grow the varieties that I can deliver on the exchange or use that mechanism.

Senator STEWART. In other words, this gives you—

Mr. LAMOREAU. Leverage.

Senator STEWART. My daddy used to use that word, and I understand that one. [Laughter.]

Mr. LAMOREAU. I feel it is very, very critical in my enterprise that I have some vehicle to use.

Continuing, I was saying that when I am out in the field, I may not know what is happening concerning the market. Immediately through the exchange, market conditions are reflected in the price. Now, all I have to find out is why the price has risen or dropped.

I am as current as anyone else and in a better position to bargain prices. For example, in 1976, when in the other fall potato producing areas the potato price was depressed, Maine had a potential for export. The futures market was sensitive to this fact and allowed me to sell the bulk of my potatoes for more money.

The third advantage of dealing in potato futures is that it gives me price protection, and that has been explained, I think.

Criticism of potato futures trading often is based on the perishability of the commodity. The modern contract on potatoes with its provisions for truck delivery and multipoint delivery adequately answers these questions. We can deliver not only to New York City, but to Boston and other cities in the east.

I fail to see where eliminating one vehicle for establishing the price, where many people are involved, and as in most futures markets, the public, or people outside the growers, are generally buyers, and the growers are predominantly sellers—how prevent-

ing these buyers from trading will help the economic position of the growers. I fail to see this.

As evidence, I would just like to draw attention—and I will enter this in the testimony—this is a chart from the Crop Reporting Board, showing the average farm gate price of potatoes in nine States. But let us take three States—Maine, North Dakota, and Idaho. These are the three fall-producing States, and they are all competitive with each other. They are large in potato production.

The period 1972 to 1977—6 years—5 of those years the farm gate price of Maine potatoes was approximately 60 percent over the other two competing States. One year, it was 15 percent less. But this tells me that something gives us a better price advantage—

SEASON AVERAGE PRICE HISTORIES—PRICE RECEIVED BY FARMERS

[Dollars per hundredweight ¹]

	1972	1973	1974	1975	1976	1977
Idaho.....	2.45	3.85	3.80	3.75	2.95	2.85
Washington.....	2.09	2.90	3.65	3.15	2.50	2.85
Maine.....	4.10	7.50	2.90	3.05	4.95	4.50
California.....	3.07	5.61	5.99	6.02	4.58	5.72
North Dakota.....	2.75	4.60	3.15	4.20	3.45	2.80
Oregon.....	2.75	3.98	3.89	3.19	2.71	2.72
Minnesota.....	2.85	3.95	3.23	4.32	3.23	2.75
New York.....	3.97	6.05	3.76	6.27	4.82	4.29
Wisconsin.....	3.57	6.40	3.65	5.45	3.95	3.90

¹ Crop Values, Crop Reporting Board, ESCS.

Senator STEWART. Are they covered by contracts, the other potatoes?

Mr. LAMOREAU. Idaho is heavy is processing contracts—

Senator STEWART. No, I mean futures contracts.

Mr. LAMOREAU. No, they are not, not in potatoes at the present time, except recently, this year, CME has a potato contract where potatoes from these areas could be hedged.

Mr. SILVER. Senator, could I respond to the question, just briefly? This is why I have been saying that the industry uses the present contract without any expansion.

As has been stated here, the CFTC has many people who utilize the contract, and they are called hedgers. This is done through what we call cross-hedging. In other words, our present contract in its present form is delivered to New York. Idaho uses it, and Alabama, as I stated to you earlier, I have many customers in Alabama that use it as a cross-hedge, knowing that they cannot deliver. But they know that they can work back what the price of potatoes in relation to Maines delivered in New York. For example, this is a high price year; we have many, many hedges from Idaho, because if you are an Idaho grower, you know exactly what the Idahos are selling at a premium when Maines are x price, and they are willing to accept the risk in a cross-hedge. And cross-hedging is nothing new. They do it on the Chicago Mercantile, many, many times, and they do it on the CBOT. Conversely, with wheat, many, many times I have seen it in our business, too, people from the Midwest will put on a cross-hedge.

Senator STEWART. Next witness.

STATEMENT OF MELFORD SJOSTEDT, STOCKHOLM, MAINE

Mr. SJOSTEDT. Mr. Senator, my name is Melford Sjostedt. I am a farmer from Stockholm, Maine.

I started my career in 1941 when I joined my father's farming business. Then I bought his farm in 1949, and I have been an owner and operator ever since.

I usually plant around 75 acres of potatoes, but this year I farmed 50. We had some strong rains in the spring, and it got too late for me to plant the full 75 acres.

I made my first trade on the futures market in 1952, and I have used it off and on ever since, some years successfully, some not. When the price is right, I have hedged a portion of my crop, and some years, I have even speculated. To be perfectly honest, when I have hedged, I did well.

Senator STEWART. When did you lose? When you speculated or when you—

Mr. SJOSTEDT. When I speculated, I did not do too well. I have had mixed results overall.

I am familiar with the market process. As my friends will tell you, I am a man who gets right to the point. Today, I have just two points I want to make.

First, the futures market is the one place where I can buy or sell potatoes 5 days a week, 12 months a year, and it is the only place it can be done. For a small farmer like myself, who does very little contracting, it is crucial to have such an open, accessible market.

Second, just as important as availability, the market provides me with critical price information. When I have to bargain with the processors, now at least I have a futures price to work from. It is like a barometer—an indication of what potatoes will be worth in the months ahead. If Congress bans futures, I will really be in the dark as to what is going on in the market. I will lose an important bargaining tool.

I would like to add, I have sold and delivered on the board, and I have always been paid. But in 1976, on that export deal, I delivered and did not get paid. That was not to the mercantile, though.

That is all I have to say, Mr. Chairman.

Senator STEWART. Who was that to?

Mr. SJOSTEDT. That was the big export deal in 1976—this went to the Wayne County Produce.

Senator STEWART. Let me ask all of you just one question, and any one of you can respond to it. Did anybody in the potato growers group in Maine lose anything as a result—this is economically, now—as a result of extensive trading on the futures in April and May? Was there a loss suffered by farmers? Was there some adverse impact?

Mr. LAMOREAU. I would like to respond to that, giving my opinion. Last year was a poor quality year for Maine, and it was evident in our current cash markets that we were having poor quality that particular year.

When the March deliveries came along, the first few contracts that hit—the bulk of them were turned down—did not make grade. It was evident also, to me and to others, that there was practically no way that acceptable deliveries could have been made. And given

those conditions, I felt the market could have hit the Moon, because there just was not the acceptable product to deliver.

I feel that if action had not been taken quickly, for the growers that had hedges on there without deliverable quality, they would have had serious problems. The futures market price did advance some, but the trading was suspended before it got out of reach of the average hedger.

So I think the grower that had hedges was protected, even though he probably lost some money, he could have lost a lot more if the market had continued to go up.

Mr. SILVER. I absolutely disagree with my friend, Mr. Lamoreau, because that is ludicrous. No. 1—and the question is this: Did they lose money? They lost their rear end. By suspending trading—the suspension of trading should be done by possibly three people—No. 1, the grower, No. 2, the financial institution that is putting up the money for that grower, and No. 3, the FCM who has it on his book and says they cannot make delivery. No. 4, which is April and May, there is a stipulation that you can make a commercial delivery, which is basically 85 percent ones, and it was stated by Ray that of the deliveries that failed in March, which must be U.S. No. 1, 85 percent would have made commercial delivery. And they would have been able to make delivery, and in our house alone, MFX, the Maine Farmers' Exchange, those prices, when they shut down trading, would have enabled the growers to pick up \$1 per hundred, a minimum of a dollar per hundredweight more, to deliver commercial grades over the U.S. No. 1 price. The supplies were available in Maine. It has been stated publicly by a USDA official.

Senator STEWART. Well, what you are saying is that the actions taken by the exchange did adversely affect economically those people who were growing potatoes in Maine.

Mr. SILVER. It absolutely did, because we had growers from all over the United States that were short the board, and they were financed by the banks, and they just liquidated and shut down the contracts. And that was absolutely the wrong step to take in our opinion, and I am sure we will be proven right.

That is subsequently why we are not trading many potatoes today.

Senator STEWART. Well, then, you lost confidence, or the people who were involved in it, lost confidence, is that correct, in the exchange?

Mr. SILVER. The exchange has many letters on record from bankers saying that it is the bankers who do most of the financing, who put up money—for example, you take our own company—

Senator STEWART. I did not ask that. I asked if—

Mr. SILVER. I am sorry. Yes, growers, certainly—here is the thing—they did not have an opportunity to finish out their hedge. In other words, if you sold potatoes in May or April, and you cut the contract off, then, there you are, the money that you have up—

Senator STEWART. You think that corrective action taken by the exchange after the event would be satisfactory?

Mr. SILVER. The exchange has made great strides in putting people on the potato board, and they are in the right direction now.

Senator STEWART. And you think that—

Mr. SILVER. Will help immensely. I do not believe the expanded—well, that doesn't—

Senator STEWART. Are you talking about the expanded contract?

Mr. SILVER. Yes. That is another story.

Senator STEWART. Well, let me ask you about that, because that is one of the proposals. If the trading of futures contracts is beneficial to the farmers who produce potatoes in Maine, then why would you be opposed to extending that same right or privilege to the farmers in Minnesota, to the farmers in Idaho, to the farmers in Alabama? What would be your objection to that?

Mr. SILVER. First of all, I have no objection to that. With the cross-hedge, they have that opportunity now with the present contract.

Senator STEWART. Let us give them a direct hedge. What is your objection to that?

Mr. SILVER. Because, as Mr. Lamoreau has stated, Maine, 5 out of the last 6 years, we have been able to obtain a higher tailgate price than the other areas.

Senator STEWART. Through the use of the market?

Mr. SILVER. Through the use of the mercantile, particularly. It is a well-known fact that Maine, because we are the only State—

Senator STEWART. So you are not opposing the contract expansion because of the fact that you do not feel like there ought to be trading in futures; you just want to maintain that advantage for the State of Maine, as opposed to providing it for other States. Is that correct?

Mr. SILVER. No, not entirely; not entirely, although that is one reason. But that is not entirely it. Our companies, I should say, think that—

Senator STEWART. You got close to saying that.

Mr. SILVER. Well, no. I am not opposed to improvements, that is for sure. But before we change a contract, I think a study—and I am glad to see that the CFTC is doing a study—the questions asked by Senator Cohen were very pointed, and they should be answered before we step in to initiate a new contract, without studying it thoroughly.

I personally do not feel the new contract will work because it is too much like the contract that is traded on the Chicago Mercantile, which does not work. You have too many areas, and in talking to our own customers who trade potatoes in great numbers, that is why they do not like to trade the contract, because there is no reason to buy the contract. In other words, you do not know whether you are going to get potatoes from Idaho or Washington, Oregon, Colorado, Wisconsin—you have no idea where they are coming from.

Senator STEWART. Let me ask you something. You deal on a contractual basis with farmers from Alabama. How do you do that?

Mr. SILVER. Very easily. I should not reveal names, but someone from Sand Mountain, a very good friend of mine whom I know you must know, calls up and says, "Don, what's the market doing?" I say, "It is trading." He says, "Sell me five cars." So we have a direct line to the New York Merc, and we sell five cars for account No. 175.

Senator STEWART. What would be wrong with his doing that himself under an expanded contract?

Mr. SILVER. Well, he would still basically do it the same way. I would hope we would still continue getting their business.

Senator STEWART. There is a slight possibility there might be somebody in Birmingham they would call.

Mr. SILVER. That is right. That is a strong possibility, Senator.

Senator STEWART. It is an even stronger possibility now. [Laughter.]

Mr. SILVER. Senator, the one big disadvantage I can see, the far out States do not bother me. We are worried about not enough supplies available to supply a futures market. But the opposite can be true, when you have too many supplies available. And nearby States, such as Rhode Island, Pennsylvania, and New York, which grow a lot of potatoes, they can practically deliver theirs in baskets to the futures market. And I am afraid that the supplies would be too readily available, and as a farmer in Maine, or in a far out area, an important area, prices would be depressed because of the ease with which they can deliver.

When I deliver a car out of Maine, I have got to stand freight for \$2 a hundred, and I get some risk. But if I am in Long Island, and the freight is only 40 cents, and the load is rejected, why, it does not really cost me that much money.

Senator STEWART. Well, how does my friend in Sand Mountain, though, deliver his potatoes? How does he do that? Does the growing of his potatoes have anything to do with his—

Mr. SILVER. Simply, the New York Mercantile Exchange price is delivered in New York, and his formula is, he figures what that would bring at the f.o.b. to Sand Mountain, Ala., because for example, he might be delivering into a processor in Pennsylvania; Sand Mountain sends potatoes into Pennsylvania for chipping stock. If the price is excessively high, he can work it back to Maine, what the price is into Pennsylvania, and then he figures out what the delivery price in Pennsylvania is, and he can work it back from Alabama. So this is a true cross-hedge.

And the only difference between a true hedge and a cross-hedge is that my friend from Alabama cannot make actual delivery. He has to accept the risk. And it is, as any cross-hedge—it does not have to be potatoes—if he will not be able to make the delivery.

Senator STEWART. But will he be in a more advantageous position if he could do as the Maine growers do, and have a direct hedge?

Mr. SILVER. I would have to obviously respond yes to that. It hurts my feelings to say that. [Laughter.]

Senator STEWART. Clayton?

Mr. YEUTTER. Would you like me to comment on that?

Senator STEWART. No; I would not like you to comment. [Laughter.]

You are going to have the opportunity to comment later on.

That is all I have for you, gentlemen. Thank you for being here.

Louis Wysocki, president, National Potato Council, accompanied by Don La Pointe, and Al Johnson.

Please proceed with your testimony.

STATEMENT OF LOUIS WYSOCKI, PRESIDENT, NATIONAL
POTATO COUNCIL OF IDAHO, POCATELLO, IDAHO

Mr. WYSOCKI. I am Louis Wysocki, president of the National Potato Council.¹ Our offices are located in Denver, Colo. My personal qualifications are that I have been a grower of potatoes since 1953. We currently grow 900 acres of potatoes on our own. We operate two large packing sheds, and we have a sales organization that moves 17 percent of the Wisconsin crop.

The National Potato Council has a longstanding position, first taken in 1965, of being for the elimination of futures trading of potatoes, and reiterates its position here today.

One of the basic reasons we have supported the creation of the Commodity Futures Trading Commission is in the hope that, with greater regulation, it would correct some of the inequities that we saw in futures trading.

We obviously have lost faith in their ability to do that, and that is why we take the hard stance and come before the Congress, to ask that they ban futures trading of potatoes on any mercantile exchange.

The reasons that the National Potato Council opposes futures trading of potatoes is because it does not do a job as a hedging mechanism for the industry, and the problems that arise from futures trading in potatoes has destructive reactions in our actual cash marketings.

For a potato to be in its deliverable state—and I think this is an important factor—it must first be removed from its storage state, physically handled, graded, packaged, and delivered, and be marketed in a matter of hours in order for it to retain its quality and meet its futures contract specifications. Proof positive of this is the rejections of contract deliveries of the March 1978 contract when they reached the delivery point.

It is this perishability and lack of storability that cause the cash marketing problems that disrupt orderly marketing. No other commodity has to enter retail trade channels immediately in order to maintain its value. Orderly marketing is further disrupted when these deliveries fail to retain their quality and subsequently, their value, and enter trade channels as distressed merchandise.

On other commodities, long hedges are oftentimes desirous of accepting delivery of the actual product to be held either in its present location, its delivery location, or for delivery to a yet to be determined location, to meet a future business commitment. Annually, we witness violently unwilling acceptance of delivery. This is caused by the potatoes' inability to meet the above-stated need.

Senator STEWART. Are you saying that the commodity is a perishable-type commodity that is difficult to store and has to be delivered at a certain time, and so as a result of that, it is not one that should be subject to futures trading? Is that basically what you are saying?

Mr. WYSOCKI. I agree. Let me further define perishability for you. Initially, the term "perishable" denotes a rapid loss of quality by such factors as decay, unless stored in a controlled environment, for whatever causes a particular decrease of quality, and then at

¹ See p. 137 for the prepared statement of Mr. Wysocki.

best, it can maintain its optimum quality for a minimum period of time.

Perishability, as it applies to potatoes and their trading on the futures market, goes beyond that in many ways. The maximum that a potato can be stored economically under the present state of the art, regardless of the environmental control used, is approximately 10 months. This means that the available supply annually reduces to zero, and depending on given growing conditions during a particular year, the supply can disappear in an even shorter period, thus leaving questionable or no availability of the commodity backing up the trade, leaving the contract open to speculation on both sides.

The potato as a commodity being traded is unique in itself in this aspect.

Senator STEWART. How does that situation change in a cash market? How does the futures market have a special relation to futures trading, the perishability of the product? In the cash market, is it any different?

Mr. WYSOCKI. Maybe I can help you on it. If I assume the question you are asking is deliverability—

Senator STEWART. Well, is the deliverability and the perishability of the product any different in a cash market than it is in the futures market?

Mr. WYSOCKI. To a degree, yes. The contract specifications are not—and I am going to talk in quantities and size of packs—are not what the markets are ready for or can assimilate at that particular time, especially when you have a lot of deliveries on the closing day of the month. With the limited amount of trading on the russet contract in the Chicago Mercantile Exchange—and I do not know if I have got my figures right, but I understand that there were approximately 15 cars that were delivered—I think the total trades are 90 cars, or somewhere in that area, on the market. In my sales organization—and I man a telephone 6 days a week—I have been hearing people say they have board cars coming, and these board cars were selling in a demand-exceeds-supply market for carton potatoes right now, they are selling for \$1 below the cash market, because it came onto the market at a time when nobody needed them, or in the right amounts, or in the right places. And if you get into table grade potatoes and the white potatoes, marketing structures and the manner in which, with the large advent of chainstores and direct shipments, directly from the farm to chainstore warehouses, where they do not go through a repacking operation, you have special packs for deliveries at certain times, specified dates for sales promotions that are going to take place on certain dates, and the futures market and the cash market in no way correlate on that.

We are able, by techniques, to get potatoes to market when our customers want them. The futures market does not address itself to that. But the problem, Senator, is that potatoes have to be put into a deliverable state; they have to be packed, retail packed. They would only maintain their quality for a matter of hours. Now, by technique, we can get it there.

But now, in order to have it deliverable, in order to be able to call, in order to be able to force regulation and force the other side

and have that, you have to be able to deliver. Regardless of whether you have a cross-hedge or not, somewhere there has to be deliverable product to keep everybody in line. There has to be a law. Delivery is the law.

There is a popular card game that is called "Call." The betters can go on and on and raise and raise, until one guy wants to get out and he says, "Call." That is delivery. And the pot has to be right. Prices converge at that time. In the futures market, they do not.

What are we talking about when we are talking about putting on a formula of pricing? I heard you listen to a story here where, if you hedged at \$12, and your cash went to \$14, you lost \$2 on the futures market, but you gained it on your cash market. How so, when the prices do not converge? This is where the additional risk is.

A futures contract—and if you will get into all the fundamentals, you are supposed to have no more of a cost in the futures market than the cost of the trade and the commission brokerage; that is supposed to be the insurance policy.

Then, how so do we have a different value? Why do we have a monetary difference? If they truly converge, and if the market is truly working, it will happen. I am sure that the National Potato Council could support that, if we can come up with a system where it actually works the way the fundamentals are meant to be. We say potatoes do not work in it, and nobody has been able to make them work yet.

Senator STEWART. The problem that you are talking about, the basic problem of a lack of convergence in price from cash to futures markets, has that been prevalent there for the 20 years that you have been involved in trading in potato futures?

Mr. WYSOCKI. In my personal opinion, without backed by records, I would say yes.

Senator STEWART. Well, why in the world would the USDA, that represents potato farmers, I assume, in Idaho and Maine and everywhere else, why would they come out with a study that indicated that it was in the best interest of the potato farmers to maintain a futures market?

Mr. WYSOCKI. They qualify that with the study—are you talking about the Dr. Paul report?

Senator STEWART. Right.

Mr. WYSOCKI. The Dr. Paul report addresses itself to the problems and identifies them well. But when it gets into the corrections of the problem, it gets very iffy. It says, "Take two aspirin, come back tomorrow, and we will see how you are doing." We have asked—the Maine Potato Commission—has asked that futures trading be suspended on such time, and says, "Quit giving it medicine until such time as you have the remedy. Quit practicing medicine," is what they are saying.

Senator STEWART. Of course, there seems to be a lack of unanimity among those who are using the market. You have just as violent an opposition on the other side by people who are presently producing and trading and dealing in potatoes, who want to maintain a market.

Mr. WYSOCKI. I thought you shot quite a few holes in that story.

You have to have deliverable product.

Senator STEWART. Gentlemen, I understand from staff you all have something to say. Please go ahead.

STATEMENT OF DAN LA POINTE, VICE PRESIDENT, GROWERS RELATIONS, NATIONAL POTATO COUNCIL

Mr. LA POINTE. My name is Dan La Pointe, and I am vice president of the National Potato Council. I produce 300 acres of potatoes in Van Buren, and I buy and sell potatoes as La Pointe Sales, Inc.

The National Potato Council has had a resolution on record since 1965 in favor of elimination of futures trading on all Irish potatoes. You may question the adequate representation in determining this resolution. Let me assure you that representation is sufficient, since 95 percent of all Irish potato production was represented at our last annual meeting.

We do not disagree with futures trading in theory. However, we have some very serious problems in trading potatoes. Actually, potato futures in the fifties started out being workable, but cultural practices now in effect, including storability, new varieties with more russet types grown, and less acreage planting, have reduced the liquidity of the potato futures contract in the late sixties and throughout the seventies. This allows for squeeze plays and manipulation.

We have tried to solve the problems, but we have received very little response from the New York Mercantile or the CFTC until the severe default of 1976, and the recent move in March when the Board suspended trading in April and May 1979.

On January 15, the Maine Potato Council wrote Chairman Marks of the board of governors, requesting the New York Mercantile Exchange to establish a moratorium on the 1980 potato futures contract, to take effect no later than February 1, 1979. We could see big problems coming in March, April, and May. In fact, the Maine Potato Council managed to set up a meeting with the CFTC in their conference on January 17, at which time we warned that the March delivery could be a bigger fiasco than the 1976 default. We were right, but it is most difficult to get people to listen to you down here.

How long will the potato growers have to suffer these interruptions and upheavals? Even the people in favor of retaining the mercantile would have to agree that bad management practices have reduced the volume of trading, and a lot of the major brokerage houses have informally boycotted the mercantile, thus reducing the number of speculators.

The president of the New York Mercantile lost his job for bad management practices. Even officials at the Chicago Exchange are appalled by the action of the board of governors of the New York Mercantile.

The mercantile's new proposed contract, according to an internal study of the CFTC, will only increase the available supply by 15 percent. This is not a viable option and will not solve the problem. The new potato contract on the Chicago Exchange will result in low volume and is ineffective as a hedge tool, despite much enthusiasm in the beginning. There has been trading in the Canadian

market in Winnipeg, but it was unsuccessful because of low volume.

There is surely a lack of volume in all potato contracts. To legislate out of business may be a strong approach, but it seems to be the only alternative.

Therefore, I urge you to report this bill out of committee.

Senator STEWART. Let me ask you a question. If your potato farmers in Maine discontinued use of the futures market, your dealers and others involved in the industry, wouldn't it die a natural death anyway?

Mr. LA POINTE. Well, they are certainly on their way there now. In the meantime, the growers have had to put up with it.

Senator STEWART. I mean, if they were to just discontinue use of this particular vehicle, wouldn't it die?

Mr. LA POINTE. Well, I think your reduction of the volume so far this year would indicate that the use has been reduced below an economic level for the mercantile.

Mr. WYSOCKI. I would add something to that. I heard some earlier testimony about the carrot and the stick approach. And I put a question mark, was that really a shell game and a card game? It is our opinion, and it is common opinion in the State of Wisconsin, that the Chicago Mercantile Exchange is creating a little bit of action, and they are hoping to attract some more. Now, how many people are supporting this, keeping it viable? The New York Mercantile Exchange has been operating for a period of years, and out of habit, it is continuing, but it is going down. But there has to be a reason why the Chicago Mercantile Exchange's contract has not gotten off the ground.

Senator STEWART. Well, some of them were indicated earlier, and they indicated that they were attempting to get more liquidity in the market, but they also indicated that if it was not, then it would more than likely die a natural death and would not affect the overall economic viability of the Chicago Mercantile Exchange.

Mr. WYSOCKI. Years ago, in my younger days, I was trucking, and I was on the Chicago market, on the salt water market. And alongside of my truck, there were a couple of individuals who had a card game going, and this one guy was winning all the time. I got in too, and you would be surprised how fast he switched the blacks and the reds in that three-card game that was there. I do not want to get into the Chicago Mercantile Exchange contract under the same basis.

Senator STEWART. Next witness.

STATEMENT OF ALBERT JOHNSON, VICE PRESIDENT, POTATO GROWERS OF IDAHO

Mr. JOHNSON. Mr. Chairman, I am Albert Johnson, from Pocatello, Idaho, a potato grower from Idaho.¹ I am a member of the executive committee of the Potato Growers of Idaho and a grower member of the Idaho Potato Commission.

I am here today representing the Potato Growers of Idaho, and written testimony has been presented by the Idaho Potato Commission.

¹ See p. 138 for the prepared statement of Mr. Johnson.

We are an association of approximately 1,300 members, and we are probably responsible for about half the production in the State of Idaho. In view of your request for brevity of time, I will only hit on a few points, because we have presented written testimony.

I also have another document I am going to leave with your staff. It is a study that our executive director made last summer, and I think it is pretty well put together, and it has been widely circulated.

Senator STEWART. I appreciate that, and we will make it a part of the record. Let me ask something that has been raised in my mind. It is becoming apparent that there might be some of this going on, and I would hate to suggest that it might happen, but it might. You have testified here today about your desire to see this contract banned because of the harm that it does to whom?

Mr. WYSOCKI. To the potato producer.

Senator STEWART. To the potato producer.

Mr. WYSOCKI. That is the interest of the National Potato Council, is to protect the potato producer.

Senator STEWART. Now, what potato producers do you represent?

Mr. WYSOCKI. We have a voluntary organization that represents the producers across the Nation, the full 48 States.

Senator STEWART. From what States?

Mr. WYSOCKI. All the 48 contiguous States that produce potatoes.

Senator STEWART. And these folks have stated in proper fashion that they are opposed to this particular marketing mechanism, that I am beginning to learn is not available to everybody but just to a few folks. It is available to some larger producers in certain categories, and now we are talking about expanding it to some extent.

Is it available, readily so, to all the people who produce potatoes in all the 48 states, or the futures trading, is this mechanism available to everybody?

Mr. LA POINTE. I would like to answer that, if I could.

Senator STEWART. I wish you would answer that.

Mr. LA POINTE. It has been referred to as the cross-hedge here, a few minutes ago—

Senator STEWART. I am not talking about that I am talking about direct access to a market.

Mr. LA POINTE. Any potato producer in the United States can hedge a Merc as a speculative hedge.

Senator STEWART. I am not talking about that. I am talking about whether or not this marketing mechanism is available to all the potato producers in the same fashion that it is available to those in Maine who want to keep it.

Mr. LA POINTE. No, it is not.

Senator STEWART. Why not?

Mr. LA POINTE. The only potatoes that can be delivered are Maine potatoes. If a non-Maine producer sells his potatoes on the Merc, it becomes a speculative hedge, because he cannot deliver his—

Senator STEWART. What if the expanded contract made that opportunity available to someone outside of the Maine area? It has been stated earlier that it would adversely affect the Maine potato producer. What if that marketing tool—you told me that same

privilege does not apply across the board. You told me that the cross-hedge is available, but he would be more advantageously benefited if he had the direct hedge opportunity.

You have also told me you represent all those potato producers. Has anybody ever said, "Why in the world don't we make this marketing device available to everybody, within the limits of the possibilities, as far as deliverability and all this stuff is concerned?" Why don't we do that?

Mr. LA POINTE. I would just like to comment.

Senator STEWART. Please comment.

Mr. LA POINTE. After my experience in Maine, I would not recommend it to my worst enemy in any State.

Senator STEWART. Well, of course, why don't you give them the darned choice about that?

Mr. LA POINTE. OK, we have.

Senator STEWART. Have they been given a choice? Have they been told, "Folks, our prices have been in most instances 60 percent above yours. How do you feel about that?" Is that the way it has been put to them?

Mr. LA POINTE. I disagree. We have the opportunity—

Senator STEWART. Somebody else said that earlier.

Mr. LA POINTE. They have had the opportunity to expand it to 15 States. A lot of those States were never asked. We of the National Potato Council have taken the time to write those people and for them to send in testimony to the CFTC. It is our understanding that the majority of these people are opposed to being included.

Senator STEWART. In other words, you all have circulated a petition, and you have pointed out the facts to these States and to these growers. Where is that information that this gentleman provided us just a few minutes ago, about the prices and the differences over the last 5 years in the potatoes that are raised in Maine and the potatoes that are raised in those States that are in competition?

Mr. LA POINTE. You may want to ask him to expand further on that.

Senator STEWART. I am going to see if he can't expand further on it.

Mr. LA POINTE. In addition, in order to give these other States an opportunity for public hearing, the National Potato Council, on October 22, wrote Chairman Stone, CFTC, requesting a public hearing, and as of today, we have not received an acknowledgement of that request.

Senator STEWART. I can assure you you are going to receive an acknowledgement of that request, because I am going to help you get that public hearing. Sometimes, people come to this body, and they say, "We represent all of the potato growers in the country," and that is fine, that is good. I represent all the folks in the State of Alabama, but all 3½ million of them do not write me on every issue that comes up, or all 1,800,000 that can vote. I sometimes get 100 letters or 200 letters, and I have got to crank them into what would be beneficial to the broad majority of the people. And we would like to do that with this legislation, too.

You raise some issues and questions in connection with Idaho potatoes—and that is what brought this to my attention. You

stated in your testimony that the present Russet-Burbank contract lumps all Russet-Burbanks into one category and can, over a period of time, erode the image of the Idaho potato.

Mr. JOHNSON. Correct.

Senator STEWART. I am worried about the possibility of having to cross-hedge from Alabama and Don eroding my economic possibilities in Alabama, too. I am just getting a little concerned about that. I mean, I do not want to be provincial, but I do reserve the right to be that from time to time.

Mr. JOHNSON. Senator, could I respond?

Senator STEWART. Yes.

Mr. JOHNSON. I am not real familiar with the New York Merc, but I am more acquainted with the Chicago Mercantile because it relates to russet contract.

In Idaho—and I do not know if you realize—but the Idaho retail price demands a better price on the market than most other russets. And one of the reasons it does is we have a peculiar situation in Idaho, I guess, in that we have a marketing order, and we pack our product in a premium pack, which a lot of Russet States do not, and that is where we get the increase in the retail market. We also do a lot of advertising and spend a lot of money advertising, and that is reflected also.

But there are very few trades made on the Chicago Merc, and one of the reasons is—and Idaho's case is what I am expanding on—is that with the marketing order, about 50 percent or a little less of our fresh sales—I am talking from the farmer to a fresh shipper—is packed in a package. Of that, only about 35 percent goes into the cartons, which are 80, 90, 100 counts. Well, that only leaves us with 15 percent of the crop that we can hedge on. The other 85 percent, we have to find another market for, either through processors, through just a fresh-pack situation, or whatever. In the case of wheat, you hedge your whole crop, but with potatoes in Idaho, we are only talking about 15 percent of the crop that actually goes into the fresh market.

Senator STEWART. Mr. Wysocki, I assure you you are going to have the opportunity to be heard on whether or not the contract should be expanded by the CFTC, as much as a person can assure you of that. I will try to get in touch with Chairman Stone, and see if we cannot get that opportunity available for you.

Mr. WYSOCKI. Would you remind him that we sent that letter?

Senator STEWART. I do not have any problem doing that at all. I will be glad to do that.

I thank all of you for your testimony.

Mr. WYSOCKI. I would like to add something; there are some things I think you should know. Earlier in my testimony, the position that has been taken since 1965 by the National Potato Council has been to ban futures trading. I am sure that the National Potato Council will take a look at any other alternatives. If futures trading can be made a viable tool for industry users, for the potato industry, I am sure there will be no problem getting that support.

With regard to the representation of the National Potato Council, the growers, we would be glad to provide you with informa-

tion—I do not think it is appropriate to bring it out here, but we can do that.

I believe that you are seeing here today a situation of frustration. You have heard Mr. La Pointe tell about attempts to work with the CFTC, with the Mercantile Exchange. In the years I have been associated with the National Potato Council and industry—I have been in the industry all my life—I have heard this over and over again. In my tenure as president of the National Potato Council, I restructured the council so that the problem that Maine has been bringing up to our council for years could be put in a position so it could. Part of that entailed putting Dotty Kelley on a committee, what we call our legislative committee, so she could be in direct contact and control. The problem was manifested mostly in Maine, because it is a Maine potato contract.

I instructed Mrs. Kelley that Maine was to take the position, if they wanted to get things moving, and take the lead, and we would support it.

One other thing, on getting information to people, you say why haven't we tried to expand it. The New York Mercantile Exchange came into Wisconsin; they were told that we do not have deliverable potatoes. I do not believe it, and somebody needs to prove to somebody that there are deliverable potatoes. Wisconsin's marketing of white potatoes does not go beyond the lines of the State of Ohio. Economics and transportation prevent us from doing it. How can we deliver? In order to keep everybody in line, in order to keep speculation out, when you have not got the aspect of deliverability, you have two speculations, one on each side, and that is why you do not have prices converging at contract close, because if I could call, if I could deliver, this guy would have to put his money where his mouth is, and that is the possibility that we do not have. If that can be provided, yes. Those are the fundamentals of hedging.

We have listened—you have not let that come into this meeting, and I appreciate that, of using up the whole hearing listening to the fundamentals and having an elementary course in the fundamentals of futures trading. Let us apply the fundamentals of futures trading to the product, and that is potatoes.

One other thing. I granted an interview as Louis Wysocki to the CFTC. A representative came to my office. I specified that I was giving information to the CFTC on the basis of myself, my personal self, and if they wanted to get it from me as the president of the National Potato Council, at a later time in that interview, we could get into that. After the interview was completed, to specify my position or back it up, I offered to sign six pages of notes that were taken there, give the CFTC representative a chance to edit them, look them over, take out wherever we referenced the names and certain fiascos, so I would be clear; I would sign them as president of the National Potato Council and stand before my board of directors and all the potato growers in the United States, to be judged if I was telling the story wrongly.

I was told that I was not entitled to that copy; after a brief scene in my office, the man left my office without any notes or any minutes of it. And if you want to ask a few questions on that, I would be happy to answer them.

Senator STEWART. I will not burden the record of this hearing with that. We may want to talk to you about it later, Mr. Wysocki.

Mr. WYSOCKI. Thank you.

Senator STEWART. Thank you all for being here.

The next witnesses are Dorothy Kelley, Merle Johnston, Commissioner Glen Manuel, Basil Fox, and Michael Carpenter.

I am going to have to ask you to make your statements as brief as possible.

Mrs. Kelley, I have been looking forward to meeting you. I have heard a lot about you during the hearing.

**STATEMENT OF DOROTHY KELLEY, EXECUTIVE VICE
PRESIDENT, MAINE POTATO COUNCIL**

Mrs. KELLEY. My name is Dorothy Kelley, and I am executive vice president of the Maine Potato Council.¹ I represent all growers of 5 acres or more. We have 951 potato farm units in the State of Maine, and the average acreage is only 109 acres.

With your permission, I would like to give you a little background on why the Maine Potato Council for 20 years has tried to eliminate futures trading. Several of the reports are attached to my testimony, so I will just go beyond that. But I would like to tell you in regard to the statement of our last referendum that we had, it was 86 percent of the growers favored the elimination of futures trading, and 14 percent wanted to keep the futures trading, and it was a 63 percent return, and that is a pretty good return on any referendum.

You have been hearing a lot of different stories here, because we do have two segments. The growers are in favor of eliminating futures trading, and our dealers in the area—we have about 120 dealers—say that they need futures trading for constructive business.

It is very difficult, really, after all these years, for the potato producers to understand why we still have to put up with futures trading when they have voted so many times.

I have read Dr. Paul's report in entirety, and I find it very well done, historically, but he did leave a lot of questions unanswered. I sort of compare the report to a cancer, with Dr. Paul the researcher, and he is willing to try any remedy to cure his patient. But if any of those remedies do not work, then the patient will die, and he so states in his report.

We do believe that actually, futures trading of commodities is an economically valuable institution for the United States. In the past when we have tried to eliminate potato futures because of the perishability and the short supply, we have come up against the idea that the potato futures contract at the New York Mercantile Exchange was the basic economic contract. However, now, the exchange does have many other contracts—U.S. silver, coins, imported lean beef, platinum, heating oil, and gold. Therefore, I do not feel that perhaps the elimination of a potato futures contract would be quite as serious. Actually—

Senator STEWART. If it is 25 percent, I believe you testified, of the volume of trading on the exchange, then it would have some kind of economic impact, I would assume.

¹ See p. 157 for the prepared statement of Mrs. Kelley.

Mrs. KELLEY. It would have to.

Senator STEWART. I do not know what their total volume is in terms of dollars, but I think we have to face the fact that if it is banned, 25 percent of that particular exchange's volume would have an impact.

Mrs. KELLEY. I would have to agree with that.

Senator STEWART. Those things, we have to weigh from time to time as we consider.

Mrs. KELLEY. One of the members of the board of governors made the statement to me that when they are attending the meetings at the present time, only 5 percent of their discussions are spent in regard to potato futures trading.

Many times, we have been asked how are we ever going to price our product if we do not have futures trading on potatoes. There are many daily, weekly, and monthly reports that are available to producers. The question has been asked how would they price their contract—

Senator STEWART. Who is setting the prices in those?

Mrs. KELLEY. These are throughout the United States, a lot of Government reports and so forth.

Senator STEWART. What do they use as indicators for price?

Mrs. KELLEY. What has happened the previous—actually, they are a day late, the reports, many of them that we have. We have our market news report.

Senator STEWART. So is that what the processors are paying for them, or the dealers are paying for them?

Mrs. KELLEY. Yes, the previous day; it would not be immediate price, most of them.

We have an agricultural bargaining council which bargains with the processors in the State of Maine, for the price. Years back, they did use the New York Mercantile futures contract for their pricing mechanism. They do not at this time. I also work for that organization. They found that the prices are not realistic or reliable now for their bargaining with the processor.

Senator STEWART. Is that because of the situation that occurred in 1976 and the situation that occurred in 1979?

Mrs. KELLEY. Yes, absolutely.

Senator STEWART. Have they gone back to this bargaining mechanism to set prices?

Mrs. KELLEY. They do, somewhat. They bargain and spend a great deal of time with the processor.

Senator STEWART. In other words, if I was the farmer now, raising potatoes, as the gentleman indicated earlier, I would not look to the market for the futures price to determine the price of my potatoes, but I would go to this bargaining unit to determine that; is that correct?

Mrs. KELLEY. This bargaining unit that we presently have bargains only with the processor; it does not bargain with the fresh market.

Senator STEWART. What about the dealer?

Mrs. KELLEY. It does not bargain with the dealer. This is only with the processor, for a contract.

Senator STEWART. Well, let's say I am a fellow who wants to sell to the dealer. Would I be adversely affected if a mechanism by

which he sets prices or operates his business—would I wind up having to sell to the processor? I mean, what would it do to me?

Mrs. KELLEY. The dealer?

Senator STEWART. No, the grower.

Mrs. KELLEY. We have 120 dealers, and they make calls, and the growers call them constantly. And because of so many dealers, sometimes we sort of nickle-and-dime the price down.

I believe that our commissioner of agriculture remarked about a mechanism that we are considering and that will go to hearing, and this is a mechanism whereby we establish a board, and this board would set the daily price between——

Senator STEWART. Who would that be?

Mrs. KELLEY. They would be appointed.

Senator STEWART. By whom?

Mrs. KELLEY. Probably by the commissioner. That has not been established.

Senator STEWART. The commissioner of agriculture?

Mrs. KELLEY. Yes. That has not been completely established.

Senator STEWART. Would they be producers or dealers or consumers or processors; who would they be?

Mrs. KELLEY. Well, they would not be processors; I could answer you that question very well. It would be producers and dealers.

Senator STEWART. And they would set the prices.

Mrs. KELLEY. Right.

Senator STEWART. In other words, I could determine from that the price.

Mrs. KELLEY. Right. Now, this price would be set between our local dealer and the producer or the packer. It would not be an outside buyer. It would be right in our area, between our dealers and our packers.

Senator STEWART. Where do you ship your potatoes?

Mrs. KELLEY. Our potatoes go all over the eastern coast, the eastern seaboard, down to Florida and into——

Senator STEWART. But you would set the price for those potatoes through a marketing mechanism that was established in your State.

Mrs. KELLEY. The minimum price that that producer should receive for his potatoes, because it does vary right within the State.

They would also have a mechanism where each of the growers would commit——

Senator STEWART. Well, what if I was a processor in New York and I did not like the prices that you were setting up there in Maine?

Mrs. KELLEY. Well, this price would have to vary every day, because it would be a minimum price for that time. It would not be a situation where maybe the potatoes in New York were selling for \$3, and Maine would say, "Well, we have to have \$4 for our price." This marketing board would call throughout the United States every day and find out what the price was, and then the board would set the price accordingly.

Senator STEWART. The marketing board would call throughout the country to determine how prices were being set in other parts of the country, and that information would be built into their——

Mrs. KELLEY. Right, built into their decision what the minimum price should be for Maine potato growers to receive for their potatoes.

Senator STEWART. Is your basic objective in setting a price by the futures market the fact that you feel speculators are doing that, and they are depressing or raising the prices as it benefits them? Is that your basic objection?

Mrs. KELLEY. That is the basic objection.

Senator STEWART. And you feel like this would—

Mrs. KELLEY. This gives us a realistic picture—for the producers, now. I represent producers; I do not represent the dealers in our area.

Senator STEWART. Well, what if I am a fellow who goes down to buy a potato chip; how am I benefited by that?

Mrs. KELLEY. Well, a consumer who is going down to buy a potato chip, I do not think it is going to make one bit of difference in the price that you are going to pay for that potato chip, because we, the producers, do not have much control over the price that the consumer pays in the supermarket for the product.

Senator STEWART. So it is not going to reflect in the price of that potato chip.

Mrs. KELLEY. I am afraid not. Perhaps this would answer Senator Cohen's question in regard to how we plan to replace the pricing mechanism.

Recently, because of the action of the board of governors, it has been very difficult to have the growers get hedging financing. Some of our lending agencies presently would only loan for the month of November.

Senator STEWART. Do you dispute the figures that have been stated about the number of people who are potato producers in Maine who are now using or have used the hedges? Do you dispute those figures?

Mr. JOHNSTON. Have used is one; who are using it today is another.

Senator STEWART. I understand that, but do you dispute the fact that in the past, potato producers have used it in percentages that were—

Mr. Fox. That is collectively, though, over a number of years, not 1 year.

Senator STEWART. It is collectively, over a number of years.

Mr. Fox. That makes quite a difference. If you took the percentage that used it in 1 year, you would find quite a bit of different action.

Mr. CARPENTER. It would be interesting to see what the percentage would be who have used it for a hedge in the past, say, 5 years—well, since 1976.

Senator STEWART. They date it through 1978, as I understand, or 5 years previous to that.

Mr. MANUEL. Many people, Senator, may just dabble in it a little bit, and then get out, and there would be a record of them having used it, you see, which is really a distorted record.

Senator STEWART. Well, do all of you gentlemen basically agree with the statements that have been made by Mrs. Kelley here today.

Mr. Fox. We concur.

Mr. CARPENTER. Yes.

Senator STEWART. Do you have anything to add to what she has provided us here, by way of information? I would frankly like to know what you think of this marketing mechanism that she is talking about, or pricing mechanism. Is there a history of that? Has that been used before?

Mr. Fox. This pricing thing that we were talking about, I think the reason that we need it so badly is because we have so many dealers. As it is now in the State of Maine, in one day we may have a dozen or 15 different prices, and it is more or less to stabilize the quote that is going out of Maine every day. It is not going to set the price of any market, only the market in Maine, and it will try to control the quotes that are going out of Maine, so they will all be the same.

Mr. CARPENTER. May I respond to that and add a couple of other points?

Senator STEWART. Go ahead.

STATEMENT OF HON. MICHAEL CARPENTER, MAINE STATE SENATOR

Mr. CARPENTER. My name is Mike Carpenter, and I am a State senator, up in Aroostook County where most of the potatoes in Maine are grown.¹

As far as the marketing mechanism, I am not familiar with it—Commissioner Smith is just in the process of drawing this up, so I do not know what it will be.

Senator STEWART. Well, it sounds somewhat like, according to staff, a proposed marketing system that would parallel the method of pricing that is presently used by the national provisioner for beef, or the yellow sheet, that has come under some considerable criticism.

Mrs. KELLEY. Actually, this mechanism is used by the raisin industry at the present time.

Senator STEWART. The same mechanism you are discussing?

Mrs. KELLEY. Right.

Mr. CARPENTER. What mechanism takes the place if we do away with futures, is a question that has come up here time and time again. And the way the farmers that I represent feel is there is nothing in the world wrong with letting a free market situation take over.

I would just like to touch on a couple of other points that have been raised by the people here. The people who have been up here this morning speaking against this bill, every bit of testimony that I have heard this morning and this afternoon, I think can be rebutted—obviously, we do not have enough time. But if you go back and look at the history of the Maine potato industry, the Maine farmer—and this is a thing that we do not seem to talk that much about, that is, what does the farmer want, what does the grower want. We have had producer dealers, producer dealer brokers, producer dealer salesmen here today, testifying against this bill. What does the farmer want? After all, isn't the majority of the economic benefits supposed to accrue to him?

¹ See p. 163 for the prepared statement of Mr. Carpenter.

I have heard this economic need or economic benefit that is available through the futures business, and my question is, to whom?

Senator STEWART. Let me just speak to that just a minute, and let us do it from a realistic standpoint. Certainly, there are people who are trading in the futures market, but there is some risk involved there, and they take that risk. They do not all gain. They do not all make a mint of money. There are risks in the farming business, too. They may be less than the risks that might be taken by those—my father was a farmer, and I would argue with that—but there are some tremendous risks there.

But let us take into consideration that there are all kinds of free market situations that exist in this economy of ours. There are all kinds of benefits that accrue, all kinds of risks that are taken, and they vary.

There are arguments that can be made on both sides of this question.

Mr. CARPENTER. Senator, why should you and I play cards, and we decide we want to do that, but the outcome of that card game affects this man's or this woman's livelihood?

Stewart Smith hit the nail on the head earlier, when he talked about the effect on the nonuser, that price as determined by the New York Mercantile Exchange is where the price is for the cash market. That is our yardstick.

You mentioned your daughter, Priscilla. If you took that pen home and told Priscilla that that was a yard long, and you told her that consistently for a period of time, you would have a hard time convincing her later on that it wasn't. And this is the problem; the nonusers.

They talked about hedges, and I heard speculative hedges. Let us talk about a hedge as a farmer who sells a few cars that he has, that he can deliver. That is what I call a hedge, and I think that has to be somewhere in the definition in the economics books.

The farmers are not hedging the potatoes in Maine today, sir. You may have these speculative hedges. You probably have a lot of dealers, a lot of brokers that are selling a lot of cars, and they can go out and buy some cars off the street to cover that if they have to. We have grown men in Aroostook County shudder of having the delivery on the mercantile. You heard about the rejections last spring, but nobody has talked about the problems that resulted from those rejections. What about the trailers that they rejected that were subsequently reinspected and found to be perfectly all right? Nobody has talked about that today. What about the questions about the inspection service; the CFTC? We could spend hours here talking about what the CFTC has done or has not done in this case. We had many trailer loads that were down for mercantile delivery. They failed the inspection. They subsequently were hauled on to another market, inspected again by a Federal inspector, and passed.

Senator STEWART. Were they sold?

Mr. CARPENTER. Yes, sir. They were too expensive to haul back to Maine. They were sold in the marketplace—and inspected by a Federal inspector and passed.

There are some real serious questions raised. We have heard about the closure of the mercantile and how that affected the Maine farmer. I heard Mr. La Pointe say that did not affect the cash market. We had headlines in the Miami newspapers and in all the New York newspapers saying Maine potatoes were junk, and immediately after that, the cash market went flat to hell.

I have heard talk about bankers supporting hedges. I talked to probably the largest bank in my area the other day, and they have not financed a futures contract in 2 years; they have been asked to do so once. I do not know who is financing them. The only people who are able to stay in the futures game today are people that have the money to do so, because you are not going to go to the Depositors' Trust Co. or the Northern National Bank and get the money.

Senator STEWART. So you are saying that futures trading is just not beneficial at all, nor has it ever been beneficial to the Maine potato farmer, and you just do not want it.

Mr. CARPENTER. I think at one point, it possibly was beneficial. I do not believe it is beneficial, nor do I believe it is being used.

And the second gentleman there, Mr. Johnston, worked with the mercantile for many years and probably could respond to that better.

Mr. JOHNSTON. Senator Stewart, I know you have had a real hard day today, and I feel for you. I am a former State legislator, and wonder where some of your other committee people are here today, to relieve you of some of those—at least lunch hour, that you may get out to lunch—

Senator STEWART. I do not really need to eat lunch.

Mr. JOHNSTON. Well, some of us do not either, but it is disturbing to see that you have to sit here this long and listen to so many sides to a situation that is very, very complex.

Senator STEWART. Well, I think there is an apprenticeship you go through in every occupation, and I think that is what this is called. [Laughter.]

Mr. JOHNSTON. I went through a similar experience, and I know what you are going through.

STATEMENT OF MERLE S. JOHNSTON, FORT FAIRFIELD, MAINE

My name is Merle Johnston,¹ and I have been with the New York Mercantile Exchange for approximately 7 years in the 1970's.

I have watched this potato industry go through many, many changes, and changes have to come about—

Senator STEWART. In your experience, let me ask you some questions. Do you consider the loss of the market and the economic plight of the Maine potato farmer, which has not been good in some instances, totally to the trading of potato futures?

Mr. JOHNSTON. No, sir, I cannot do that.

Senator STEWART. What are some of the reasons?

Mr. JOHNSTON. Well, No. 1, we are going through changes. And as Dr. Paul said in his written statement, Maine has undergone many that are not conducive to futures trading today.

No. 2, our acreage is decreasing; the country's acreage is increasing.

¹ See p. 164 for the prepared statement of Mr. Johnston.

No. 3, we are planting a potato that is not long in storage; it deteriorates. As an example, the problem in the May delivery of last year.

The thing is that we have gone through some changes that we just cannot continue in a futures market as such. Now, way back in the fifties and up into the seventies, it was fairly stable.

Senator STEWART. Well, do you dispute the fact that was presented by another fellow from Maine a minute ago that the tail-gate prices for the Maine potato—other than in 1 year when it was 15 percent lower—was 60 percent higher than their competitors from North Dakota and one other State?

Mr. JOHNSTON. This could be a fact of statistics, but it does not attribute to a futures market.

Senator STEWART. You do not think the futures market had anything at all to do with it?

Mr. JOHNSTON. No. Let me ask you something. In 1976, we had \$19 and something on the futures market, and our cash market never, never came near that. You see, the reflections are not there today.

What is happening is they are trading potatoes with speculative motives and working violent, volatile markets, and the cash markets in Maine drag, and they do not come near what they have been doing the last few years.

Senator STEWART. Well, do you have a fallback position B, where if this particular piece of legislation is not passed, and there may be some objections to it, there may be some people who do not want it to pass, and it might have a good strong possibility of getting vetoed. The administration does not even support it.

So what would you suggest as an alternative?

Mr. JOHNSTON. Well, the alternative is—and I really, sincerely believe it probably will not get passed, because I know what people say of the economic benefits of this—but if it is not passed, then the Commodity Futures Trading Commission had better get on the job and do something with the New York Mercantile Exchange's management of a futures market that just does not work for the situation today. They have allowed too many infractions. They have changed the rules, inspections have been hard to work—

Senator STEWART. If you have done nothing else, you have made me a great believer in some activity, at least in the area of hearing, with regard to the Commodity Futures Trading Commission.

Mr. JOHNSTON. That is one area. The other area is the management of the futures market with the New York Mercantile Exchange. They continue to violate the rules, and one of the gentlemen from New York mentioned their advisory committees and so forth—we had them when I was there, and they disbanded them and did not listen to them and probably will continue not to listen to them if it is not beneficial to the New York trading practices and so forth.

Senator STEWART. What did you do with the New York Mercantile Exchange?

Mr. JOHNSTON. I was a manager of an information office at that time; they called it the main information office. It was an office that was trying to organize, educate, get the growers involved in a futures market and stand to a point where you can defend it. The

last several years, after the actions in 1976 and 1979, there is no way that you can defend the actions that have come about, and you have to say that we have got to eliminate the potato futures market.

Give them the commodities that are unperishable. Take the perishable away from the potatoes; they took the onions away from them. I think the onion growers have survived, and have probably done just as well.

Now is the time for Maine and the potato industry to lose their marketing tool, as we call it, that has become ineffective and just does not work, and let them have the other bodies which they have been building up and doing well at, and the mostly stable ones—cattle, hogs, you name it—and they are mostly commodities that are not perishable. You can hold cattle. I have got them, and you can hold them for 30 years if you want to.

So these are things that relate to the futures market today.

STATEMENT OF BASIL FOX, WASHBURN, MAINE

Mr. Fox. Mr. Chairman, this is the third time I have appeared before a congressional committee trying to get rid of the mercantile.¹

Senator STEWART. You mean the futures trading.

Mr. Fox. The futures trading, yes, and futures potatoes, in particular. I think the New York Mercantile on potatoes and the FTIC, I think they have lost their credibility, if they had any. I think we have every reason to believe that. And when they come up with all their little suggestions and Band-Aids that they are going to put on to improve this thing, I do not think their past record would warrant us believing that. And if they do not believe it, and nothing is corrected, and this bill is vetoed or turned on, I think within a few years, we will see it back here again.

Senator STEWART. Well, the only reason for my questions this morning to the members of the New York Mercantile Exchange was to stress that there is a need for confidence, and if there is not, then we are going to lose this potato item anyway. There is apparently not much trading even in the Chicago Exchange in that contract. So, it is going to die a natural death. And something is going to have to be addressed by the agency that this converse setup will have to handle that problem.

But I would hope that they would have some involvement by the people who are producing the potatoes. It would seem to me that that would be something that would be needed.

I am sorry, but we are going to have to go on to the next panel. I did want, though, to give you the opportunity to introduce yourself and make some statement.

STATEMENT OF GLEN MANUEL, COMMISSIONER OF INLAND FISHERIES AND WILDLIFE, AUGUSTA, MAINE

Mr. MANUEL. All right, I will, because you might be confused when you look at it. My name is Glen Manuel, and I am from Aroostook County, Maine. I am currently the commissioner of inland fisheries and wildlife.

¹ See p. 165 for the prepared statement of Mr. Fox.

However, I just want to point out that I have been a potato farmer all of my life. In fact, I am the fifth generation of farmers up there.

I have outlined in my report, which I hope your staff will have a chance to go over, my ideas on why the exchange is not good for the State of Maine, and I have specifically zeroed in on continuity of supply and orderly marketing. That is something that really has not been touched on here today.

The report is there, and somebody can read it. Thank you.

Senator STEWART. Well, let me assure you that each one of your statements is going to be taken, and I am going to take a look at in summarized form, and I will make a report to the remainder of my colleagues, and I am sure Senator Church and others are going to make sure that we hear from you all and address the issues that you have raised.

Mrs. KELLEY. Senator Stewart, may I just make one request? I have a statement here from Duane Smith, our extension economist, and could that be added to the record, please?

Senator STEWART. We would be glad to.¹ We will hold the record open.

I am glad to have had all of you here, and I am particularly glad to see you former State legislators, because that is where I got my start.

Mr. JOHNSTON. Thank you for giving us your time, Senator.

Mr. CARPENTER. Senator Stewart, the attorney general's office of the State of Maine, if you will send a copy of the transcript of this hearing, reference the exchange earlier this morning with the CFTC people, I have talked to the young lady who is the attorney that has had the problems, and her figures, her dates, do not agree with what was quoted.

Senator STEWART. Well, of course, he was speaking, I think, if I am not mistaken, just from his best recollection, so it could be that there is some—but we will be glad to try to resolve that.

Thank you.

The next panel is Darryl Cook, Bill Weber, William Loughmiller, and Dean Fulmer.

We have a rollcall vote that will take place in the next 20 minutes, so if we could get to your testimony now and you could briefly summarize it, I will try to get our questions to you.

Introduce yourselves for the record, and then proceed.

STATEMENT OF BILL WEBER, QUINCEY, WASH.

Mr. WEBER. I am Bill Weber from Quincey, Wash. I am a farmer, I farm about 2,500 acres. I started farming in 1960.

I am for keeping futures on the board. Just to hit on a few points that I think we need to work on, we get probably \$1,300 an acre on these potatoes when we are raising them, and that is a big gamble. By using the futures market, we can cut that gamble down by a lot. The years that the price of spuds is low, there is usually some time in there that we can sell them on the futures and come out ahead instead of taking a big loss.

¹ See p. 168 for the statement of Mr. Duane Smith.

I think one of the big things we need to do is educate the farmer and the lender on the futures—which we are doing in Washington right now.

Senator STEWART. Well, let me just ask you a question. Has the futures been of economic benefit to you?

Mr. WEBER. Well, I have just used it this year, and it has so far, yes. And some of my neighbors are delivering right now on that contract, and they are very happy with it. And I guess, the way they talk, the guys that are receiving them—

Senator STEWART. Do you deal with the New York Mercantile Exchange or the Chicago?

Mr. WEBER. Chicago. This is the Russet contract. But I would be in it heavier right now, except the bankers do not understand anything in our area. This is new.

Senator STEWART. My goodness, do you mean bankers do not understand something?

Mr. WEBER. Right. And they are now coming around on it. We just had a seminar the last 2 days, in fact; I had to leave it to come down here. And a lot of the bankers were there.

Senator STEWART. Well, you know, sometimes they are reluctant to get into new areas, so you have to educate them a little bit, and maybe that is the best way to approach this.

Mr. WEBER. Well, I have been twisting their arms for the last—all summer here, on this thing.

Senator STEWART. Has their experience been good when dealing with this, then?

Mr. WEBER. Well, I am dealing with a banker out of Rainier National Bank, and they are using myself and my banker for the guinea pigs in this thing.

Senator STEWART. Well, you are taking a risk.

Mr. WEBER. Right. And they are happy with what is going on so far; they are following it real close. They told me right now they want me hedging more for next year.

Senator STEWART. Well, then, you are opposed to the legislation—

Mr. WEBER. Right, strongly.

Senator STEWART [continuing]. As a potato grower.

Mr. WEBER. I grow about 800 acres of spuds. And we need to get more volume in this thing, and the way to do that, I think, is to educate the guys and get more in there.

I think that these guys that break the rules in here—and you guys know who they were—I think they should get longer suspensions, and this would maybe put a stop to some of that.

One thing I want to say, I think some of the Idaho growers, probably their pride is hurt more than anything on this, because their potatoes are put in right along with ours, in Oregon and a couple of other States; we all raise the same potatoes, and we get our seed the same places—

Senator STEWART. Well, the Governor of Idaho says they are different, now.

Mr. WEBER. Yes, I understand that.

Senator STEWART. You have seen that ad, have you?

Mr. WEBER. Yes, right. We had a little discussion over that. That lawsuit, I think, did us more good than anybody. We got a lot of advertisement out of it.

Senator STEWART. I did not realize you had a lawsuit; if I had, I would not have raised the question on this. [Laughter.]

Mr. WEBER. Anyway, our potatoes are graded and sorted, the same as theirs are. We have got a marketing act, and we have got to put out a good grade, too. The Idaho potato does bring more on the market if it is going east, mainly due to freight.

I also think that maybe on the Maine futures up here, that maybe a lot of the farmers are not using them, but it sounds like a lot of the dealers are hedging for the farmers, and the farmers probably, part of them, do not even realize that. Without them, they probably would not be getting as much money as they are.

I guess that is about all I have to say.

Senator STEWART. I appreciate your testimony and your apparent understanding of the situation, from your standpoint. Thank you.

STATEMENT OF DARRYL COOK, SHELLEY, IDAHO

Mr. COOK. Senator Stewart, I am Darryl Cook, from Shelley, Idaho. I classify myself as a family farmer. We have quite a few acres, but then, we have a pretty good-size family. I farm about 7,500 acres in Bingham County, Cassia County, in Idaho, and then Eureka County, in Nevada.

I think I would like to talk a little bit on marketing, why I am in favor of retaining potato futures trading. I certainly do not dispute everything that my friend and neighbor, Al Johnston, testified to here.

But marketing is part of the problem for me, because I am not set up to contract with processors or anyone who is contracting out of storage or out of field. And if you are not in there, then you are just not in, so that it is up to me to sell on open contract.

Senator STEWART. Does this provide you with a competitive mechanism, or give you some other outlet for your potatoes in Maine—in the futures market, is that what you are saying?

Mr. COOK. Yes, I am saying that the futures market helps me. The only way it could help me more, like Mr. Johnston said, we are only putting—when we are talking about boxes, we are only putting from 15 to 20 percent of our crop that we can actually sell on futures. But I consider it a little bit like halitosis; it is better than no breath at all. [Laughter.]

Our farm produces about 750,000 a hundredweight of potatoes, and it is quite a job to market them. We have a terrific investment in these potatoes. As a matter of fact, our expenses last year were \$4.50 per minute, year round; this year, it will be considerably higher because of energy costs, and so forth.

In my potato-growing experience, I have been dealing with one large processor on a block of 500,000 sacks. I was dealing with him for about 3 weeks, and then the USDA report came out, which is always great for us growers—we always count on the market dropping about 50 cents. Anyway, after all this negotiating and everything, and it had about come to a head, they said, "We are withdrawing from the market for another 30 days now."

Well, where does that leave the fellow with 750,000 bags of potatoes to market? What I am going to do, if the market looks good enough on hedging, I will hedge my potatoes in order to reinforce my position financially.

Last year was a big loss. I did not use it last year. And it is always easy to look back—we all have 20/20 hindsight, and we could have done better if we had used it, but whether or not I have been smart enough to do it or not, I am not saying that.

But working it as a hedge, I look at it as if a broker or a processor or a handler should come and offer me so much money for my potatoes, I have the right to say yes, I will take it, or I will not take it. The same way with the futures market. Once the futures, if they get up to where I feel like it is a paying proposition for me, I hedge; if I do not think it is, I will not. It is up to me. I make that decision.

And I think if we lost this, we are losing a tool. I would like to see it stay on; I would like to see it improved. I would like to see Idaho's crop qualify for 70 or 80 percent on the futures market. And I am sure if we keep it, that they will have this opportunity to improve it. I think the people who are in charge of the exchanges will——

Senator STEWART. You think it is a protective mechanism, from the marketing standpoint, for the grower of potatoes.

Mr. COOK. Yes; I feel that way. It is one more way for me to try to market mine and on a profit. And I think everything else has been pretty well covered, and I know you are short of time, so I thank you for your time.

Senator STEWART. Well, we have a vote, and I am going to have to go, and I apologize for that. Next witness.

And thank you for coming. I appreciate it.

STATEMENT OF WILLIAM LOUGHMILLER, TWIN FALLS, IDAHO

Mr. LOUGHMILLER. I am William Loughmiller, and I am an Idaho farmer and potato grower in the Twin Falls area. And my testimony was only 5 minutes long to start with, and I can shorten it to about 1, to help you out a little bit.

I think that we should continue to have futures trading in potatoes. I would urge, though, that there be more efforts put into regulating trading properly and that the penalties should be proportionate to the offense. I think the penalties that have been levied so far, the one that I am familiar with, would be like me receiving a parking ticket, compared, both in our net worths and——

Senator STEWART. I would respectfully disagree with you on one of these things, and I will support these folks on the Commodity Futures Trading Commission, to take somebody totally out of the market is about as severe a penalty as you can get. That just takes him out of the market, so he does not trade, as I understand it, in any market; is that correct? Or do you just take him out of the competitive futures?

Mr. CONNOLLY. All trading privileges on any contract market.

Senator STEWART. All trading privileges on any contract market. So that, for all intents and purposes, is putting him away for a while.

Mr. DUNN. Six years.

Senator STEWART. Six years. All right. Now, the fines, I will admit, do not amount to anything.

Mr. LOUGHMILLER. They are not proportionate to the effect they had, probably, on the market.

Senator STEWART. No.

Mr. LOUGHMILLER. The second thing I would like to see is, instead of eliminating the contract that the changes be made so that a processor grade could be considered for delivery, because over half of Idaho's production is processed, and all that I raise is processed.

I brought one visual aid along that I got after I got into the Washington area, and usually a visual aid is worth a thousand words.

These potatoes were advertised in a local supermarket as Russet bakery, and these are potatoes that were selling for 33 cents a pound, that we are not allowed to even sell or be paid for in our area. And I think that we need to spend more time worrying about this problem than we do about the futures. I think this has a far greater effect on marketing.

These are two potatoes, and over half of the potatoes on the display in this particular supermarket, in a reputable part of town, were of this quality or worse, and there were probably just a few that were actually fit for human consumption as far as our standards go.

Senator STEWART. Thank you.

STATEMENT OF DEAN FULMER, IDAHO FARM BUREAU, POCATELLO, IDAHO

Mr. FULMER. Senator, I have a brief statement I would like to read. I am Dean Fulmer, from Roberts, Idaho. I am involved in a family farm operation, and we grew 160 acres of potatoes this past year.

It is a pleasure to appear before you today representing the Idaho Farm Bureau Federation, the largest farm organization in Idaho.

Our potato advisory committee met on November 6 and reviewed our position relative to legislation to ban futures trading in potatoes. We have three areas of concern, and I will speak on them as follows.

No. 1, reasons for continuing potato futures trading. In other words, we oppose this bill.

No. 2, the situation in Idaho; and No. 3, some suggestions for a futures contract that would be traded by producers.

The Idaho Farm Bureau Potato Advisory Committee has discussed what changes could be expected if the proposed legislation were enacted. We have considered the possibilities of futures and cash market manipulations and their relationships. Our thoughts are summarized as follows.

No. 1, this committee is familiar with the practice of using rollers to depress the cash market prices which, whether we have a futures market or not, we will still have people trying to manipulate the cash market.

Senator STEWART. You do not mean to indicate that there would be somebody trying to manipulate the cash market if we were to do away with potato futures, do you?

Mr. FULMER. I certainly do indicate that. There are people who would do that.

Senator STEWART. I just wanted you to make that plain for the record.

Mr. FULMER. A volatile futures contract is one tool available to growers to protect themselves from disruptive marketing practices. The elimination of potato futures trading would deny growers the opportunity to protect themselves from fluctuations in market price, reduce our access to credit necessary for production purposes, and cause greater instability in market prices at harvest time.

No. 2, the Idaho potato producers do not make extensive use of hedges today. By law, our State production continues to increase at a rate of 1.5 to 2 percent per year. The demand for fresh potatoes decreased by one-third—a loss more than offset by increased conception of processed potatoes. Producers and the marketing system have been responsive to the shift in consumer demand. Over 55 percent of our crop is now marketed as processing grade potatoes.

Since the futures contracts are limited to fresh grade only, hedging is not practical for some producers. Furthermore, the Chicago Mercantile Exchange contract calls for U.S. No. 1 Russets, 80's, 90's, and 100's, packed in 50-pound cartons. Normal fresh-pack marketing utilizes 5-pound, 10-pound, 20-pound, and 50-pound standard sizes. The terms of the CME contract for potatoes are outdated, and its utility to growers is thus reduced.

No. 3, we recommend that potato futures contracts be improved to permit expanded use of the hedge by producers. To accomplish this objective, we believe (a) processing grade potatoes should be studied as a basis for contracts, rather than fresh grade potatoes; (b) additional delivery points should be designated; (c) the CFTC should enforce trade rules to eliminate manipulation possibilities in futures trading.

These changes would permit greatly expanded use of futures hedging by producers.

The increased participation would in itself reduce the manipulation possibilities and permit more growers to benefit from this important tool.

In closing, Senator, I would like to make the point that I believe there is a difference in Idaho potatoes—the gentleman from Washington indicated there may not be. In fact, there is a difference in the potatoes in Idaho themselves. We have areas that do not ship fresh. I happen to live in the upper valley, where we do ship fresh—

Senator STEWART. I anticipated hearing some of that from one of the three of you.

I thank you all very much for your testimony, and appreciate you coming.

Our last panel is Glenn Clark, from Glenn Willett Clark Associates, and Jack Schwager, director of commodities, Smith, Barney, Harris & Upham, in Ossining, N.Y.

Gentlemen, I would ask you, if you would, to summarize your testimony, because you both look like experts to me. [Laughter.]

STATEMENT OF JACK SCHWAGER, DIRECTOR OF COMMODITIES, SMITH, BARNEY, HARRIS & UPHAM, OSSINING, N.Y.

Mr. SCHWAGER. OK. I will try to talk fast.¹ My name is Jack Schwager, and I am director of commodity research at Smith, Barney and have held a similar position for the past 6 years. Let me get right to the point.

I was curious what facts the proponents of this bill would offer for banning potato futures, and I am still curious. I have not heard a single fact—I am not talking about opinion, but fact, why they should be banned.

A lot of people do not like them; I am willing to grant that. But is that a reason to consider this bill?

Senator STEWART. Well, let me give you one fact that they gave me. They said it adversely affected economically the operation of the market in New York and the potato farmers in Maine.

Mr. SCHWAGER. Well, let me get to that; let me get to the allegations. The first allegation, that price is determined by manipulation, and speculators are determining prices. I have included a chart here, which just shows potato prices and supply.²

Senator STEWART. Are you saying that there was no speculation on the market in 1976?

Mr. SCHWAGER. Well, the 1976 instance which was brought up, the prices in that year correlated with supply.

Senator STEWART. I am not asking you that. I am asking you, are you saying that there was no speculation in May 1976 on the market?

Mr. SCHWAGER. Sure there was speculation; speculation is always there. Speculation is part of—

Senator STEWART. I am talking about something that adversely—

Mr. SCHWAGER. Oh. The default of 1976 occurred to the potato futures delivery after the contract expired. The default situation occurred, in fact, after the—

Senator STEWART. So the market did not have anything to do with that?

Mr. SCHWAGER. No. It was not the fault of the market. It was the willful default by certain—

Senator STEWART. Then, why did the people over here impose the fines and take the disciplinary action?

Mr. SCHWAGER. Oh, because there was—

Senator STEWART. Why did they assess the fine?

Mr. SCHWAGER. Well, I am not a member of the exchange, but if I can assume the situation, perhaps the exchange should have been more watchful to prevent the situation.

Senator STEWART. Well, what was the situation?

Mr. SCHWAGER. There was a default of delivery. But my point is—

Senator STEWART. And whose fault was that? Was that the fault of the potato producer, the potato dealers?

Mr. SCHWAGER. Well, this went on as a legal question for years, and I was not involved in that, but I think the findings were that there was fault on both sides. There was an obvious fault on those

¹ See p. 169 for the prepared statement of Mr. Schwager.

² See p. 177.

who sold and did not have the potatoes, and there was, I think, also determined that there was fault on the buyers' side.

Senator STEWART. And that was in the marketplace, was it not?

Mr. SCHWAGER. They were using the marketplace. It was not the marketplace that was—

Senator STEWART. It was not the potato farmer in Maine that was using the market; there were not a bunch of hedgers up in Maine.

Mr. SCHWAGER. Well, the shorts, to my understanding, were actually from Idaho and had gone short a very large position without having the actual potatoes for delivery. That is the situation as I know it.

But my main point on this contention is that prices, historically—and there is very clear evidence—potato prices have fluctuated in terms of supply and not in terms of any speculative activity.

Senator STEWART. What was that, now?

Mr. SCHWAGER. That potato prices have fluctuated continuously, on an ongoing basis determined by economic facts.

Senator STEWART. Well, what we are talking about is confidence in the marketplace, and let me read some names. The Commission took action against a Mr. Simplot; who is he?

Mr. SCHWAGER. Mr. Simplot is a large potato grower from Idaho.

Senator STEWART. Did he have a seat on that exchange?

Mr. SCHWAGER. I do not know whether he did or he did not.

Senator STEWART. Did he buy or sell or do anything at all?

Mr. SCHWAGER. But Mr. Simplot was using the exchange as a vehicle for what was ultimately determined to be a clear case of default.

Senator STEWART. All right. Now, who is Mr. Tagares?

Mr. SCHWAGER. Tagares is another grower from the Northwest.

Senator STEWART. What was he doing? What vehicle was he using?

Mr. SCHWAGER. My understanding was that he had a similar position to Mr. Simplot.

Senator STEWART. And who is Mr. Cox?

Mr. SCHWAGER. I believe on the Maine side, on the purchasing side, but I am not positive. I was not really involved in this default. I came here to testify as an economist and a statistician.

Senator STEWART. But you know, if you raise the question, I am going to ask you a few questions about it. Who is Mr. M-a-y-r-s-o-h-n?

Mr. SCHWAGER. I do not know the name.

Senator STEWART. You are not familiar with him?

Mr. SCHWAGER. No.

Senator STEWART. The Commission took action against him. Now, these gentlemen were using something, and it is my understanding that it was a potato futures contract.

Mr. SCHWAGER. There is no question that they used the potato futures contract.

Senator STEWART. Now, that potato futures contract was available for purchase or sale on the New York Mercantile Exchange.

Mr. SCHWAGER. Well, the question I would ask, if there is a default in a contractual agreement, do you disintegrate the industry, or do you prosecute the—

Senator STEWART. No one is talking about disintegrating the industry. I am just talking about admitting, by gosh, that there is some problem.

Mr. SCHWAGER. Sure, there is. There is no question, I think that anybody who says that potato futures should continue, would say that the monitoring should be there, and every effort should be made——

Senator STEWART. Well, apparently there was some suggestion that this did not occur, and the market did not have anything to do with it. Why in the heck do you think these people have got some concern out here?

Mr. SCHWAGER. The concern is there. There is the default situation, which is a clear case of wrongdoing, and I do not think anybody contends that. Whether they were adversely affected by that, I would question, because cash prices during that period did not do anything out of the ordinary. They did what could be expected on the basis of prevailing economics.

Senator STEWART. They came here today on the basis of some difficulties that they experience as a result of futures. Now, they said that it is a volatile market——

Mr. SCHWAGER. They said they suffered economic loss. I did not see any figures of how they suffered economic loss——

Senator STEWART. Well, I imagine they will provide some figures.

Mr. SCHWAGER. I did not see any cash prices going down because of that situation. I did not see any direct connection between the claim that this default caused them to lose money out of their pockets. That is what I am questioning. And that particular instance was a clear case of wrongdoing, and no one questions it.

Senator STEWART. Are you saying that manipulation of the market by some people who were fined did not adversely affect the potato growers in Maine or the potato growers in Idaho, and did not affect the marketplace adversely at all, in terms of price?

Mr. SCHWAGER. I would say that the effect was very minimal because it occurred after the futures contract expired, and the cash markets did not exhibit any inordinate price movement after that fact. So I would say that on that basis, I do not think it is absolutely provable, the connection, but you can look at the cash price situation at that point and——

Senator STEWART. Then why did they change their monitoring activity after the situation had occurred in May 1976?

Mr. SCHWAGER. Because the default was obviously a defect, and everything should be done to prevent that from occurring again.

Senator STEWART. What about in March 1979?

Mr. SCHWAGER. In March 1979, it was the concern that the situation could occur, and to prevent that from occurring, and to safeguard against any delivery problems, the board decided to suspend trading.

Senator STEWART. Now, there were some statements made that some people made a hellish profit in 1979, and I do not remember it being the Maine potato growers or the Idaho potato growers. I think it was some folks who were trading on the futures exchange that this particular individual is referring to.

Are you telling me—and I want you to say for the record here—that no one made tremendous profits during that particular period of time when the trading was suspended.

Mr. SCHWAGER. The irony of it, that those people who voted for the suspension, if anything, lost money on that vote. The exchange, by stopping trading, knocked out their most profitable contract. The board of governors, which is primarily composed of brokers on the exchange, were eliminating their income, a major source of their income. To my knowledge, no one who participated in that vote had a position which would have benefited from that vote.

Senator STEWART. You say that it created no adverse impact in the producers of potatoes, economically or otherwise?

Mr. SCHWAGER. In that instance, what I am saying is that the action was done with the motivation of doing the right thing. Whether it was right or wrong, it was done on that motivation, and no one gained by it.

Senator STEWART. I am asking you what happened to those folks who produced the potatoes?

Mr. SCHWAGER. Well, I do not know if it is possible to answer it, because we do not know what would have happened had the futures contracts continued to be traded.

Senator STEWART. Well, why did this fellow who is the chairman of the board testify that they put some potato growers and potato dealers on the committee after that time? What was that aimed at?

Mr. SCHWAGER. Well, the criticism was made that they should have had more input from the Maine potato industry.

Senator STEWART. So in response to that criticism, they put them on there?

Mr. SCHWAGER. Exactly.

Senator STEWART. Is that a cosmetic type thing, or—

Mr. SCHWAGER. No. Well, personally, I think that perhaps they should have had that input, and the mechanism should have been there before.

Senator STEWART. Why would that mechanism need to be there before? If the Maine potato growers and the Idaho potato growers were not adversely affected, then why would you need that input? Why would you need it?

Mr. SCHWAGER. You need the input so that you can take the best action for those who are using the market.

Senator STEWART. Right. So they have confidence in it, and so they do not come here and ask me and other Members of the Senate to ban an item that is supposed to be beneficial to them. For some reason, they do not have the same feeling about it that you do.

Mr. SCHWAGER. Well, those who use the market are not here saying it should be banned; those who do not use it are here. And if, by coincidence, we happen to have three bumper crops, and we have low potato prices, potato futures make a very nice scapegoat. So it is easy to say that prices are low because speculators are driving them down.

Senator STEWART. You make that statement in the light of speculators being punished for using the market, and I do not understand how you can say that. I must not be hearing you. I must not be in the same room with you.

Mr. SCHWAGER. Well, if we have prices over a continuum of a whole year——

Senator STEWART. I am not talking about prices. We are talking about manipulation of the market.

Mr. SCHWAGER. I am not saying that manipulation never occurs. It occurs in futures, and it occurs in cash, and it occurs in every business. I am not saying it does not occur.

Senator STEWART. Well, why doesn't someone from the industry admit that there might be a problem somewhere in here, and say, "We want to take corrective action"?

Mr. SCHWAGER. Well, of course, the exchanges are constantly trying to revise their techniques to minimize any such problems. Of course there are problems. No one is setting there and saying everything is perfect. What we are saying is we have a viable vehicle, that this is not the cause of some of the other allegations and problems that have been made. That is the only statement now. In terms of does manipulation occasionally occur, are there some wrongdoings, yes, and every effort should be made to correct that. But it does not make sense to knock out the whole vehicle.

Senator STEWART. I might tend to agree with you and be more favorably inclined to your position if those who were in positions of responsibility would recognize that perhaps somewhere along the line, some mistakes have occurred on the market side, some corrective measures need to be made, and they are working hard and diligently to get that done. If all we are doing is reacting to adverse criticism, and hiding our heads in the sand and saying, "You know, there are no problems here"—obviously, there are problems.

Mr. SCHWAGER. Nobody is saying that. Clayton Yeutter was making the point of all the efforts his exchange is taking——

Senator STEWART. I am not talking about Clayton Yeutter.

Mr. SCHWAGER. Well, that is the Chicago Mercantile Exchange, the other potato contract. And the New York Mercantile Exchange has proposed a new contract. They have taken more potato growers on through an advisory capacity. So steps are being taken, and I do not think anybody within the industry would claim that everything is perfect——

Senator STEWART. Well, obviously, everything is not perfect in the dealers' and growers' and producers' opinions; they have got their opinions.

Mr. SCHWAGER. Now, I sat here all day, and I heard people say there was no convergence between futures and cash. All I know is that I have this study—I just took the simple statistics, I took the cash, I took the futures, I took a simple subtraction——

Senator STEWART. Your study indicates that that takes place.

Mr. SCHWAGER. That absolutely there is a convergence. Now, it does not mean that if the cash price is \$6.10, the futures will come down to \$6.10. Maybe it will be \$5.70, maybe it will be \$6.40, but there is a definite pattern of convergence——

Senator STEWART. Do you have a copy of that study that you can make available for the record?

Mr. SCHWAGER. Yes. It is in here, all documented, and the actual tables are there which would show that.

Senator STEWART. We will make that a part of the record.¹

Mr. SCHWAGER. So I totally contest, on purely statistical grounds, that there is no convergence. The cash and futures have a very stable relationship. Some years, it may go out to as much as a dollar-plus on the expiration, but that is by far the exception. And a hedger could always assume that it is going to go out that dollar, and instead of selling them at \$8, will sell them at \$9, and will protect himself against that risk.

But the contention that has been made, with people constantly coming up here and saying there is no convergence, I did not see any numbers, I did not see any proof, and I know that I have done this study, and the numbers are clearly there that there is convergence and there is stability between futures and cash.

Senator STEWART. I appreciate your providing that for the record. Are there any other statements you want to make?

Mr. SCHWAGER. Just that the allegations of legalized gambling and that hedgers cannot use this market are preposterous. And as I think has been clearly demonstrated here, hedgers do use the Maine market, and it is a method of risk avoidance, not a method of gambling, and that is just a poor, cheap shot.

And the idea of having prices set by a board, when you have a perfectly competitive market, why anybody would want them regulated by a board to me seems to be a tremendous jump backward. And futures markets, just in closing, are highly competitive markets, they are very efficient, and they are one of the things that work best in our economy, and it seems to me to be rather ironic to try to take a step backward by saying let us go to a marketing board or something like that, to replace a competitive market.

And if I could end, you asked the question earlier, Senator, why should the marketplace instead of Congress make the decision, and I will end by asking the same question. If there is really something wrong with this contract, why not let the marketplace, by freedom of choice, determine something is wrong, and let those dealers and producers who do not want to use it, not use it, and if enough of them do not, the marketplace will not be there, and nobody will have a problem, and we do not need the Senate to pass this bill.

Thank you very much.

Senator STEWART. Thank you for being here. I appreciate your testimony.

STATEMENT OF GLENN WILLETT CLARK, GLENN WILLETT CLARK ASSOCIATES

Mr. CLARK. Senator Stewart, my prepared statement,² I believe, fairly adequately sets out my basic conviction, that abolition of futures trading in potatoes, or indeed, in any other commodity, is unwarranted and unwise.

But let me leave to the record that statement and two documents referred to in it, together with a further article I have prepared, discussing the actual anti-inflationary impact of futures trading.

Let me instead, in the very brief time available to us, identify, on the basis of what I have heard here today, what I believe to be the cardinal problems associated with potato futures trading.

¹ See p. 177.

² See p. 185 for the prepared statement and attachments thereto of Mr. Clark.

I was one of the early and most severe critics of Messrs. Simplot and Tagarres, writing an article, "The Sins of Potato Speculators," in the New York Times in September 1976, in which I spread blame all over—

Senator STEWART. I am glad my farmers got an article in the New York Times.

Mr. CLARK. What was happening here was that there was a simple default on an obligation.

But the exchanges are responsible, and continue to be responsible, for a very basic problem. They specify a premium grade of potato as the basis grade. Workable futures markets do not do this. The lowest common denominator of commercial acceptability gives the basis grade for more workable agricultural futures contracts.

Senator STEWART. You are saying that the product grade that they are requiring is what is creating the problem?

Mr. CLARK. A large part of it, in my judgment.

Senator STEWART. Have they corrected that?

Mr. CLARK. I think they have not.

Senator STEWART. What have they done, if anything, to speak to that, because apparently, that delivery problem in March 1979 or about that time—

Mr. CLARK. Well, the March 1979 problem relates directly to this.

Senator STEWART. What did they do after that to correct it? What did the New York Mercantile Exchange do after that, since delivery was the problem, in your opinion?

Mr. CLARK. I am not aware of any proposals—though there may have been some—to alter the contract specifications to provide for a nonpremium grade as the basis for futures market pricing and delivery.

Senator STEWART. Do you think that would improve the situation?

Mr. CLARK. Marginally. Something else would be far more helpful.

Senator STEWART. What would that be?

Mr. CLARK. That would be as the study of the U.S. Department of Agriculture suggests—and the name of another eminent scholar ought to be associated with this—taking nothing from Dr. Paul—

Senator STEWART. And Dr. Kahl.

Mr. CLARK. No. Dr. Tomeck, from Cornell University.

Senator STEWART. I was just adding the other one who was involved in that USDA study.

Mr. CLARK. Well, he is involved in it. Tomeck is one of the authors of this study. Almost everything worth knowing about potato futures trading has long ago been put in print under the names of either Roger Gray or William Tomeck. I recommend a careful perusal of anything and everything they have said, as very nearly definitive of an honest view of the matter.

I would go further only to suggest this—

Senator STEWART. After today's hearing, I think I am going to write a book. [Laughter.]

Mr. CLARK. I would go further to suggest as I did earlier, well before the USDA study—that the appropriate manner of settling futures contracts that have this characteristic is one which does not call for nor require physical delivery. On the assumption that

you can find a valid cash price, simply trade money instead of going through these games of delivery and inspecting, et cetera, et cetera.

Senator STEWART. The cash settlement proposal is something you would approve?

Mr. CLARK. Absolutely. This is not at all unprecedented. It exists in principle with respect to cotton. It exists in fact with respect to iced broilers. And, as Dr. Gray pointed out today, historically, it existed in the Liverpool markets.

Monetary statements should be instituted generally. It is the only feasible method of instituting futures market with respect to stock market indexes, and it could readily be employed for financial instruments generally. My long article in the Emory Law Journal analyzes this in some detail.

Senator STEWART. Have you got a copy of that article?

Mr. CLARK. I do indeed have a copy, and I will submit it for the record.¹

Now, one final point I would make. If we are to have cash settlements—for this is where the USDA is pointing us, and this is what I suggested earlier also—we must nonetheless know what we are talking about in terms of the cash commodity. It will then not do to say that you may have potatoes coming in from all over the map for delivery in settlement of futures. I was born and raised in Idaho. I am a partisan of the Upper Snake River Valley. An historic premium does seem to attach to Idaho. I will not say that they are or are not better than Washington State potatoes. But I will say that people engaged in the trade must know what commodity, of what grade, of what origin, of what specifications, of what commercial acceptability, they are talking about.

It does not matter that that commodity be a commodity produced in a limited area, or even that it have consistently a limited availability for delivery, so long as you are coupling monetary settlement of futures with an exact specification of a grade priced accurately in a cash market to which futures settlements refer.

I suggest that this is what you have in the Chicago wheat futures market in practice, where a particular nonpremium wheat, soft red, is that which is priced, even though others can be delivered.

Senator STEWART. You are not going to let my Alabama potatoes get in there—

Mr. CLARK. I am suggesting that the manner in which Alabama potato growers can most usefully effect a direct hedge would be under a contract whose specifications called, not for delivery, but, rather, for monetary pricing against an absolutely defined commodity. Perhaps this will have to be, in the Eastern United States, round white Aroostook County potatoes of exactly specified grade.

Senator STEWART. That is all right.

Mr. CLARK. But Alabama growers should have available a direct hedge. This can be done if we will get off the nonsense of thinking that delivery is the sine qua non of futures contracts. It is not. Futures markets are financial institutions. They exist apart from, and for reasons other than, delivery.

Senator STEWART. You lost me with that last term.

¹ See p. 198.

Mr. CLARK. Futures markets are price markets. Well-advised participants in futures markets enter futures markets with the contemplation that delivery will not take place.

Senator STEWART. So in summary, what you are saying is that the proposal of a cash market with a defined product that people can hedge against would be your suggestion as a solution.

Mr. CLARK. Absolutely, absolutely.

Senator STEWART. Well, thank you. I appreciate your being here, both of you, and being patient to wait until this time. I have got to go to the floor and vote, of all things, on an abortion amendment. This is the 25th time we have voted on that in this session of the Senate.

Let me say this much—did you have something else?

Mr. CLARK. One further comment

Senator STEWART. I have about 5 minutes to get to the Chambers.

Mr. CLARK. You should not assume that the CFTC's posture in this: In prosecuting Simplot and Tagarres, in imposing fines on the New York Merc, is the whole story. I would suggest that the crucial events inhibiting use of futures markets by bona fide hedgers occurred not in 1976, but in March 1979, and that the fault is quite equally shared by the Commodity Futures Trading Commission in rather suggesting, as was manifest by their precipitate action with respect to March wheat on the Chicago Board of Trade later in that month, that the Federal regulators were about to descend on a market and close it down, however briefly.

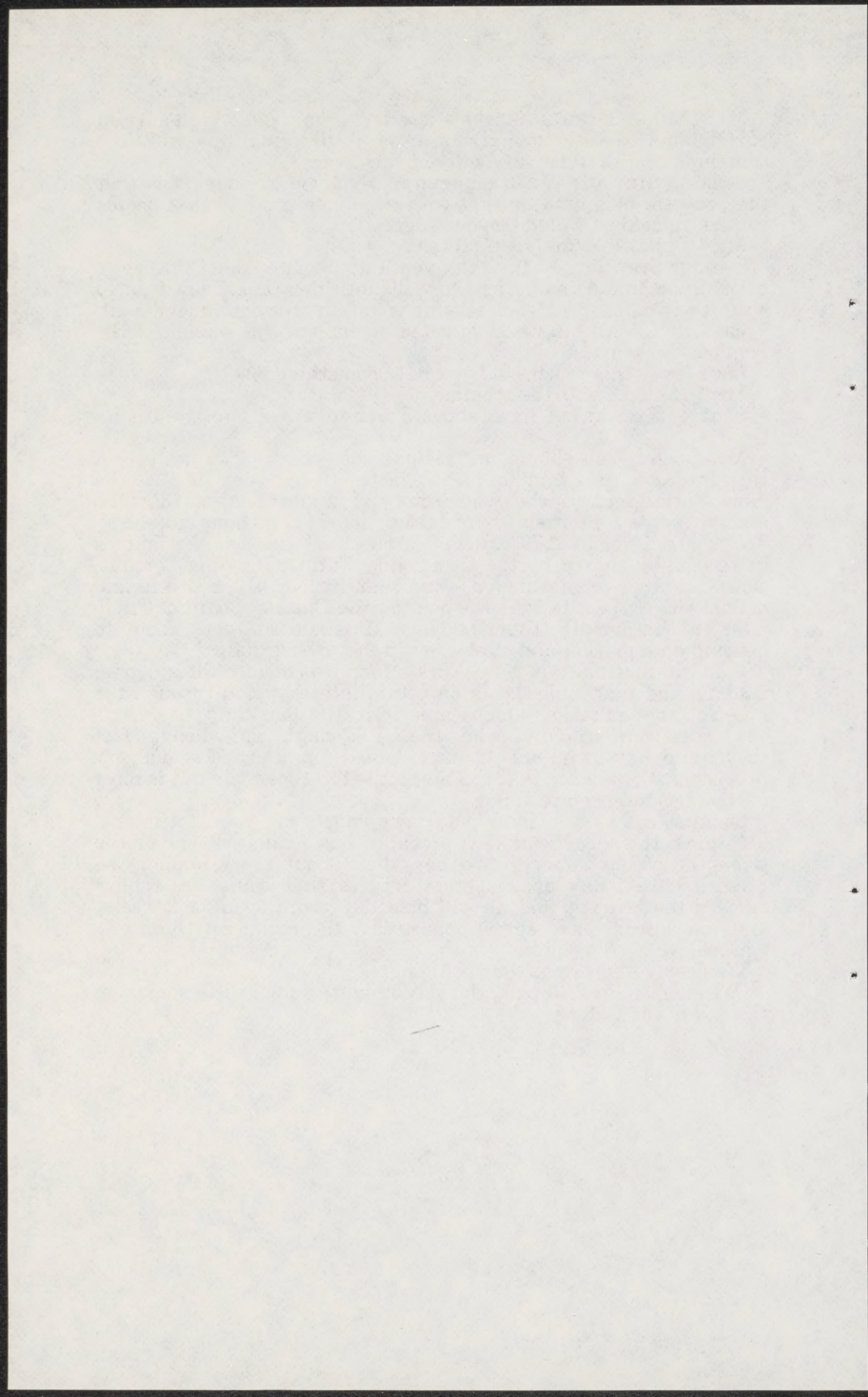
I do think that the New York Merc overreacted in stopping trading, and that, indeed, Maine potato interests paid through the nose for that mistake, which came from the fact that the Merc's governors were scared of what the CFTC might do, when in fact they could have, and should have, called for alternative delivery provisions. Confidence that the market will be open when it is most needed has not been restored.

Senator STEWART. Thank you very much for your testimony.

I think this hearing today probably has exhibited one of the strengths of our country. We have had about every opinion expressed here today about potato futures that could be. I have enjoyed the hearing, and we will hold the record open for 2 weeks, and you will all have ample opportunity to provide anything else you feel we need to have.

We deeply appreciate your being here.

[Whereupon, at 2:40 p.m., the subcommittee adjourned, subject to the call of the Chair.]



APPENDIX

STATEMENT OF HON. READ DUNN, JR., COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION

Thank you, Mr. Chairman and members of the subcommittee, for providing the Commission with this opportunity to express its views on S. 770, a bill to amend the Commodity Exchange Act to prohibit trading in potato futures on commodity exchanges. Although we understand the concerns which prompted the introduction of this bill to prohibit all futures trading in potatoes, the Commission believes the bill is unnecessary. Congress has provided the Commission with the authority to determine whether contracts for futures trading should be permitted and the responsibility as well for continually monitoring the performance of these contracts. Although there have been problems in potato futures trading, the Commission believes that there are practicable solutions to these problems. This view is supported fully by the United States Department of Agriculture which is of the opinion that existing problems can be resolved through revised contract terms and conditions. However, if this proves not to be the case and the Commission has reason to believe that potato futures trading is contrary to the public interest, it can institute proceedings to revoke contract market designations to trade potato futures.

The Commodity Exchange Act requires that each board of trade meet stringent requirements enumerated in Section 5 of the Act, in order to be designated as a contract market in a particular futures contract. One of these requirements for designation under Section 5(d) of the Act is that each board of trade provide for the prevention of manipulation of prices and the cornering of any commodity. Section 5(g) of the Act provides, as an additional designation requirement, that a board of trade demonstrate that transactions for future delivery in the commodity for which designation as a contract market is sought will not be contrary to the public interest. The Commission interprets this requirement to include an economic purpose test, namely, a demonstration by the board of trade that a futures contract on a particular commodity can reasonably be expected to serve a price discovery or risk shifting function.

Furthermore, after designation in a particular futures contract has been granted, a contract market must continue to satisfy these initial criteria and has an on-going obligation to comply also with twelve additional requirements set forth in Section 5a of the Act. Among these additional requirements, Section 5a(12) requires that each contract market submit to the Commission for its approval all bylaws, rules, regulations and resolutions, which relate to terms and conditions in contracts of sale to be executed on that contract market or other trading requirements (except the setting of margins). Section 5a(10) of the Act requires each contract market to permit the delivery of any commodity which is the subject of a futures contract under such conditions as will tend to prevent or diminish price manipulation and other forms of market disruption.

In addition to these obligations imposed upon a contract market, under Section 8a(7) of the Act, the Commission is authorized to alter or supplement the rules of a contract market in order to ensure fair dealing and protect the integrity of that contract market. Congress has also authorized the Commission, under Sections 5b and 6(a) of the Act, to suspend or revoke the designation of any board of trade as a contract market.

Consequently, since the Commodity Exchange Act provides the Commission with the authority to modify the terms and conditions of futures contracts or, alternatively, to suspend or revoke trading in potato futures or any other futures contract traded on a contract market, we believe a Congressional prohibition on potato futures trading to be unnecessary.

Futures trading in potatoes was initiated in 1931 on the Chicago Mercantile Exchange and came under regulation in 1936 with the enactment of the Commodity Exchange Act. In 1941, the New York Mercantile Exchange was designated to trade futures in Maine round white potatoes. The major futures trading activity in pota-

toes has been on the New York Mercantile Exchange's Maine potato futures contract. As Table I in the attached Appendix indicates, during the last several years, the average number of open contracts in this market has ranged from 6,700 to over 14,000 contracts, with an annual trading volume of 268,000 to over 800,000 contracts. Trading activity on the Chicago Mercantile Exchange, which reinstituted trading in Russet potatoes in 1967, has been quite small by comparison.

As the subcommittee is aware, there have been a number of well publicized problems involving potato futures trading. Those incidents together with subsequent Government and Exchange actions are summarized in the attached Appendix. Briefly, the Government's enforcement actions have resulted in, among other things, the suspension of trading privileges for periods of four and six years and the imposition of fines for the major respondents in the three cases of alleged attempted or actual manipulation which have occurred since 1971—including the May 1976 default on the Maine potato futures contract. In addition, both the New York Mercantile Exchange and the Chicago Mercantile Exchange have made substantive changes to their respective contracts on potatoes. Some of those changes were the subject of Commission hearings prior to Section 5a(12) approval.

In addition to these actions, the Commission found it necessary on November 3, 1976 to order the New York Mercantile Exchange to establish emergency procedures regarding the last few days of trading in its November Maine potato futures contract. The Commission's order required margins equal to one hundred percent of the value of the contract and prohibited new positions except for purposes of making delivery. The Commission acted because of an anticipated shortage of railcars relative to the announced intentions of longs to require delivery. In our view, the contract was liquidated in an orderly fashion.

As a result of these incidents in potato futures trading, the Congress, in Section 27 of the Futures Trading Act of 1978, directed the Secretary of Agriculture to conduct a comprehensive study of futures trading in Irish potatoes—including Commission and Exchange rules and regulations pertaining to such trading. During the pendency of that study in March, 1979, the New York Mercantile Exchange found it necessary to cease trading in all 1979 spring potato futures contracts due to the fact that the preponderance of deliveries on its March futures contract were failing to pass inspection. This most recent problem in trading was considered in the detailed report submitted by the Department of Agriculture to each House of Congress on October 15, 1979.

The extensive study of potato futures trading performed by the Department of Agriculture emphasized the performance of the actively traded New York Mercantile Exchange's Maine potato contract. The Department of Agriculture observed that this contract still serves an important economic purpose, even though its usefulness for hedging has diminished somewhat in recent years.

The Department of Agriculture report further noted that, although the economic problems of the potato industry in Maine are real, those problems are not attributable to futures trading. The Department observed that, from an economic perspective, the only reason for a complete ban on futures trading would be a demonstration that the negative effects of futures trading somehow outweighed the benefits and that little could be done to correct the balance. However, the Department concluded that no such demonstration has been made.

The Department of Agriculture report concludes that the New York Mercantile Exchange potato futures contract should be modified to improve its hedging performance. To that end, the Department of Agriculture offered several suggestions, including (1) that the New York Mercantile Exchange contract be modified to include round white potatoes from other states, (2) that the May delivery month not be abolished without further consideration of alternative contract specifications, and (3) that a system of optional financial settlement be adopted.

We believe that futures trading in potatoes does have important economic benefits as a price discovery and risk-shifting mechanism. My own personal observations indicate that both inter-seasonal and intra-seasonal price variations in potatoes are high and, absent a futures market, these tremendous risks would be borne by either producers or dealers. Therefore, I believe that the option of shifting the risks of high price variations through hedging in the futures markets should continue to be available. In addition, since major potato producing areas are often remote from substantial consuming areas, I believe that the price discovery process inherent in futures trading assists both potato producers and dealers.

As the Department of Agriculture report notes, no legislation is necessary to correct or curtail futures trading in potatoes—including a prohibition of trading. The Commission has the present authority to require modified contract terms or to abolish trading if necessary. The Congressional prohibition of futures trading in

potatoes would reflect a judgment that no futures contract could be designed to meet the interests of hedgers. The Commission believes that such a judgment is unwarranted. In this connection, the Department of Agriculture report made several substantive recommendations for modification of the Maine contract, including the suggestion of cash settlement for liquidation in lieu of delivery. This suggestion is novel and untested but may be beneficial. These recommendations will be studied carefully by the Commission in its review of the substantially revised potato futures contract recently submitted to the Commission for approval by the New York Mercantile Exchange. These revisions include delivery of round white potatoes from 15 states and FOB delivery at the option of the short if the initial delivery fails inspection. We are carefully reviewing these substantial revisions.

I would also like to speak to the issue of producer dissatisfaction with futures trading in potatoes and how this enters into the Commission's considerations. This dissatisfaction appears to take widely different forms. For example, some producers would like to trade potato futures contracts but are dissatisfied with the specifications of the present contracts. Others, who have in the past viewed futures trading in a neutral sense, now distrust the market impact of futures trading because of various liquidation problems.

Many other producers are apparently opposed to futures trading of potatoes in any form. From what we gather, these persons feel that futures trading is inherently disruptive to the overall price structure of the market. This is an important public interest issue. However, the general arguments against futures trading have either been non-specific or vaguely referenced to the broad range of problems which I have already discussed. The Commission anticipates negative producer comments concerning futures trading in potatoes because it realizes that some potato producers are skeptical of selling their crop on paper. The Department of Agriculture report notes that it has not uncovered substantial ways in which producers who do not use potato futures trading have been harmed by such trading. However, the Commission is, of course, open to specific comments and evidence on this point.

In closing, although Congress certainly has the prerogative to prohibit potato futures trading, we believe that such an action would result in an inappropriate abandonment by the Congress of the regulatory scheme which it adopted in 1974 and just recently amended. We believe Congress selected the proper course in granting the Commission the responsibility and authority to modify, suspend or revoke trading in potato futures or other commodities if futures trading fails to serve the public interest. Therefore, we do not support this proposed amendment to the Commodity Exchange Act to prohibit trading in potato futures on commodity exchanges.

NOTE: The above statement represents the majority view of the Commission. The minority view of Chairman James M. Stone is expressed in a separate letter of October 30, 1979, to Chairman Talmadge of the Senate Committee on Agriculture, Nutrition, and Forestry.

APPENDIX

The Commodity Exchange Authority ("CEA") charged that parties on both sides of the May, 1971, Chicago Mercantile Exchange ("CME") Idaho potato futures contract attempted to manipulate prices. The Secretary of Agriculture settled that complaint on the basis of cease and desist agreements from all respondents and suspension from trading for periods ranging from 90 to 180 days. The CEA also investigated, and the Commission subsequently filed an administrative complaint alleging that the May, 1974, CME potato futures contract was manipulated by a trader on the short side. As a result of the problems with the May liquidation on the CME, that Exchange made a series of changes in its contract including point of origin delivery, new railcar specifications, additional delivery points outside of Idaho, a truck delivery option and new packaging specifications. In 1976, there was a 1000 car lot default on the May contract on the New York Mercantile Exchange. The Commission investigated and filed an administrative complaint alleging attempted manipulation by persons on both sides of the market.

The Commission has settled these complaints—with all but one of the respondents—on the short side of the market, with cease and desist orders, civil money penalties and suspensions from trading for periods ranging from two to six years. The hearing against the remaining respondent on the short side is completed and the parties are in a post hearing briefing schedule. The Commission's complaint against respondents on the long side of the market is scheduled to be heard on December 3, 1979.

With respect to the 1976 default on the New York Mercantile Exchange, the Commission filed an administrative complaint charging the Exchange with the

failure to exercise its self-regulatory responsibilities. The Commission settled that complaint on the basis of a cease and desist order and a civil money penalty of \$50,000. Thereafter, the Commission directed the New York Mercantile Exchange to make significant modifications in its potato futures contract.

The Commission staff is presently reviewing the March, 1979, declaration of market emergency by the New York Mercantile Exchange on its potato futures contract. The Commission expects to complete its study in the near future and will then determine whether the exchange acted in an appropriate fashion.

VOLUME OF TRADING AND ANNUAL AVERAGE MONTH-END OPEN INTEREST FOR THE NEW YORK
MERCANTILE EXCHANGE, MAINE AND THE CHICAGO MERCANTILE EXCHANGE, WESTERN RUSSET
(PREVIOUSLY IDAHO)

[Potato futures for fiscal years 1969-79]

Fiscal year	New York Mercantile Exchange— (contracts of 50,000 lbs)		Chicago Mercantile Exchange— (contracts of 80,000 lbs)	
	Volume of trading	Open interest	Volume of trading	Open interest
1969	478,410	15,316	88,347	1,391
1970	334,777	9,856	90,246	2,256
1971	205,694	9,324	32,725	1,362
1972	152,607	5,589	7,250	345
1973	385,616	13,310	6,314	367
1974	833,481	14,080	14,189	391
1975	664,202	14,746	606	33
1976	819,545	14,385	3,505	204
1977	450,126	9,876	4,585	136
1978	495,454	12,922	234	42
1979	¹ 268,785	¹ 6,728	750	108

¹ As noted in the text, the NYME suspended trading in all spring contract on March 9, 1979.

STATEMENT OF DR. STEWART N. SMITH, COMMISSIONER OF AGRICULTURE OF THE
STATE OF MAINE

BACKGROUND

Mr. Chairman, members of the Committee, I am Stewart Smith, Commissioner of Agriculture of the State of Maine.

I appear before this subcommittee from a varied background as a potato producer who used the potato futures market, a former potato dealer, a former president of the Maine Potato Council, a former State Legislator involved in potato industry issues, an agricultural economist by professional training, and a former employee of the United States Department of Agriculture involved with general farm programs. I am here representing the State of Maine. I appear before you in support of the elimination of futures trading in potatoes.

ISSUES

I base my position on my analysis of two questions:

(1) Is trading of potato futures contracts beneficial *in general* to the potato industry?

(2) Has the specific contract and contract market which has been used for trading Maine potatoes in the past benefited the general welfare?

I believe the answer to both questions is negative. As to the first question, extensive doubt exists as to the general benefits to be derived from trading potato futures contracts. Since futures trading in potatoes cannot be demonstrated to be beneficial, it is time to provide an opportunity to explore the viability and marketing capabilities of the potato industry without a futures market.

As to the second question, the New York Mercantile Exchange has not proven to be a sound or reliable futures market. In fact, because of price aberrations in late month contracts, the 1976 default, and the 1979 emergency suspension, it has proven to be the reverse. The harm it has caused the industry over the past five years should be sufficient reason for Congress to preclude the continuation of the New York Mercantile Exchange's potato futures contracts.

TRADING OF POTATO FUTURES CONTRACT IS NOT BENEFICIAL IN GENERAL TO THE
POTATO INDUSTRY

Potato futures have been traded nearly 40 years, providing a mechanism to discover price and to shift risks. A well-run futures market can probably provide a valuable service to many industries. From personal use, I have found futures contracts beneficial as a hedging mechanism in the past. Several studies have also demonstrated their value, including a recent study by Dr. Allen Paul, et al. at the United States Department of Agriculture. Although Dr. Paul found flaws in the current New York Mercantile Exchange contract and procedures, he generally concluded that a futures contract could be beneficial to the industry.

However, Dr. Paul, and several analysts before him, have missed a central point in the futures market controversy. None of them have measured the impact of the existence of a potato futures market on the non-users who make up the bulk of the potato industry. Dr. Paul suggests that non-users can be harmed by a malfunctioning futures market. The more important question (which he did not address) is whether non-users are harmed by the mere existence of a futures market, regardless of how well it functions.

Substantial evidence exists which indicates that the Maine potato industry has been so harmed. For twenty years, the Maine potato industry has been in a general decline with respect to acres harvested, yields per acre, total production and market distribution. Several reasons exist for this decline, but one factor which looms large is the unwillingness of producers to commit in advance their crop to a sales agency. Without this commitment, the industry cannot maintain, let alone expand, its markets. I am convinced that the lack of commitment is due basically to the existence of a futures market, holding out an elusive promise of a price which generally exceeds the current cash price. As long as this situation exists, Maine cannot develop a responsible market structure.

Some would argue that producers who behave as I have described are not rational, economic decision-makers, that they do not fit the role of economic man that we economists prefer to analyze. This is probably true; however, it is also true that economic decisions are made in a social and political context which does not always reflect the pure objectivity of rational economic thought. Once aware of societal and political reality, an economist must adjust his analysis to reflect proven behavioral characteristics. Dr. Paul's study did not address this aspect of potato futures contracts. My own observations, which I believe would be borne out by in-depth economic analysis, indicate that while the micro-impact on users may be acceptable, the larger impact on non-users is not.

In addition to the generally negative impact on non-users, the existence of the New York Mercantile Exchange's potato futures contract has had a second harmful effect on the Maine industry. This harm results because the existence of a futures market encourages the State's potato dealers to devote their energy (and establish their priorities) based on futures trading rather than on direct marketing. It would be naive to assume that the actions of potato dealers and their employees are not influenced, in many cases, by their own position in the futures market. When their position is short, their actions are apt to be inherently contrary to the interest of Maine producers, who are best served by actions which advance market prices. To the extent that dealers and their employees devote their business hours to promoting future transactions rather than physical potato sales, they have a conflict of responsibility with the potato packers and producers who rely on their assistance for direct marketing. This inherent potential for conflicting responsibilities and interests prevents the establishment of a sound market program which will benefit packers and producers. Thus, in spite of benefitting some users of the futures market, futures trading has prevented the Maine industry from working in a coordinated manner to establish a united, successful market structure.

I do not believe the elimination of a potato futures contract will be the panacea for all the problems of the Maine industry. Nevertheless, since we have had a futures market for Maine potatoes for some time, since the industry has declined substantially during that time, and since there is substantial evidence that the existence of futures trading and the decline of the industry are related, the reasonable approach is to abolish futures trading in order to provide an appropriate opportunity for establishment of an alternative market mechanism, one which can provide the benefits of both price discovery and risk avoidance without the disadvantages which have been associated with NYME's futures contracts for potatoes.

THE POTATO FUTURES CONTRACT TRADED ON THE NEW YORK MERCANTILE EXCHANGE
HAS NOT BENEFITED THE GENERAL WELFARE

Even if it were decided that well-run futures markets did not in general, substantially disadvantage the Maine potato industry, it is absolutely clear that the existing potato futures contract on the New York Mercantile Exchange simply does not serve the general welfare. The potato futures contract of the New York Mercantile Exchange is disadvantageous for several reasons including:

(1) the apparent inability of the New York Mercantile Exchange to operate in a manner which allows legitimate hedgers to use the contract for insurance;

(2) the demonstrated inability of the New York Mercantile Exchange Board of Governors and/or the Commodity Futures Trading Commission to prevent manipulation;

(3) the unwillingness and/or inability of the New York Mercantile Exchange and/or the Commodity Futures Trading Commission to respond to the concerns and needs of the potato industry; and

(4) the fact that very few Maine farmers actually use the New York Mercantile Exchange's potato futures contract. These problems are serious. They are apparently insusceptible to correction by contract amendment, Commodity Futures Trading Commission oversight or similar efforts. The harm caused the Maine industry because of these failures is grave enough to necessitate the elimination of trading in potato futures contracts.

Legitimate hedgers cannot successfully use the New York Mercantile Exchange's potato futures contract because the contract is not traded or consummated in an orderly, reliable manner. The basic test of the adequacy of a futures market is whether or not the futures price converges with the cash price in an orderly manner. In the past five years, only the 1975 contract has terminated in an orderly fashion. Experience in each of the other contract years indicates that the New York Mercantile Exchange's contract has simply lost its value as a hedging tool. The difference between the average futures price and the Maine cash price for the final five days of the trading on the May contract has varied from \$2.96 in 1977 to \$1.56 in 1975. This divergence, amounting to 90 percent, indicates that cash and future prices are not converging, and this failure precludes the possibility of using the New York Mercantile Exchange for a successful hedging program. In addition to the divergence between cash and futures prices within each year, price volatility during the last five days has been excessive. Average daily prices have varied as much as \$1.62. This volatility precludes the opportunity of orderly liquidation of hedged positions.

The extreme price fluctuations and absence of convergence are indicative of a market situation which is too thin to allow for futures trading. This appears to be the case because the volume of Maine round white potatoes available for satisfying contract requirements has decreased substantially in the past ten years. The Katahdin variety, the only major variety which can be stored long enough to satisfy the April and May contracts, has decreased from 52 percent of the production in 1969 to 23 percent in 1978. It is questionable whether this reduced volume of supplies is adequate to provide a basis for trading sufficient to reflect the general value of the commodity. Although the New York Mercantile Exchange has put forth a new contract involving states other than Maine, the addition of the proposed 14 states to the supply will not correct the limited supply for the late months. The historical facts have changed since the inception of trading futures contracts for potatoes. So long as the supply of this commodity remains essentially as it is today, the New York Mercantile Exchange's potato futures contract will not be capable of serving the legitimate needs of the industry.

Related to the problem of the New York Mercantile Exchange's unsuitability for legitimate hedging is the second problem of the demonstrated inability of the New York Mercantile Exchange or the Commodity Futures Trading Commission to adequately control manipulation. The recent history of the New York Mercantile Exchange demonstrates that its governing board has not prevented price manipulation or the cornering of the supply of potatoes by the dealers or operators on the board. The very nature of the commodity—its perishability and its relative unavailability in large numbers for delivery, especially in later months—makes it inherently difficult, if not impossible, to prevent such manipulation. There is certainly extensive evidence to indicate that the 1976 default was caused by market manipulation, manipulation which the New York Mercantile Exchange and the Commodity Futures Trading Commission were either unable to recognize, unable to prevent or unable to control. Similarly, the New York Mercantile Exchange appeared to be unable to prevent market manipulation in 1979.

As you know, the New York Mercantile Exchange (with the apparent blessing of the Commodity Futures Trading Commission) suspended trading in potato contracts in March of 1979 by emergency resolution. One can certainly infer from the transcripts of the Commodity Futures Trading Commission meetings in March that perhaps the real reason for the "emergency" action was manipulation of the market. The Commodity Futures Trading Commission believed that there were improper transactions taking place and believed that the New York Mercantile Exchange was aware of these problems. Nevertheless, the proclaimed basis for the emergency action was the lack of quality of the Maine potato; a basis not supportable in fact and a basis the very enunciation of which was harmful to the Maine industry. Perhaps the New York Mercantile Exchange blamed the Maine potatoes rather than admit it was unable to respond to the broader problems of manipulation and inappropriate price divergence.

The result of the inability of the New York Mercantile Exchange or the Commodity Futures Trading Commission to control manipulation is clear and obvious harm to the potato industry. The Maine industry is harmed by the direct financial loss to its farmers as well as by the indirect damage to its reputation which results from the New York Mercantile Exchange's declaring that Maine's potatoes are of poor quality. There is no assurance whatsoever that the New York Mercantile Exchange or the Commodity Futures Trading Commission will be any more capable now than they have been before of curing these problems.

The third problem, the lack of accountability of this specific contract market, is somewhat more amorphous but equally significant and injurious. Like the others, it does not appear to be susceptible to an easy remedy. Indeed, the government agency solely responsible for a remedy has not functioned in any way to address this situation. The problem is one of the inability of the industry to influence the New York Mercantile directly or indirectly through the Commodity Futures Trading Commission.

I would suggest that any board of trade which is as immune from the needs and the influence of the people who grow the commodity traded as the New York Mercantile Exchange is cannot possibly function in the public interest. The New York Mercantile Exchange suspension of trading of its potato contract last March is evidence of the serious consequences of this problem. The testimony given by Mr. Michael Marks, speaking for the New York Mercantile Exchange, at the Commodity Futures Trading Commission hearings last May indicated that this decision was made without consultation with anyone in the State of Maine (except their own employee Peter Johnston). Indeed, when questioned as to the advice of the New York Mercantile Exchange's so-called "Potato Committee", Mr. Marks could not recall its membership. While the New York Mercantile Exchange has made some effort to improve its communication with Maine people, these gestures are not sufficient to assure us that the Exchange will, in fact, either ascertain or consider the interests of the Maine industry. Dr. Paul's study, which concludes that the New York Mercantile Exchange's potato futures contract may be beneficial assumes the existence of an amended contract properly managed and enforced. There is no reason to believe, however, that the serious management problems which have obviously plagued the New York Mercantile Exchange in the past have been or will be remedied.

At least as significant as the New York Mercantile Exchange's demonstrated lack of concern with the people who are part of the Maine industry, is their asserted immunity from legal action (except that instituted by the Commodity Futures Trading Commission). As you know, the decision of the U.S. District Court for the Southern District of New York in *National Super Spuds v. NYME* held that there was no private right of action against the New York Mercantile Exchange. After the 1979 suspension, a lawsuit was filed against the New York Mercantile Exchange by Lyle Jordan, Ueal Patrick and Frank Pancerz (U.S. District Court, So. Dt. of New York #79 CIV 3157 ADS). The New York Mercantile Exchange immediately moved to dismiss the litigation, asserting that there was no private right of action against the Exchange. So long as the public, which has been harmed, has no legal recourse against the New York Mercantile Exchange, it cannot be deemed to be functioning in the public interest. It is true, of course, that the Commodity Futures Trading Commission has legal power to control the New York Mercantile Exchange. However, our review of the transcripts of the March Commodity Futures Trading Commission meetings and of the actions taken by the Commodity Futures Trading Commission since then do not indicate that this avenue adequately protects the public's interest. The Commodity Futures Trading Commission transcripts indicate a desire on the part of the Commodity Futures Trading Commission to support the New York Mercantile Exchange rather than to independently review its actions. In fact,

the Commodity Futures Trading Commission never directly reviewed the New York Mercantile Exchange emergency action, although we believe they were affirmatively required to do so by the terms of their own regulations. (17 CFR § 1.41 (f)). Nor has the Commodity Futures Trading Commission responded to the request of the Maine Attorney General to exercise its investigatory and enforcement powers to review the New York Mercantile Exchange's action. In March, Richard S. Cohen, the Maine Attorney General, requested the Commodity Futures Trading Commission to investigate the New York Mercantile's actions, to allow the State to participate in the process, and to make available to the Maine people the results of this investigation. If there has been such an investigation (beyond the "public hearing" held in Presque Isle, Maine in May), we remain unaware of its nature, scope or results. In the absence of a strong regulator, and the possible absence of a remedy through private litigation, it is difficult to believe that the New York Mercantile Exchange can either function in or be accountable to the public interest. So long as the futures market is unaccountable, it should not be allowed to continue.

The fourth problem is perhaps the most self-evident. Simply stated, the theoretical advantage of a potato futures market no longer exists in reality.

The major advantage of the New York Mercantile Exchange potato contract to the Maine industry was its availability for hedging or insurance purposes. Indeed, the New York Mercantile Exchange advertises and promotes its contract on this basis. However, over the past few years, in view of the 1976 default and the 1979 suspension, this has been false advertising and empty insurance. While it may well be that a "properly" run futures market would benefit the potato industry, there is no evidence that the New York Mercantile Exchange is or can be such a market. The value of any insurance program is its stability and reliability, and the New York Mercantile Exchange can demonstrate neither. The 1976 default and the 1979 emergency suspension are extraordinary evidence that the New York Mercantile Exchange is not a properly-run potato futures market.

Even if we could be assured that the New York Mercantile Exchange might become a properly functioning market mechanism, its value remains questionable. Many farmers simply do not have the financial resources necessary to take advantage of a hedging program. This is particularly true now when many of Maine's financial institutions, justifiably shy of the reliability of the New York Mercantile Exchange contract after its "emergency" invalidation last year, are not anxious to finance future trading. The Farmers Home Administration, which finances 40% of the potato crop in Maine, does not provide any financing for hedging programs. In the past, FmHA has subordinated its interest to private financing institutions which provided hedging funds, but the elimination of that approach has automatically precluded 40 percent of the production from hedging opportunities. The unsatisfactory experience of other financing institutions has probably eliminated even more.

In view of the fact that the majority of farmers cannot use the New York Mercantile Exchange for hedging, and the fact that the New York Mercantile Exchange has proven absolutely unreliable, even for those farmers who do, it is clear that this committee should refuse to allow the contract to continue. This elimination of futures trading in potatoes will provide the opportunity for Maine to improve its potato industry by developing alternative marketing mechanisms.

STATEMENT OF MICHEL MARKS, CHAIRMAN, BOARD OF GOVERNORS, NEW YORK MERCANTILE EXCHANGE

My name is Michel Marks, Chairman of the Board of Governors of the New York Mercantile Exchange. Thank you for this opportunity to discuss S. 770.

For well over a century, the New York Mercantile Exchange has served the agriculture, industrial, marketing and investment communities by maintaining a futures market for commodities. The Exchange itself does not participate in trading; its function is to ensure that the trading process is open, fair and orderly. To accomplish this, it provides the physical facilities, the trading rules, the mechanisms for their enforcement, and the necessary reporting and record-keeping systems.

Potatoes are among the commodities traded at the Exchange, accounting for 23% of the volume traded at the Exchange for 1979 and averaging 60 percent of total volume over the last 5 years.

WHAT IS A FUTURES MARKET?

Price risk is a reality of the free market. Growers and shippers with unsold inventory are concerned about price declines which may impair their profit mar-

gins. Users are concerned that prices will rise before their requirements are purchased. For both, the futures market can reduce the risk.

A commodity exchange provides the forum for a public auction market where commodities may be traded for future delivery. It provides representatives of the farm and business community with a mechanism for buying or selling commodities for hedging purposes—the transfer of risks associated with price fluctuations—and it assures a liquid market by attracting speculative interest on the part of the investing public.

The futures contract specifies a set quantity and quality to be delivered. A producer can sell a futures contract, obliging him to deliver the commodity at a certain price at a later date, when the futures price covers his costs plus a return, or profit. A user can purchase futures when the price compares favorably to the current price plus the cost of storing the commodity over the designated time period. Both seller and buyer gain the advantage of locking in a favorable price in advance of the transfer of ownership. A futures contract, however, is not used for merchandising, and generally 97-98 percent of all contracts are liquidated prior to maturation. For potato futures, less than 0.5 percent of the contracts traded result in delivery.

At the New York Mercantile Exchange, futures contracts in Maine potatoes and other commodities are traded. During trading hours, futures prices fluctuate in response to expectations for changes in the value of Maine potatoes at some later date in the season. Each hedger and speculator can determine a favorable price to buy or sell in accordance with his own evaluation of prospects for supply and demand. The price reflected by the combined buying and selling transactions thus represents the latest assessment of what knowledgeable traders expect the market price to be at some specific point in the future.

Price volatility in the cash market over the marketing season causes the risks associated with producing, owning and storing potatoes. Without the benefit of a forward contract or sale of futures, there is no guarantee that one can sell potatoes at a price exceeding the cost of production.

If prices decline following planting or harvesting, the loss in crop value can significantly alter anticipated profits. Since there are considered time lapses between the planting, harvesting and marketing of potatoes, price declines during the interim periods can reduce or possibly wipe out potential profits. The prudent use of futures can protect the grower from such adverse price movements. For shippers, sales of futures against purchases can lock in a return.

For processors and users, there is obviously a risk in the possibility of a significant price increase prior to purchasing requirements. Rather than attempting to stockpile for later use, which would raise the cost of procurement as a result of the financing and storage costs, not to mention the exposure to downside price risk in inventory value, futures could be purchased to cover forward requirements.

Even without taking a hedge position, both buyer and seller can benefit from the existence of futures in making their pricing decisions. The judgment of the market as to what potatoes will be worth in the months ahead can be readily measured against the price today plus the costs of storage and against alternative forward contracts.

For the hedger, the advantages of an active future market are great. As a price discovery mechanism, futures contributed to the orderly marketing of products. For instance, a processor with storage facilities can better determine whether it is wise to purchase and store potatoes at current prices or buy on an "as needed" basis, depending on the forward pricing structure reflected by the futures contracts. If prices for later months are lower than current levels plus the storage costs and likely shrinkage loss, the buyer has the option of purchasing product only to meet his immediate needs and buying futures against later requirements. Thus, he can determine his product cost well in advance of actual purchases. The same is true for sellers, who can lock in a profitable price at which to peg production and marketing plans with a prudent hedging strategy.

No one is forced to base his potato prices on the futures market prices. Buyers and sellers who are dissatisfied with the futures price can ignore it completely, and can establish their own prices. If buyers are dissatisfied with the futures price, they can make bids below that price. But informed sellers will not sell to them so long as there are those bidding more. So, if buyers want to trade, they have to meet the market price. Conversely, if sellers are dissatisfied with the market price, they can make offers above that price. But informed buyers will not buy from them as long as there are sellers offering potatoes for less. So, if sellers want to trade, they too have to meet the market price. Therefore, prices based on the current futures price

are the prices for the commodity in question, because they reflect the broadest interest, the best information, and the best-balanced trading in the commodity.

The ability to make or take delivery of potatoes is what keeps prices within reasonable bounds. When futures prices appear too low, the industry buyer steps in to absorb the potatoes offered; when prices seem inordinately high, the grower or shipper steps up offerings of potatoes to take advantage of the better price. The speculator stands in the middle, willing to take the other side of trades which the hedger may not be able to come to terms on with his cash market counterpart. Thus, speculation by private investors is diverted into a potent and productive channel, allowing the industry to shed price risks.

In summary, the futures market offers the opportunity to lock in prices for likely sales or purchases over the growing and marketing season. The ability to hedge reduces the number of unknown variables in the conduct of business. Plans for production, marketing, storage or purchases can be made on a more solid basis. And for farms heavily dependent on potato income, forward pricing with futures can actually mean the difference between profit and loss.

ANTAGONISM TOWARD FUTURES TRADING

Despite the evidence pointing to the benefits provided by the existence of futures markets, there have been repeated attempts to ban potato futures. Various charges have been made and opinion polls, although of doubtful objectivity, have shown anti-market sentiments. The opponents of futures trading believe that speculators are undermining prices, and that if the futures market did not exist, prices would be higher.

Representatives of potato associations have cast the blame for the economic ills of the industry on futures trading, yet there are clear indications that the problems of the potato industry originate elsewhere. The call for banning a free market institution a serious matter. So, let's consider the major arguments.

1. *Argument.* Maine's competitive position relative to other potato production regions has declined since the 1950's. Farm population and farm-related businesses have also declined in Aroostook County, where most Maine potatoes are grown. This is due primarily to the existence of the futures market.

Answer. Although the Maine potato industry has suffered setbacks in recent years, futures trading has not been the cause. The recent USDA study clearly pointed that out. Increased potato output in the other major producing regions due to population shifts, different growing conditions, and the production of preferred potato varieties have largely contributed to the problems faced by the Maine industry. However, despite this, the season average price received by farmers in Maine compares favorably with the U.S. average. (See Table I.)

2. *Argument.* Few growers hedge in the futures market, and those who do are often unsuccessful.

Answer. The assertion that few growers hedge in the market is false. The futures market is used by many small and medium size farmers as well as large-scale commercial growers, i.e., by those who have the greatest economic risks. A 1978 survey by the University of Maine confirms that 68 percent of Maine's farmers have used futures (Addendum I). Further, Commodity Futures Trading Commission Commitment of Trader Reports reflect substantial use by hedgers (Addendum II). Also, many small growers use the market indirectly: they obtain credit from banks, supplies from fertilizer companies, etc., by pledging part of their growing crops as collateral; their creditors then protect the value of this collateral by hedging in the futures market. Without the protection of the futures market, such credit would be much more expensive to the growers, if available to all.

3. *Argument.* The potato futures market could not absorb the volume of hedging that would be required to secure price protection for the entire crop.

Answer. The market has often absorbed large volumes of new hedging without any sacrifice in price level; and its capacity is nowhere near exhausted.

4. *Argument.* Potatoes are a perishable commodity which cannot be stored from year to year; all stock must be sold at the end of the marketing year. Perishable commodities like potatoes are unsuited to futures trading.

Answer. The perishability argument is simply an assertion. No proof has been presented. On the contrary, the anticipatory pricing and hedging functions of a futures market may be even more important for a perishable than for a non-perishable commodity, because existing supplies must be rationed to, but not beyond, the end of the marketing year. Furthermore, the months for which futures are traded conform to the peak marketing periods.

5. *Argument.* Futures trading causes disorderly marketing as growers are persuaded to hold their crop for spring.

Answer. The futures market did not establish the potato marketing season, but rather, adapted to it. Maine has the ability due to its geographic location to hold potatoes longer into spring than some of its competitors and thus can take advantage of seasonal price rises which often occur in the spring. However, arguments that Maine growers are holding increasingly greater numbers of potatoes into spring are not warranted. Table II shows that Maine marketings are being conducted on an orderly basis and that the percentage of marketings in the late spring months has actually been declining.

6. *Argument.* The buying and selling by speculators causes erratic and unwarranted price movements making it impossible to hedge potatoes.

Answer. Potato prices are volatile as a result of the inherent nature of the potato market. Per capita consumption of potatoes is relatively stable regardless of price; thus, small changes in crop size result in wider variation in price. Also, since the potato crop is perishable, year-end stocks cannot be stored from one marketing season to another, and must be sold for whatever they will bring, or become a total loss. Consequently, the potato industry has long been plagued by the classical boom-or-bust price-production response cycle: low prices cause less acreage to be planted, which in turn causes a short crop and high prices, encouraging increased acreage which brings a surplus crop and low prices. For these reasons, potatoes have always been an uncertain source of income.

The futures market only mirrors the volatility of the underlying cash market. Price volatility is really being confused with price visibility. Cash market transactions are privately negotiated and variations in price between deals may not be readily apparent, although in daily cash market quotations it is not unusual to see a wide spread between prices for the same grade pack of potatoes on any given day.

7. *Argument.* The potato market is populated by gamblers, who know nothing about the potato industry.

Answer. A gambler assumes an artificial risk created for his amusement, whereas a speculator assumes a naturally existing economic risk and attempts to reduce that risk by making reasoned forecasts of conditions in the future. Speculators in the potato market provide a liquid market in which hedges can be placed at the profitable prices.

8. *Argument.* Speculators spread rumors which help them to manipulate prices.

Answer. A large central market is the most efficient means of assimilating information. Traders in futures markets need accurate information, and rumors are soon discredited by facts. The pricing information provided by the futures market is the small growers' best means of competing on even terms with the large growers and buyers. The broader the market, the better the information.

Some of the same arguments were leveled against onion futures in 1958 resulting in the congressional ban on that market. However, studies conducted by independent economists and the USDA since then have clearly shown that futures trading in onions did not alter seasonal patterns for producing, storing or pricing onions. A 1972 USDA study indicated that futures caused no adverse effects on the onion industry and the ban on futures trading actually resulted in greater price risk for those in the industry who previously had a mechanism for transferring that risk to others willing to accept it (Addendum III).

The recent USDA study on the impact of futures trading on the potato industry also invalidates such charges and explicitly states that the abolition of futures trading would not provide the solution to the underlying economic problems of the Maine potato industry.

In a comprehensive report, the USDA analyzed the major questions on the nature of futures markets in general, as well as the impact of futures trading on the potato industry. The viability of the Maine Potato Contract and its past performance were evaluated in depth. But, while the report suggested changes in the present Maine-only contract, it opposed congressional abolition of futures trading in potatoes. The study recommended revisions in the contract to include all states which produce round white varieties similar to Maine and a provision for financial settlement.

REMEDIES UNDERWAY BY THE EXCHANGE

The New York Mercantile Exchange recognized the declining viability of a Maine only potato contract even prior to the March 1979 delivery problems which necessitated the early termination of April and May futures contracts.

When the Maine potato futures contract was initiated at the New York Mercantile Exchange nearly 40 years ago, Maine produced approximately 35-40 percent of the entire U.S. fall potato output. Therefore Maine potato prices generally reflected the overall supply-demand balance.

But Maine now accounts for less than 10% of the fall potato crop in the U.S., and the time has come for a change in the futures contract. The New York Mercantile Exchange has made that change through its expanded round white potato futures contract which will permit delivery of fall-harvested round white varieties grown throughout the eastern and central states, resulting in a significant increase in deliverable supply that will represent nearly 100 percent of the fall round white potato crop.

Because demand for potatoes is essentially inelastic, relatively small changes in supply can result in significant price swings. Expansion of the contract to include other states will not just increase the deliverable supply, but will also provide a more balanced picture of the marketplace.

Many of the features of the present contract are incorporated into the expanded version. The delivery mechanism, however, has been modified, and a new provision for replacement deliveries has been added. The major advantages of these revisions will be to provide a closer relationship between cash and futures prices through the entire term of the contract, further facilitating hedging.

A broader supply base, which encompasses the competitive forces within the potato market, is especially advantageous to hedgers. Everyone benefits when markets behave in a rational and realistic fashion. The viability of a futures market as a hedging mechanism is based on the assumption that futures prices will reflect real or anticipated cash prices. Futures prices are a gauge of what both buyers and sellers expect to happen in the cash market days, weeks or months ahead.

The revised contract was submitted to the Commodity Futures Trading Commission (CFTC) in July. Further, recommendations contained in the USDA study, particularly those regarding financial settlements, are being carefully studied for possible improvements in the contract.

In addition, the Exchange has taken steps to give the potato industry a greater role in the review and management of the potato contract. The Potato Advisory Committee was reconstituted to increase representation from the industry, and the Board of Governors broadened the responsibilities of that Committee. Under the energetic chairmanship of Mr. Brian Ketchum, a member of the Aroostook County potato industry, the Potato Committee has in fact strengthened the communications between the industry and the Exchange.

NEW YORK MERCANTILE EXCHANGE OPPOSES BAN ON FUTURES

Every individual has the right to act in his self-interest, to produce and to offer for trade what he has produced, as long as he does not violate the rights of anyone else. Similarly, two individuals have the right to voluntarily trade with one another, as long as they do not violate one another's rights or the rights of anyone else. Everyone has the right to produce potatoes and to offer them for sale. But no one has a right to force others to buy his potatoes, or to pay a price which they do not want to pay.

Futures markets for basic commodities have grown and prospered because they do serve a vital role in the producing, storing and marketing of those commodities. When some of these markets lost their viability, they were discontinued, without a legislative ban, since they no longer attracted sufficient interest to sustain them. Free market institutions and enterprises exist because they serve a purpose, and are thought to be valuable by those who use them. Therefore, only the most useful institutions and the most productive enterprises can continually attract financial interest and participation.

Furthermore, the proposed legislation to ban potato futures sets a precedent for any pressure group to demand termination of other markets. If the potato market is outlawed this year because prices are "too volatile" or "too low," which markets could be outlawed next year because prices are "too high"?

Naturally, the New York Mercantile Exchange opposes the bill to ban potato futures trading. As an Exchange, we provide a neutral forum for the trading of futures contracts. Individual members of the potato industry can presently choose to hedge or not to hedge as they see fit. We believe it is unjust that those who have chosen not to utilize the futures market now seek to deprive others of their right to choose. Those who do not hedge will gain nothing from the abolition of futures trading, while those who have taken advantage of futures as a means of price protection have much to lose, the most important of which is their right as Americans to engage in business enterprises beneficial to themselves and the public.

For all of these reasons, we urge the Committee not take action on S. 770.

TABLE I.—SEASON AVERAGE PRICE RECEIVED BY FARMERS, MAINE VERSUS UNITED STATES

[Crop years 1967-78]

Crop year	Maine price to farmer	U.S. price to farmer	Maine as percent of U.S. average
1967.....	136	187	72.7
1968.....	185	223	82.9
1969.....	220	224	98.2
1970.....	198	221	89.5
1971.....	170	190	89.4
1972.....	410	302	135.7
1973.....	725	490	147.9
1974.....	290	401	72.3
1975.....	605	448	135.0
1976.....	495	359	137.8
1977.....	336	355	94.6
1978.....	386	338	114.2

TABLE II.—PERCENTAGES OF RAIL AND TRUCK SHIPMENTS, BY MONTHS, FOR MAINE POTATOES

[Crop-year]

Month	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79
September.....	0.2	0.3	0.2	0.4	0.7	0.1	1.6	2.0	2.0	1.8	2.3	1.5	.....	.....
October.....	.6	1.3	.6	1.7	2.3	1.3	2.6	5.9	5.4	3.6	5.2	6.5	2.8	3.5
November.....	6.0	5.9	4.6	4.5	5.3	4.4	6.8	9.7	12.5	7.8	9.1	11.3	6.9	7.9
December.....	8.3	7.4	8.0	5.5	7.4	6.5	7.7	10.1	11.0	10.1	9.1	11.5	10.6	13.9
January.....	11.7	9.1	10.5	10.2	12.0	10.6	9.7	11.2	12.0	13.0	11.5	14.8	12.5	15.0
February.....	12.1	11.9	12.4	11.1	11.2	12.2	11.7	11.6	11.4	13.4	12.3	11.7	13.7	15.7
March.....	24.2	21.2	17.8	20.5	18.8	20.5	18.6	17.7	18.0	17.8	21.3	14.1	18.5	26.7
April.....	21.3	21.2	22.0	22.1	23.3	22.5	16.5	16.4	15.8	19.0	17.2	15.1	18.8	17.3
May.....	10.8	14.6	17.4	14.6	13.2	15.7	17.0	12.5	9.4	13.9	11.0	10.0	16.9	.....
June.....	3.6	5.1	5.9	7.0	5.4	5.1	3.7	2.9	2.7	.....	1.5	2.6	1.5	.....
July.....	1.4	.1	1.0	.2	0.2	0.4	0.1	.....	.....	.....	.....	.....	.....	.....

TABLE III.—TOTAL POTATOES—USED FOR SEED ¹

[In thousand hundredweight]

	1976	1977	1978
Maine.....	2,852	2,737	2,668
New Hampshire.....	5	5	.....
Vermont.....	19	14	14
Massachusetts.....	74	67	72
Rhode Island.....	74	70	76
Connecticut.....	46	42	36
New York, Long Island.....	449	482	429
New York, upstate.....	633	598	612
Pennsylvania.....	504	481	455
Indiana.....	101	88	97
Michigan.....	629	651	614
Minnesota.....	1,102	1,059	1,029
Nebraska.....	102	122	110
North Dakota.....	1,987	1,885	1,755
Ohio.....	193	203	182
Wisconsin.....	974	1,050	1,144
Total.....	9,744	10,298	9,293

¹ Includes all varieties and includes seed sold to other States which may have been moved out of storage prior to April 1.

Source: USDA Potatoes and Sweet Potatoes Utilization.

ADDENDUM I

SURVEY OF MAINE POTATO GROWERS, 1977-1978—BEHAVIOR AND PERCEPTIONS REGARDING POTATO FUTURES TRADING: PERCEPTIONS AND ATTITUDES ABOUT THE NEW YORK MERCANTILE EXCHANGE

Executive Summary of a Report Submitted to the New York Mercantile Exchange

[Prepared by the Social Science Research Institute of the University of Maine at Orono—David Kovenock,
July 17, 1978]

INTRODUCTION TO THE STUDY

A. The purpose of the Survey of Maine Potato Growers has been to determine growers' 1977 plantings (by potato variety) and harvestings; current marketing practices; knowledge of and behavior regarding the trading of potato futures and the New York Mercantile Exchange; sources of information about the potato business; own business structure and financing; and personal demographic characteristics.

B. This report provides an analysis of the Survey data concerning growers' behavior and perceptions regarding the trading of potato futures (Section I), and perceptions of and attitudes toward the New York Mercantile Exchange (Section II). The report contains detailed methodological appendices.

C. The Survey data are based on telephone interviews conducted from November 5, 1977 to March 9, 1978, with a representative sample of 704 of the estimated 1,273 Maine potato growers. The response rate is estimated at between 84 percent and 95 percent.

D. For the purposes of the project, a "potato grower" or "operator" is defined as the individual (or as one and only one of several individuals) who made the potato marketing decisions for a Maine farm that planted potatoes in 1977 for commercial sale.

I. GROWERS' BEHAVIOR AND PERCEPTIONS REGARDING FUTURES TRADING

Data from the Survey suggest the following generalizations:

A. More than two-thirds (68 percent) of all growers have traded futures at one time or another. These "traders" planted 83 percent of the state's 1977 potato acreage.

1. Traders are disproportionately growers who have more than 50 acres of potatoes, who reside in Aroostook County, are between 35 and 64 years old, have attended college for one or more years, and/or had 1976 family incomes in excess of \$20,000.

2. When the non-traders were asked why they don't trade:

a. 25 percent said they don't like "the odds" or don't like "gambling";

b. 19 percent indicated they prefer other means of "marketing";

c. 16 percent mentioned financial or operational constraints;

d. 21 percent said explicitly that they don't know enough about trading to engage in it; and

e. 18 percent gave a very general, a vague, or a "don't know" response.

3. Thus, approximately two-thirds of the "reasons" given for not trading suggest that growers who don't trade either do not know, or believe that they do not know, enough about trading properly to engage in it.

B. Three-fourths (78 percent) of those who have traded described their most recent trade as a "hedge", 18 percent called it a "speculation", and 4 percent volunteered that it was both a hedge and a speculation.

1. The larger his operation the somewhat more likely the operator is to speculate rather than hedge.

2. However, 55 percent of the growers describing their most recent trades as "speculation" planted 100 acres or less in 1977.

3. When asked to define "hedging":

a. Less than 60 percent of the grower-traders immediately associated the term with risk avoidance;

b. Another 30 percent defined the term in such a way that we cannot determine whether they understand the risk-avoidant character of the pure hedge;

c. 5 percent to 10 percent confuse hedging with speculative forms of trading; and

d. 4 percent to 8 percent apparently have no image of hedging whatsoever.

4. "Speculating" is viewed:
 - a. As "gambling" by 29 percent of the grower-traders;
 - b. As a more neutral form of risk-acceptant behavior by another 25 percent; and
 - c. As "dealing in something not owned" by another 25 percent;
 - d. The remainder either equated speculating with "buying rather than selling" (4 percent), with some other specific behavior (5 percent), or gave a vague definition (6 percent) or couldn't provide any definition (7 percent).
- C. Nearly five-eighths (61 percent) of the traders claimed that their most recent trade "worked out" the way they wanted it to.
 1. Recent hedges were more likely to be so characterized (64 percent) than recent speculations (51 percent).
 2. Grower-traders planting 51 to 100 acres were more likely to be satisfied with the outcome of their most recent trade (63 percent) than were growers with 50 or fewer acres (49 percent).
 3. But those with more than 100 acres were not more likely to be pleased with the outcome than those with 51 to 100.
 - D. Fewer than one-fourth (23 percent) of all growers (30 percent of all growers who've ever traded futures) reported hearing anything about the 1977-1978 Maine Potato Contract.
 1. One-half to two-thirds of those who had heard something (about 12 percent to 15 percent of all growers) could provide an obviously valid distinction between that Contract and the previous one.
 2. About one-half of those, perhaps 7 percent of all growers, could provide two or more valid distinctions.
 - E. The Survey data suggest a lack of information about futures trading both among those who have traded futures as well as among those who haven't.
 1. Most of the non-traders, and a substantial minority fraction of the traders, apparently perceive futures trading at best as risk-taking, at worst as pure gambling.
 2. For whatever reasons (perhaps because of widespread participation by potato growers in speculative forms of hedging), many growers do not think of the risk-avoidant futures market instrument, the "pure hedge", when they think and talk about their own and other growers' participation in the futures market.

II. GROWERS' PERCEPTIONS AND ATTITUDES ABOUT THE MERCANTILE EXCHANGE

A. Virtually all Maine potato growers (99 percent) have heard of the New York Mercantile Exchange. But many—even most—don't know very much about the Exchange:

1. Only 9 percent of the growers correctly perceive that the Exchange is organized as a non-profit entity; 78 percent perceive it as profit-making; 13 percent admit they don't know the facts of the matter.

2. Nearly 30 percent of all growers report that they don't know how the Exchange is governed; 27 percent ascribe control of the Exchange to "negative reference" groups: "big shots," "big money," "Jews," "politicians," "bankers," etc.; only about 30 to 40 percent of the growers describe Exchange governance in terms reasonably consonant with reality.

B. When asked for their "feelings toward the Mercantile Exchange," 21 percent of the growers chose "generally favorable," 29 percent said "generally neutral," and 50 percent said "generally unfavorable."

1. When responses are weighted by 1977 potato acreage (plantings), the percentages become 27 percent favorable, 25 percent neutral, and 48 percent unfavorable.

2. When growers are counted equally—but those with fewer than five acres are excluded, the data show nearly 22 percent reporting generally favorable feelings, nearly 28 percent neutral, and nearly 51 percent unfavorable.

C. These last findings would seem to conflict with the announced results of the Maine Potato Council's April 1978 mail "poll" of "growers of five acres or more": that "81 percent voted to eliminate futures trading, while . . . 19 percent favored retention of such trading on the New York Exchange." But the Institute's Potato Grower Survey question and the Council's poll are neither directly comparable nor equally valid measures of the attitudes of all Maine potato growers.

1. The Survey's question is a straight-forward measure of grower feelings toward the Exchange. The Council's poll question does not inquire about feelings toward the Exchange or about futures trading—nor does it measure growers' preferences as to whether futures trading should be eliminated. Rather, it asks whether the Council should engage in lobbying against the trading of futures on the Mercantile Exchange. It is possible that some growers "voting" "yes" in the Council poll were

"sending them a message" (e.g., of reform) rather than saying that ought to be eliminated.

2. The Institute's Survey question allows for favorable, unfavorable, and neutral responses. The Council's poll permits only "yes" or "no" responses.

3. Neither the Institute nor the University of Maine has taken a position on the potato futures and Exchange "issues." On the other hand, the Potato Council has long publicly advocated the elimination of trading in potato futures.

a. Thus, its poll might be looked upon by some growers not as a neutral referendum on the futures issue, but as an active solicitation of support for the Council and its long-standing position.

b. Growers in opposition to that position therefore might be reluctant to legitimize the Council's poll by their participation in it—particularly since such participation required the grower to sign his name and address on his poll "ballot."

c. Research has shown that partisan figures tend to hear disproportionately from their partisans.

4. The wording and context of the Institute's Survey was neutral with respect to the issues involved. The Council's poll "ballot" included an implicit endorsement of the Council's position by 'authority figures'.

5. The Institute's telephone sample Survey attained a response rate of between 84 percent and 95 percent. The Council reports its mail poll response rate as 62 percent.

6. Thus, the Council's mail poll results are not comparable with the Institute's telephone Survey data.

a. Neither the questions asked nor the response categories provided are comparable.

b. The Institute's Survey was designed and executed according to the canons of objective, scientific survey research; the Council's poll was not.

D. However, with 50 percent of all Maine growers expressing "generally unfavorable" feelings toward the Mercantile Exchange, the Exchange suffers what is at best a serious "image" problem. However, many other American economic and political institutions also suffer such problems. Although there are no national surveys directly comparable to the data generated by the Potato Grower Survey question on feelings toward the Exchange, the data on Americans' levels of confidence in 12 national economic and political institutions produced by a 1977 Louis Harris national survey, when contrasted to the Potato Grower Survey results, suggest:

1. The New York Mercantile Exchange's overall rating among Maine potato growers is low—significantly lower than the national population's ratings of many national institutions.

2. At least some national economic institutions—certainly "advertising agencies" and perhaps "organized labor"—to take two examples for which data are available, have lower national ratings than the Exchange has among Maine growers.

3. The conflict over the Exchange among Maine's potato growers is relatively more intense than the nationwide conflict over any of the 12 national institutions examined.

E. The reasons growers give for their overall feelings toward the Exchange suggested four major themes:

1. There is a debate, among the growers themselves, as to whether the Exchange (and futures trading) has a positive or a negative overall financial impact on the growers themselves.

2. The major theme of the comments made by small but significant elements of Exchange supporter (7 percent) and neutrals (12 percent), as well as by a very large minority of the Exchange's opponents (36 percent), consisted of complaints that the market made by the Exchange is too strongly influenced—if not controlled—by speculators, most of them, presumably, non-growers.

3. Only a minority of the growers' "reasons" appear to make any distinction between the Exchange itself, the futures market, and the concept of futures.

4. No significant number of grower explanations of views explicitly refer to possible positive or negative effects, real or imagined, of the Exchange's activities on groups other than the growers themselves.

F. The level of information growers have about the Exchange is positively related to their feelings toward the Exchange:

1. The few who correctly perceive the non-profit orientation of the Exchange are significantly more likely to have generally favorable feelings toward the Exchange than are the many who misperceive the Exchange's orientation to profit.

2. While only 42 percent of those who attribute control of the Exchange to its actual governing institutions and processes have unfavorable overall feelings toward the Exchange, the Exchange is opposed:

- a. By 55 percent of those who attribute Exchange governance to "politicians";
- b. By 62 percent of those who ascribe control to "big shots," "big business," etc.; and
- c. By 72 percent of those who said the Exchange was controlled by "the Jews" or used other anti-Semitic descriptors.

G. The size of the grower's operation (as measured by acres of potatoes planted in 1977) is for the most part positively related to his feelings toward the Exchange. More specifically:

1. Among growers of from roughly 20 to approximately 100 acres, the larger his operation the more likely the grower is to have favorable views of the Exchange.

2. However, growers of substantially more than 100 acres are not significantly more positive toward the Exchange than are growers of about 100 acres. In the 100-plus acre "plateau," feelings are divided about 31 percent favorable, 25 percent neutral, and 44 percent unfavorable.

3. Growers of 20 or fewer acres are more likely to characterize their feelings as "neutral" (51 percent) than as generally favorable (15 percent) or generally unfavorable (34 percent).

4. When Maine growers are divided into the few (12 percent) living outside Aroostook County and the many (88 percent) living within it, we find:

a. The Aroostook grower of 20 or fewer acres is less likely to be neutral toward the Exchange than his non-County counterpart; and

b. County growers of more than 20 acres are significantly more likely to have negative feelings toward the Exchange than growers of comparable acreages outside the County.

H. Growers' experience with the futures market is also strongly related to their Exchange attitudes. For example:

1. Growers who've never traded futures are less likely to be favorable (11 percent), more likely to be neutral (40 percent), and roughly equally likely to be unfavorable (49 percent) toward the Exchange than growers who have traded at one time or another (25 percent favorable, 24 percent neutral, 50 unfavorable).

2. But when we explore this relationship with controls for size of operation, we find:

a. Farmers with 50 or fewer acres of potatoes are significantly more likely to have overall negative views of the exchange if they have traded than if they haven't.

b. Experience with the Exchange seems to have little relationship with the Exchange attitudes of growers of 51 to 100 acres.

c. However, among growers of more than 100 acres, those who haven't traded are more likely to have unfavorable views of the Exchange than those who have traded.

3. Growers reporting that their most recent trade failed to work out as they wanted had less favorable views of the Exchange (15 percent positive, 21 percent neutral, 64 percent negative) than growers pleased with their most recent trade (31 percent favorable, 25 percent neutral, less than 44 percent unfavorable).

4. However, size of operation has an effect on Exchange attitudes that is independent of the outcome of growers' latest trade.

a. 70 percent of those operators with 50 acres or less whose most recent trade was unfavorable have generally unfavorable views of the Exchange.

b. But among the over-100 acre producers pleased with their most recent trade, only 34 percent are dissatisfied with the Exchange.

I. Potato growers' social and economic attributes are related to their overall feelings toward the Exchange. Generally speaking, the lower the age and the higher the education or income, the more favorable are feelings toward the Exchange.

1. Age is negatively related to Exchange attitudes regardless of the grower's size of operation.

2. However, the positive relationships between education and Exchange feelings and income and exchange feelings hold only for growers of more than 20 acres.

3. Among the 1 to 20 acre operators, the more highly educated the grower of the higher his income, the more likely he is to be critical of the Exchange.

4. Among growers with incomes of \$10,000 or more in 1976, the higher the education the more favorable the views of the Exchange.

5. But significantly, at \$10,000 or below, the higher the education, the less favorable the grower's views of the Exchange are likely to be.

J. Since young farmers are more likely to support or be neutral toward the Exchange than are older farmers; because support for the Exchange tends to increase with education and size of operation; and since levels of grower education and the average size of a potato farm are increasing, we would predict that, other things remaining the same, the aggregate of growers' feelings toward the Mercantile Exchange will become more favorable toward the Exchange in the years ahead.

K. However, all other things are not likely to remain the same. The cash and futures market for potatoes and the actions of potato community and political leadership change much more rapidly than do the demographic characteristics of potato growers. And, unlike the changes in grower demographics, the market and leadership actions may well cause an increase in unfavorable views of the Exchange.

ADDENDUM II.—ROUND WHITE POTATOES, NEW YORK MERCANTILE EXCHANGE; COMMITMENTS OF TRADERS IN ALL FUTURES COMBINED AND INDICATED FUTURES, AUG. 31, 1979

[Contracts of 50,000 pounds]

Futures	Total— Open interest	Reporting (large) traders								Nonreporting (small) traders speculative and hedging	
		Speculative				Hedging		Total			
		Long or short only		Long and short (spreading)							
		Long	Short	Long	Short	Long	Short	Long	Short		
All.....	4,516	2,115	481	80	80	301	1,466	2,496	2,027	2,020	2,489
Old.....	4,516	2,115	481	80	80	301	1,466	2,496	2,027	2,020	2,489
Other.....	0	0	0	0	0	0	0	0	0	0	0
Changes in commitments from July 31, 1979:											
All.....	+ 730	+ 435	+ 251	+ 45	+ 45	+ 143	+ 276	+ 623	+ 572	+ 107	+ 158
Percent of open interest held by each group of traders:											
All.....	100.0	46.8	10.7	1.8	1.8	6.7	32.5	55.3	44.9	44.7	55.1
Old.....	100.0	46.8	10.7	1.8	1.8	6.7	32.5	55.3	44.9	44.7	55.1
Other.....	100.0	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)
Number of traders in each group (reporting traders):											
All.....	35	17	8	2	2	3	12	20	20	.....	.....
Old.....	35	17	8	2	2	3	12	20	20	.....	.....
Other.....	0	0	0	0	0	0	0	0	0	0	0

CONCENTRATION RATIOS, PERCENT OF OPEN INTEREST HELD BY THE INDICATED NUMBER OF LARGEST REPORTING TRADERS

Futures	By gross position				By net position			
	4 or less traders		8 or less traders		4 or less traders		8 or less traders	
	Long	Short	Long	Short	Long	Short	Long	Short
All	24.5	23.7	37.8	32.0	23.9	18.5	35.5	24.4
Old	24.5	23.7	37.8	32.0	23.9	18.5	35.5	24.4
Other	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)	(¹)

¹ Less than 0.05 percent.

ADDENDUM III

EFFECTS OF FUTURES TRADING ON PRICE PERFORMANCE IN THE CASH ONION MARKET, 1930-68*

[Technical Bulletin No. 1470—U.S. Department of Agriculture, Economic Research Service]

SUMMARY

A shift in price performance (level and variability of prices) in the cash onion market apparently occurred between 1930-40 and 1946-57, the latter period characterized by an active futures market in onion contracts. However, because World War II occurred during the intervening years, it was not possible to immediately conclude that the observed change was caused by the introduction of futures trading. In addition, an analysis of various measures of price performance revealed that no change occurred from 1959 to 1967, the 9 crop years following the congressional ban on futures trading. If the crop years of 1931, a somewhat unique year during the entire period, and 1958, the transitional year from active futures trading, are eliminated, the analysis would support the general conclusion that there was no significant shift in price performance in the cash onion market during the entire period from 1930 to 1968.

Aggregate within-season price variation differed among markets and over time, with greater variation occurring at shipping point than at wholesale. However, if the perfectly competitive market is used as a reference point, price variation did not appear excessive, particularly for the period following World War II.

One component of aggregate within-season price variation is price change associated with storage cost, referred to here as price seasonality. Two previous studies concluded that the introduction of the futures market resulted in a flatter seasonal pattern in cash onion prices. However, an updating of these two studies showed that, with the exception of 1958, the seasonal pattern remained unchanged following the ban on futures trading. Further, if the 1931 crop year is omitted from the analysis then it is difficult to support the hypothesis that there was a significant shift in the seasonal pattern of cash onion prices during the entire period. This applied whether using the farm price or an f.o.b. shipping point price and whether using monthly or weekly price indexes.

A second component of aggregate within-season variation is the monthly price range, a statistical measure used to assess the impact of the price discovery process. A substantial reduction in within-month price variation occurred between the period of no futures trading and the period of substantial trading; no significant change occurred following the ban on futures trading. This suggests that whatever caused the shift in price performance from the first to the second period persisted through the third period. However, if 1931 is omitted, a major portion of the observed difference between the first and second periods is eliminated. Consequently, it is not clear that there was, in fact, a significant shift in within-month price variation.

The perfectly competitive market in space was used as a framework for analyzing price relations among spatially separated markets. Overall, the results were mixed and do not lend themselves to general and defensible conclusions. The source of this result lay in the problem of data pooling: When data for all years were pooled, the analysis indicated a deviance of price performance from the competitive norm; with a smaller degree of aggregation, performance appeared to approach the norm. As a minimum, it is clear that the nature of price performance over space was changing but it is not at all clear what effect, if any, the presence or absence of the futures market had on that performance.

CHAPTER 1. PERSPECTIVE

A question of considerable interest to students of agricultural marketing relates to the impact of a futures market on the performance of the pricing system of the commodity involved. This question is becoming more and more important as the structure of cash markets is undergoing change brought about by such things as improved transportation and communication systems, more extensive use of specification buying, increasing reliance on bargaining, and the use of such institutions as marketing orders. These structural shifts raise serious questions concerning the efficacy of the traditional pricing mechanism of these commodities. Simultaneously with these changes, futures markets have been playing an increasing role in the marketing of farm commodities, both in terms of trading activity in established

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futures markets and in terms of new futures markets opening up. Thus, it is of paramount importance to continue the attempt to assess the role of futures markets in pricing performance.

This assessment has been somewhat difficult in the past because of the lack of a well-developed theoretical framework and the difficulty of doing empirical research. These mutually reinforcing problems have resulted in the inability of students of agricultural markets to answer specific questions and charges concerning the contributions of futures markets to pricing performance. Only in very recent years has a body of empirical research begun to emerge which is providing initial insights into some of the answers. Progress along these lines is needed and welcome. This report will, hopefully, make a modest contribution to this development.

The research considered in this report involves an assessment of the impact of futures trading on the cash onion market. Of the commodities that have been involved with futures trading, the history of the onion market makes it of special interest to students of price performance. The period since 1930 may be considered as three subperiods: From 1930 to World War II, there was an active and well-developed cash market for onions but there was no futures market; for approximately 10 years following the war there was, in addition to the cash market, an active futures market; finally, futures trading in onions was banned in 1958 by congressional action and there has been no trading in onion futures contracts since that time. Thus, one may study price behavior in this cash market during three distinct periods—no futures trading, active futures trading, and no futures trading. This quasi-laboratory situation is somewhat unique for the empirical analysis of futures markets in agricultural commodities. For some commodities, such as livestock products, it is possible to study a market before and during futures trading, since these markets have come into existence in recent years. For others, however, such as feed grains, it is not possible to meaningfully study periods without futures trading because these commodities have had active futures markets for many years.

The contribution of this report is twofold. First, and perhaps of primary importance, it serves as an educational document. An attempt is made to reveal the complexity of evaluating price performance in an actual cash market and, at the same time, to indicate some of the characteristics of price relations over time and over space that should be considered in such an evaluation. Second, an analysis of the actual performance of cash onion prices from 1930 to 1968 is presented.

Format of report

The remainder of this chapter delineates the scope of the study and discusses some fundamental considerations necessary to provide a perspective for evaluating the conclusion drawn. The next chapter summarizes the results of the research and presents the conclusions drawn with respect to price performance in the cash onion market. The remaining chapters present the research results that provide the basis for these conclusions.

Definition of the onion market

Seasonal crops.—Since onions are grown seasonally in many regions throughout the United States and are sold in a national market, a study of the "onion market" should necessarily reflect the total situation. However, since the ultimate purpose of the research relates to the onion futures market, it is possible to restrict the scope of the study. There are four seasoned onion crops; early spring, grown primarily in Texas; late spring, grown in Texas and California; early summer, grown in Texas and New Mexico; and late summer, grown in the northern tier of the United States. The first three of these seasonal crops are harvested in the Southern States during warm weather and must move to market as soon as they are harvested. On the other hand, by taking advantage of the cool weather following the harvest of late summer onions in the Northern States it is possible to store them for subsequent sale for up to 7 months.

This late summer or storage crop provided the basis for the futures trading in onions and, thus, the price performance for this crop received the major emphasis in the current research. However, it was appropriate from time to time to consider the early spring, or Texas crop since this crop often competes in the market with remaining storage stocks from the previous late summer crop. Even in years when the two crops are not in direct competition, expectations concerning the magnitude of the Texas crop and the time of its arrival on the market may have a perceptible impact on the market price of the late summer crop toward the end of the storage season.

Geographic scope of the market.—In the context of the late summer crop, a comprehensive research endeavor would encompass the complex interrelations among the supply and demand conditions in all of the several producing regions.

However, it was possible to reduce the scope of geographic coverage to a considerable extent. There is reason to believe that historically the Rocky Mountain range has served as an effective dividing line creating a certain degree of independence between the Eastern and Western United States with respect to the onion market. To the extent that this is true, one sector of the market may be studied without explicit consideration of the other sector, and this approach has been adopted herein.

For current purposes, attention focuses primarily on cash prizes in Michigan and Chicago. This recognizes that delivery on the onion futures contract was at Chicago and that Michigan has historically been a major supplier of the Chicago market. Consequently, the impact of market forces should be reflected in the performance of price at these two points in the marketing system. In addition, it is of considerable interest to investigate the relationship between Michigan and New York prices to determine the nature of price performance over space. Since the onions produced in these separate regions must be priced in a national market, it seems reasonable to expect an interdependency to exist between the prices received in the two regions.

Prices series used

There remains the question of what specific price series to use in the analysis. As students of agricultural prices are painfully aware, there is no such thing as only one price for any commodity; rather, there is an array of prices, each relating to some alternative definition of the commodity of interest. For the current study, there are two such prices. One is the price received by farmers, sometimes referred to as the farm price, and the other is a price reported on the f.o.b. shipping point basis. The reported farm price is derived by dividing the total revenue from all sales of the commodity by the total quantity sold. As a result, it is a composite price reflecting not only basic supply and demand conditions in the market but also differences in grade and quality, differences in selling methods, differences in containers and packaging, and so on. The problem with using this price in a time-series analysis is that its value may change from one year to the next, not because of changes in basic supply and demand forces, but because of a shift in the distribution of the total crop by grade or because a new type of packaging material is introduced. In other words, the "commodity" represented by this price is not constant over time.

To circumvent this problem, it is desirable to use an f.o.b. shipping point price since such a price typically refers to a specific grade and quantity for which the definition changes little, if any, from year to year. To the extent that this is true, year-to-year changes in this price should be more reflective of changes in the market forces one is attempting to assess. In addition, this price series corresponds more closely to the futures market price series than does the farm price. For these reasons, this study used f.o.b. shipping point prices for Michigan and for New York. For Chicago, the wholesale price for Michigan onions was used. In several places, comparisons involved prices at other shipping points and in other wholesale markets. All prices are in units of 50-pound sacks.

Development of continuous price series.—As in most empirical research, serious data problems were encountered. Of primary concern was the lack of consistency in the price series to be used, both in terms of reporting base (e.g., for some years the price may be quoted on the basis of at least 70 percent No. 1's, while for other years the base may be 60 percent) and in terms of missing observations. For most of the comparisons made, weekly prices were used and were calculated by taking the midpoint of the weekly price ranges reported in various issues of the annual reports filed by USDA's market new service. For some of the price series, data for entire years were not available. For others, there were weeks during which, for some reason or another, prices were not reported. In an attempt to have as complete a series as possible, several adjustments were made. For example, in any case where just 1 week was missing, a price for that week was entered by taking the midpoint of the prices reported for the preceding and following weeks. The one exception to this rule was when a gap of 2 or more weeks occurred following the first reported price for the shipping season or preceding the last reported price for the shipping season. In that case, the actual length of the shipping season was changed by dropping the first or last reported price, whichever was appropriate.

Deflation of prices.—When studying the price of an agricultural commodity, such as onions, over a long period of time, it is important to distinguish between two sets of forces which generate price change. One set of forces affects the general price level for all farm commodities. Population growth, changes in income levels, general business conditions, and international conditions are suggestive of general forces at work in the economy that would affect the level of all prices. The other set of forces giving rise to price change is unique to a particular commodity, onions in this case.

Changes in supply of onions from year to year, development of new technology for harvesting and storing onions, other cost changes, and changes in consumers' dietary habits, for example, would be viewed as forces essentially unique to the onion market.

From the standpoint of empirical analysis, this means that the analyst must contend with both the general and the unique forces if he is to explain the historical course of observed price. Since this study was concerned only with the unique factors, it was necessary to adjust cash onion prices to remove the effect of the general economic forces. This was accomplished by dividing each price by an appropriate price index for all commodities. This deflation procedure transforms observed prices into "real" prices, i.e., prices adjusted for the general price level. In the following chapters, actual onion prices have been deflated by the Index of Prices Received by Farmers, All Commodities, 1910-14=100.

Price variation and time-unit of observation

The definition of the appropriate time-unit of observation for assessing price performance can be crucial, because conclusions concerning the adequacy of performance may differ depending on whether one considers daily, weekly, monthly, or long-term price change. The importance of recognizing the time-unit of observation cannot be overemphasized, because failure to recognize it can lead to considerable confusion. It is possible for one student of onion price performance to conclude that onion prices vary excessively and another to conclude that onion prices exhibit a remarkable stability over time. Such opposing points of view could simply reflect different time-units of observation used—one researcher might have considered day-to-day price variation and the other year-to-year variation.

This section discusses briefly the types of time movements recognized by students of commodity prices. The intent is to identify the various components of a time series of price and to suggest some of the reasons why these components may be observed. Methods for detecting and analyzing these components are not considered.¹

Short-term variation.—Price variation occurring within a trading day or from day to day is usually referred to as short-term variation. Such variation may be in response to changes in market conditions occurring during the period. For example, a sudden snowstorm in Michigan may retard the flow of onions into the Chicago wholesale market, resulting in a short-term increase in price which is quickly canceled once the usual flow of onions is resumed.

A slightly different cause of short-term price variation is a change in expected market conditions. The price of late summer onions during the latter part of the storage season is quite sensitive to conditions relating to the upcoming new crop from Texas. Consequently, changes in conditions which are expected to affect the quantity or quality of this crop, or the time that it is expected to arrive on the market, can have a marked impact on the short-term variation in the late summer onion price. Heavy and unexpected rain over the weekend during the Texas harvest could result in a substantial increase in onion price from Friday to Monday.

Regardless of the cause, short-term price variation is typically nonrepetitive. Under casual examination it may appear to be random. To the extent that it is caused by random events—in the sense of unpredictable events—it is random. For this reason, very little theorizing and very little empirical effort have been devoted to short-term price variation.

Seasonal variation.—Seasonal variation in a commodity price is usually associated with change in price from month to month. In fact, seasonality is a 12-month cycle which is repeated from one year to the next. Most agricultural commodities, because of their production and marketing characteristics, exhibit a seasonal price pattern. Seasonal shifts in demand may also generate a seasonal pattern in price.

For some annually produced commodities, such as late summer onions, the requirement that a certain portion of the crop be stored for sale while the commodity is not being harvested results in a definite seasonal price pattern that is associated with the cost of storage.

Annual variation.—Annual, or year-to-year, variation in the season average price is usually associated with crops that are harvested during a relatively short period only once during a calendar year, such as late summer onions. The observed change in price from one crop year to the next is basically a manifestation of changes in supply and demand. Since the demands for many agricultural commodities are relatively stable over time, these annual changes in price are normally associated with changes in supply, such as those that result from changes in weather conditions during the planting, growing, and harvesting periods.

¹ Interested readers are referred to F. L. Thomsen and R. J. Foote, *Agricultural Prices*, McGraw-Hill Book Co., 1952—especially chapter 17.

Long-run trend.—Long-run trend refers to a directional movement in price which persists over a long period of time. It is generally associated, in turn, with long-run, or persistent, trends in factors affecting the supply and demand of agricultural commodities. Continuous population growth and changes in technology are illustrative of factors giving rise to long-run trends in price.

Cycles.—A cycle is defined as a regularly recurring movement in price which generally requires several years to complete the pattern. Such a price pattern is typically associated with the livestock sector, where the full effect of a decision to increase or decrease production is not reflected in market price until several years later. Cycles are not, in general, associated with annually produced commodities.

STATEMENT OF ROGER W. GRAY, PROFESSOR AND ECONOMIST, FOOD RESEARCH
INSTITUTE, STANFORD UNIVERSITY, STANFORD, CALIF.

I am Roger Gray, Professor and Economist in the Food Research Institute at Stanford University. I am appearing before you at the request of, and at the expense of the New York Mercantile Exchange. I share with some of you a sense of *deja vu* on this occasion, since I testified in opposition to Senator Muskie's bill (S. 332) in 1963, and have subsequently (in 1966 and 1972) opposed other efforts to ban potato futures trading. My first study of potato marketing problems was my doctoral dissertation completed in 1952, and I have subsequently published several studies dealing with futures trading in potatoes and onions, as well as numerous studies relating to futures trading in other commodities. I have attached a copy of my curriculum vitae because it exhibits the extraordinary focus upon analyses of futures market performance in my research and consulting work over the past 25 years. I would urge you to refer to my earlier statements on S. 332 (1963), H.R. 6006 (1966), and H.R. 7287 (1972) in order to confirm that my conclusions were based upon analyses of market performance and that these met and refuted the most frequent allegations heard against the potato futures market. My most recent published study of this market was "The Futures Market for Maine Potatoes: An Appraisal" (1972). Since 1972 there has been a major convulsion in commodity prices, as well as in costs of production, and continued shifts in areas of potato production and in potato consumption patterns. Despite the stress which these developments have imposed, I find no reason to retract the summary assessment which I drew in that study and repeat here.

This has been an analysis of the performance of a new marketing institution in the context of an old and stubborn marketing problem. The futures market for Maine potatoes has been active for less than two decades whereas potato price uncertainty and cyclicity have persisted since the price record began. The historical variability of potato prices had been arrested during the price-support program of the 1940s—a program which induced the emergence of a highly specialized potato growing industry, born out of price certainty and far more dependent upon price certainty than its antecedent conglomeration of sideline potato enterprises and barely nascent specialists. Could the mutant survive the ancestral diet, or did it depend wholly upon the mother's milk which had imparted such vigor up to the weaning stage? Was there an even better alternative, whereby a diet of reasonable price stability could be developed which would assure the survival of the new industry on its own feet?

An organized futures market is the logical mechanism through which to enable producers to plan production according to prospective prices and to convert these to certain prices through hedging. The potato futures market was the first ever to attract significant hedging business in the context of discontinuous inventories and a cyclical price-production pattern. The forward pricing and inventory rationing functions are both more difficult and more important in this case, as compared to such continuous inventory cases as the grains. The success of this market, in economic, terms, has already been demonstrated—it has provided reasonable signals to those who would look and price certainty at reasonable levels to those who would avail themselves of it by hedging. The level of hedging use has continued to grow, hence the measure of success has gradually increased. Anything like full success from a total industry standpoint cannot be achieved until a much larger segment makes use of this or other potato futures markets, but already there are signs of improvement in industry production response. Most importantly to date, however, has been the contribution of this market to the vanguard of potato growers and shippers who use it. The analysis in this paper can leave no doubt as to why its users support it.

In preparation of my appearance today I have studied and considered various materials and proposals which I wish to comment on briefly prior to inviting your

questions. The first of these is a sizable study out of the U.S.D.A., authored by Paul, Tomek, Kahl, and Deaton. This is a formidable team of analysts who have considerable background in studies of this type. Their concern that cash and futures prices have not been converging in late delivery months in recent years is a real one. I would not go so far as they do in characterizing the futures market as being "sick," nor would I deny that it needs improvement. I think that the latest proposed contract revisions from the exchange are responsive to the problem. Whether they prove to be fully responsive remains to be seen. The proposal by Paul, et al, for contract liquidation by formula is bold and ingenious. If I were more certain than I am that the cash price quotations upon which it rests were fully representative quotes from a free, liquid, and continuous market, I would be more inclined to endorse the proposal. As it stands, I would reserve judgment pending this assurance and pending observation of performance of the revised contract.

I have also read the various statements submitted at the CFTC hearings in May of this year. I find in these little that differs from the emotional and political attacks to which the market has been subject for the past quarter century. One exception pertains to the March suspension, in which it appears that the exchange may have over-reacted, although I have not studied all of the evidence in detail.

A final subject upon which I have done considerable reading is the abuse to which the market was subject in 1976, given that the major offenders had a large illegal short position, I can appreciate grower resentment of the episode. I cannot share their optimism, however, that with the closing of the futures market he and other large potato buyers would not exploit their market power to depress potato prices.

STATEMENT OF DR. CLAYTON YEUTTER, PRESIDENT, CHICAGO MERCANTILE EXCHANGE

POTATO FUTURES—A BLESSING IN DISGUISE

Mr. Chairman, I am Clayton Yeutter, President of the Chicago Mercantile Exchange. I thank you for the opportunity to appear today before this subcommittee.

Agriculture has been historically viewed as the lynchpin of our society. Textbooks recount numerous "feast or famine" situations in which the outcome significantly altered the economic, political and social structure of nations. Obviously, anything that threatens the agricultural productivity of a nation affects the nation as a whole. Any risk that seeps into the agriculture framework has a potentially negative impact on the entire economy.

In America today, we see even greater productivity being accomplished by a shrinking number of farmers, so it is easy to understand why agriculture risk looms large in our country's economic life. In dollars-and-cents, fewer producers are shouldering greater risk from the volatility of prices. These risks do not, however, stop with the producer. Ultimately, production costs—including the cost of price risk—are passed on to consumers in the form of higher prices. It therefore, follows, logically and conclusively, that management and marketing techniques that work to reduce a producer's risk benefit our entire population—the entire marketplace.

One technique that works, with a proven track record, is the futures market. In parlance of the trade, commodity producers and processors, as hedgers, transfer their risk of price fluctuation to speculators. These speculators willingly assume that risk in the hope of reaping a profit.

The more zeal with which this risk transferral process takes places, the better the marketplace functions. In other words, the greater the number of market participants, the more efficiently the system reduces risk.

Futures markets today are working well. For example, our Exchange experienced a 90 percent increase in volume in 1978 over 1977. We will be up another 35 percent or thereabouts this year, with a total volume of more than 20 million contracts. That speaks for a lot of people using a mechanism that is doing its job.

That mechanism did not always exist. Although futures markets have made tremendous strides in the past few decades, the concept that drives them is centuries old. The institution of futures trading traces its roots to Japan in the late 1600s where a "forward market" in rice was established. Futures markets today are predicated on that same idea—substituting a paper "futures" transaction now for a cash transaction later.

In America, futures markets began in Chicago during the middle 1880s. Businessmen found themselves faced with the same type of risks that Japanese noblemen encountered centuries earlier. The seasonal shortages and gluts of grain and perishable commodities stimulated wild price fluctuations that spanned the market spectrum from producer to consumer. The livelihood of merchants often teetered as

unpredictability in the marketplace proved a shaky fulcrum. Gyration prices became the "Mother of Invention" for businessmen who began to alleviate the problem through use of forward contracts. Producers and users could specify when and how much of a raw product would be bought and sold months before actual delivery.

As this system flourished, an organized trade center was set up to accommodate the merchants. The first of these evolved into the Chicago Board of Trade; the second, which was geared toward eggs and butter, became the Chicago Produce Exchange and ultimately the Chicago Mercantile Exchange.

The formation of futures markets was a response to a deep-seated need by farmers for a way to reduce risk. Over the years, as risk has grown, so have futures markets expanded in scope and sophistication. My predecessors at the Chicago Mercantile Exchange developed successful futures contracts in a variety of livestock products—fat cattle, feeder cattle and hogs, e.g.,—and in lumber. And our International Monetary Market began the first successful entry into financial futures. With foreign currency and interest rates futures, the risk protection previously available only to the agricultural sector was set in motion for the financial world.

Time and time again, futures markets have been recognized as performing several basic and important economic functions. One—the shifting of price risks—I have already mentioned. Two others of major significance include price discovery and the generation of management information.

Properly used, futures markets enhance the flow of goods from producer to consumer. They allow producers to "hedge" themselves against volatility that already exists in the marketplace. Putting it another way, they serve as an insurance policy against risks that few producers—including potato producers—can afford to absorb in today's world.

Secondly, futures markets are a price discovery mechanism. Since futures markets project supply-and-demand fundamentals into the future, prices determined in futures trading constitute a prediction of what a large group of people believe market conditions will be in the coming months. The benefits from this spill over into a much larger arena than that of the trading pit. All facets of business can gain from the prognostications this price forecasting mechanism provides.

Thirdly, a huge amount of information is generated during the price discovery process, and the gathering and updating of this information contributes greatly to good financial management.

Taken collectively, futures markets and business, whether agricultural or financial are, to some degree, symbiotic. Without futures markets to help stabilize prices and move goods through production and marketing channels, risk uncertainty would certainly dampen economic productivity. Yet futures markets would not have been conceived, nurtured or be flourishing today if the risk in cash markets had not fostered their use.

Let us now consider the applicability and value of futures trading to the potato industry. To illustrate the variability of potato prices, and thus demonstrate the wisdom of a hedge which reduces that price risk, consider some production and price statistics.

Idaho is the largest single potato producing state in the country. In the 1974-75 crop year, U.S. No. 1 count cartons of 80, 90 and 100 size Russet Burbank potatoes from Idaho fluctuated in a \$7.75/cwt range over an eight-month period. Weekly average prices, according to USDA, for those potatoes varied from a high of \$13.00/cwt in late September, which marks the beginning of the fall potato crop, to a low of \$5.25/cwt in late March, the end of the peak production period. Prices then rose again by the end of May to \$11.87/cwt.

Variability is by no means confined to the distant past. During this last crop year, for example, prices dropped from \$10.50/cwt in the fall to below \$7.50/cwt by April 1.

This means a lot of growers were exposed to considerable price risk for their 1978-79 potato crop.

By hedging a portion of that crop, potato growers and storers could have reduced the price risk which occurred, and could have locked in prices much more attractive than what many of them finally received.

I know from personal experience that hedging works. I used it—and used it successfully—in my own farming and livestock operations long before I had any formal association with this industry. I learned long ago that it is economically foolish for a businessman—be he agricultural or non-agricultural—to fail to take advantage of attractive hedging opportunities in a futures market if and when they are available to him. Instead of throwing brickbats at such markets and other advanced marketing techniques, businessmen need to learn how to use them. They

can learn, and they will learn, for it is to their financial advantage to do so. But this is a long term educational process, not helped along by legislation such as that before you today.

Proposals to ban futures trading—in potatoes or or any other product—make no economic sense whatsoever. To support such proposals would be a disservice to thousands of people. It is true that many of the potential participants in a potato futures market do not today use that market. In most cases this is because they simply do not yet understand the concept. That is the educational challenge before all of us. In other cases, however, it is because of disillusionment with the way potato futures trading has been conducted in the past. To that I can only say, if the mechanism needs fixing, let's fix it! But let's not abandon a most valuable marketing vehicle simply because it is sputtering. To do so would be to deliver a political and economic blow to our free enterprise system that it just does not deserve!

Mr. Chairman, that concludes my statement. I would be pleased to answer any questions that you may have.

STATEMENT OF LLOYD A. SCHMIDT, EXECUTIVE VICE PRESIDENT, RED RIVER VALLEY
POTATO GROWERS ASSOCIATION

Senator Stewart, and Members of the Committee, my name is Lloyd A. Schmidt. I am the Executive Vice President of the Red River Valley Potato Growers Association, located in East Grand Forks, Minnesota and Grand Forks, North Dakota. This Association represents 950 potato farmers in the Northwest region of Minnesota and North Dakota. This area produces approximately 95 percent of all potatoes grown in those two states. The production of these growers totals in excess of 3 billion pounds of potatoes each year.

I am here today to express the strong support of the Red River Valley Potato Growers Association for S770, which is being heard here today. The Red River Valley Potato Growers Association for many years has supported the efforts of the Maine Potato Growers, as they have attempted to obtain the elimination of futures trading on potatoes. Although potatoes from the Red River Valley have not been used for trading on the futures board, we have supported growers from the state of Maine because of the manner in which they have been used for the benefit of the traders, or probably more specific, the speculators. Although, this in itself would be enough reason for us to support S770 we find ourselves much more serious in our efforts to obtain the elimination of futures trading on potatoes.

The reason for this seriousness is the proposal which was submitted by the New York Mercantile Exchange, to the Commodity Futures Trading Commission, for the inclusion of potatoes from Minneapolis and North Dakota as well as 12 other states in a New York Mercantile potato futures contract. This proposal, to include potatoes from the Red River Valley, was submitted to the Commodity Futures Trading Commission without the benefit of even one hearing, in either of the two states, prior to its submission. I recall one telephone call, attempting to conduct a hearing in the Red River Valley. The proposed time frame was to have the hearing at a time when the Red River Valley was up to its waist in water, and it was still rising. Needless to say, we rejected the idea at that time and no other date was recommended by them. I did travel to Maine, representing our industry in the Red River Valley, to give our views in opposition to this proposal. Further, letters have gone to the Commodity Futures Trading Commission from the Commissioners of Agriculture in both Minnesota and North Dakota, objecting to the inclusion of our potatoes into the Round White Potato Futures Contract. In fact, Commissioner of Agriculture Just, from the state of North Dakota, in his letter also called for the elimination of futures trading on potatoes as the best answer to futures trading on potatoes. I would like to add here Mr. Chairman, and Members of the Committee, that if the proposal of the New York Mercantile Exchange to the Commodity Futures Trading Commission is approved over our very strong objections, we will be considering legal action as a possible remedy.

Another reason for our strong support of S770, is the fact that the New York Mercantile Exchange, is seemingly unable or unwilling to police itself and protect everyone equally from possible harm. In addition to this, we find, the Commodity Futures Trading Commission equally as inept in handling the policing of the activities of the New York Mercantile Exchange. We have seen defaults, manipulations, unwarranted rejections and early and unsuspected halting of trading. We have heard Commissioners of the Commodity Futures Trading Commission say, or read, transcripts where they have said that they are aware of buyers that have broken seals on trucks to replace good potatoes with bad potatoes, to make certain that the truck load is rejected so they would not have to accept the load. Mr. Chairman, I am

not naive enough to think that actions such as these do not happen. But, I am naive enough to believe that the government still has a desire to correct a situation where people are abused, and in some cases literally driven out of business.

Yet, what do we find actually happens, we have a default, and the wrong doer has his fingers slapped, and I might add not very hard. We have a situation where 57 loads of potatoes leaving Maine pass inspection, 49 of which were rejected as not passing re-inspection only a few hours later in New York. Some of which, a few hours beyond, did pass inspection again in the state of Pennsylvania. What is the outcome of that? In the transcript of the March 28th meeting of the Commodity Futures Trading Commission, the Chief Federal Produce Inspector for the Eastern Division, was quoted as saying; "In his judgment 80 percent of the potatoes would have been deliverable." We should also add here Mr. Chairman; that this transcript, among other things, was obtained only after legal action had been started against the Commodity Futures Trading Commission. We then come to the rapid and somewhat curious halting of trading of the April and May contracts. What is the outcome of that? Again, according to the transcript of the CFTC meeting, one would think that the Commission is much more interested in rationalizing the actions of the New York Mercantile Exchange, keeping a low profile for the CFTC and making Senators and Congressmen happy, than they are being intent on regulating the actions of the Mercantile Exchange, which by its actions, has demonstrated that it cannot regulate itself.

For those who think these and other problems can be corrected by increased activity by the government or a new contract, let me say, that these problems and these actions have existed for years. Attempts have been made, such as the creation of the Commodity Futures Trading Commission, to no avail. It is time that we looked at this problem as it pertains to potatoes, a perishable commodity, and admit to ourselves that it cannot be regulated. The speculators and manipulators are going to be one step ahead of us at all times and these problems will not go away. The only way to rectify the problem is to eliminate futures trading on potatoes.

We have been asked; how can we expect to put a price tag on our commodity and market our crop without a body such as the New York Mercantile Exchange, setting the price through its trading activities. I submit to you, Mr. Chairman, and Members of the Committee, that the prices released each day on futures contracts has absolutely no bearing, in fact on pricing of potatoes from the Red River Valley. The prices charged for, or paid for, seed potatoes are set in negotiations between the producer, the receiving producer or the broker working directly for either one. The price of table stock potatoes is set on actions between the producer/shipper and the outlet receiver of those potatoes. The price for chipping potatoes is set by the producer and the chipper, or the broker working directly for either one of them. The potato market, at least from the Red River Valley, is set on a supply and demand situation. We know what we have to sell, and they know what we have to sell. It is the negotiations between the two, only, that set the prices of these sales. It would be safe to say that a large price movement, upward or downward, by the New York Mercantile Exchange would have some psychological effect. However, this would be for a very very short time. At most, a matter of days.

Mr. Chairman, and Members of the Committee, again; our Association calls for the total elimination of futures trading of potatoes. There is no reason for it and it serves no purpose for the grower. I cannot possibly see how it helps the consumer and as far as the middle man or the speculator is concerned, I quite frankly, don't care. We do not need any fictitious manipulations of prices in this country when farmers and consumers alike are being faced with financial ruin everyday of the week, every week of the month and every month of the year. The best judge in every other perishable commodity in this country, the best judge of what price should be, is supply and demand. Why potatoes, the only fruit and vegetable now being traded, should be singled out for this type of action is inconceivable to me and the members of our Association. Why aren't others traded if it is so good. We do not need, we do not want and we object strongly to futures trading on potatoes and urge you to recommend the elimination of all potato futures trading.

I thank you for allowing me to appear before you today.

STATEMENT OF CARL WEBBER, PRESIDENT, MAINE POTATO SALES ASSOCIATION

My name is Carl Webber. I live and work in the small farming community of Mapleton, Maine. I have been involved in farming and market sales all of my life. I am employed by Lovley Farms, Inc. of Mapleton, Maine. Our Company is a relatively large producer of potatoes. We also operate a sales office through which we market our own production and production of others. I am also President of

Maine Potato Sales Association whose membership includes people and firms who convert an estimated 70 to 80 percent of the fresh potato sales portion of the Maine crop to cash each year. Our organization supports futures trading of potatoes under a proper contract, responsibly managed and enforced.

The New York Mercantile Exchange has for many years offered Maine potato growers a valuable hedging device, or price insurance, against the risk of a market decline. Good, bad or indifferent the hedging opportunities have been available every trading day to any grower in Maine at publicly stated prices.

Production credit institutions and local Aroostook County banks have routinely financed hedging operations in connection with production loans made to growers. In fact, some institutions have actually required that hedges be made as an additional security against the large amounts of money advanced for production and harvesting expenses. Dealers of Maine potatoes have been active participants in the hedging aspects of the Exchange, buying actual potatoes from growers and making an off-setting sale on the Mercantile. These dealer operations frequently take place when there has been a strong advance on the NY Mercantile and their associated growers are offered the full advantage of the prices that then prevail for future delivery in the various option months. Dealer purchases from growers may not necessarily specify Mercantile delivery but may in fact be for any or all of the various size bags in which Maine potatoes are shipped. In these cases, the dealer is enabled to pack and ship on a custom basis to his trade outlets while the grower has a firm and acceptable price that is guaranteed. The grower is also relieved of the unknown capital drain in margin funds that he would otherwise pay as a direct Mercantile customer. The matter of judging when and how to make and later liquidate hedge positions becomes the dealer's responsibility, leaving the grower with enough other management problems but eliminating any doubts of sale proceeds.

Maine has been the only state which has had the option of using futures contracts which pertain to potatoes produced in one major production area.

During recent years producers in Maine have received more money per hundred pounds of potatoes produced than most major competitive production areas such as, Idaho, Minnesota, North Dakota, Oregon, and Washington.

There have been frequent polls and surveys in Maine relative to futures trading of Maine potatoes. Two polls have been conducted recently among Maine growers on the subject of futures trading.

One of these polls, conducted by Maine Potato Council, was actually a solicitation of a negative response against trading on the New York Mercantile Exchange. The Council was actually asking growers to endorse a pre-established program to lobby against trading futures on the New York Mercantile Exchange. Prior to and during the poll the Council continued to oppose the futures trading in its trade paper "Potato Councilor".

It is very possible that some growers who voted in the poll, as solicited by the Council, were suggesting that the Council should make an effort to reform rather than eliminate the trading of futures on the New York Mercantile Exchange.

It is also possible that the 62 percent response to the poll means that many of those growers who favor futures trading, or do not support the Council position, did not care to respond. At any rate it can not be considered that the Council's poll is a valid measure of the Maine Potato Industry attitude to the trading of potato futures as such. In fact, results of a more recent poll conducted by Social Science Research Institute of the University of Maine conflict with the 1978 Council poll. The findings of the later University poll conducted from a neutral position and attaining a response rate between 84 percent and 95 percent indicates that growers representing only 48 percent of the acreage have generally unfavorable feelings about the New York Mercantile Exchange. A clear majority of the acreage representation is either neutral, or has favorable feelings about the Exchange. It could be expected, based on these results, that even greater favorable feelings exist toward futures trading of potatoes as such. Many of the negative feelings can be attributed to a need for contract improvements, management and enforcement, rather than the concept of futures trading.

In addition to recent polls to assess grower attitudes numerous professional studies have been made to evaluate the effects that the trading of potato commodity futures has on Maine's potato industry. As far as I can remember all such studies have indicated a positive value of having futures trading.

In June of 1979 the Maine Food and Farmland Study Commission reported to the Governor of Maine its findings that "the trading of potato commodity futures provides a very important mechanism for improving coordination in Maine's Potato Industry."

A more recent study commissioned by USDA is also supportive of potato futures trading. This report also points out the very true fact that few, if any, of the Maine Potato Industry problems are attributable to a malfunctioning futures market.

I know of several dealers who do business with growers for future delivery and who naturally make offsetting hedges on the Mercantile. These growers are happy to take full advantage of the offered price but some have occasionally voted against futures trading. The logic of these negative decisions cannot be explained other than it is the general psychology in Maine to blame all of the potato industry's problems on a group of traders in New York.

The New York Mercantile Exchange is not without its failings as regards Maine potatoes but recent concerted efforts of self-policing and enforced compliance with every trading rule has certainly created an atmosphere of greater confidence in its ability to serve the Maine potato industry and provide the necessary speculative interest that is so essential to price appreciation at various times during the production, harvesting, and marketing of the Maine crop. Speculators who are willing to assume the risk of market decline are clearly desirable partners of the Maine farmer.

There has been some vague discussion in Maine recently of reverting to the old days when buyers would make preseason purchases and pay a deposit to the grower. This was a fairly common practice in Maine prior to the Mercantile years. These purchases were invariably made at low prices but with the deposit advanced as an inducement to the grower. These purchases never amounted to any large volume, did not take place every year and were always traded at private prices never available to all the growers. Moreover, older salespersons in Maine recall the extreme difficulty of getting buyer performance of the contract in the event of a market decline. The present Mercantile rules require that all buyers and sellers be fully margined on a daily cash settlement of an adverse trading position. Such a margin arrangement was never a part of the so-called old time futures contracts. The present buyer element in the market place has changed a great deal during the past quarter century, chiefly dominated by chain store outlets who have a distinct aversion to any form of potato futures trading.

It must be noted that in the absence of any established futures trading market, processors in Maine would have absolutely no competition in establishing preseason contracts to be delivered during the processing season. The present Maine Mercantile contract serves as an important counter-balance to unrealistic prices that would otherwise be offered by the processors, who incidentally use a great deal of Maine potatoes on a preseason contract basis. To a similar extent local street buyers and packers would not have this type of restraint when making day-to-day purchases from growers who do not pack their own potatoes.

In view of the overwhelming evidence that potato futures trading has a beneficial effect in the process of potato selling and an obvious lack of true facts to support discontinuing this option, I urge that the Senate Bill under consideration receive your negative response.

STATEMENT OF DONALD C. SILVER, VICE PRESIDENT, MAINE FARMERS EXCHANGE, INC. AND VICE PRESIDENT, MFX COMMODITIES, INC.

My name is Donald C. Silver. I am Vice-President of Maine Farmers Exchange, Inc., Vice-President of MFX Commodities, Inc., past Chairman of the Potato Division of United Fresh Fruit and Vegetable Assn., and past President of Maine Potato Sales Assn. Maine Farmers Exchange is a licensed potato dealer, which celebrated its 20th Anniversary last year. MFX Commodities is a Futures Commission Merchant dealing in all commodities.

Our firms are opposed to the Church-Muskie Bill to eliminate potato futures trading on all Exchanges for the following reasons:

1. The potato industry can not afford to lose another important market for protection of their investment.

2. Growers will be at a disadvantage when negotiating preseason contracts with anyone. Both the processors and the dealers would lose a true buying hedge.

3. In the past the futures market has been the only market which afforded growers a profit prior to harvest. Financial institutions need the futures market to protect their loans. Most financial institutions have financed hedging of potatoes as part of production loans extended to worthy producers.

4. No person or segment of the industry is forced to trade futures. Trading is voluntary, not mandatory. Those growers who have used the futures to protect their investment have done so to their advantage.

5. Many studies have been made on the subject of potato futures trading. Every study that we know of has been favorable. It is a shame that we continue to waste your time, my time, and our money to prove once again that a futures market is a necessity for a profitable potato industry. With the high investment in potato production today it would be regrettable to eliminate the option of having a futures market to insure a profit.

Past publicity as alluded to various grower polls conducted by grower organizations, such as Maine Potato Council, which have concluded that futures trading is a bad influence on the regular cash sales. It is not true. For instance the most recent poll conducted by Maine Potato Council in April, 1978 inferred that 81 percent of the Maine growers voted to eliminate futures trading. This was not a true conclusion because:

1. The survey question did not measure the growers' preference as to whether futures trading should be eliminated. Rather, it asks whether the council should use its resources to lobby against the trading of futures on the New York Mercantile Exchange. It is possible that some growers voting "yes" in the council poll believed they were asking for reform rather than saying futures ought to be eliminated.

2. The announced poll results that 81 percent voted to eliminate futures trading does not mean that 81 percent of the Maine potato industry were in opposition. In fact only slightly more than half the growers voted. Even then nearly 25 percent of those who voted were in favor of futures trading. No matter how one interprets the Maine Potato Council poll it does not accurately reflect the true sentiment of the Maine potato industry.

To illustrate this point, another survey completed by the Social Science Research Institute of the University of Maine completed in July, 1978, was conducted from an impartial approach. The Social Science Research Institute poll concluded that 25 percent of Maine growers weighted by acreage, were either neutral or in favor of using the New York Mercantile Exchange as price protection. The Social Science Research Institute findings were in obvious conflict with the announced Maine Potato Council results. Certainly the Social Science Research Institute study more accurately reflects potato growers attitudes in Maine.

Many mis-statements relative to the effects of a futures market have been made during previous hearings and in news releases. I do not believe it necessary that these mis-statements be repeated today. You have available the results of the most recent study on potato futures trading authored by Dr. Alan Paul for the U.S.D.A. as authorized by the Congress sponsored by Senator Cohen. This study has facts on the subject which will contradict the malicious untrue statements which are often presented without back up facts. I urge you to base your decisions on the merits of futures trading by the facts presented on Dr. Paul's study. The Paul study is based on facts rather than based on emotion and ignorance. For example the potato industry has suffered three disastrous price years and those in favor of the Church-Muskie bill are looking for a Scape Goat.

We trust your committee will conclude as we have previously stated that the potato industry cannot afford to lose an important market. I urge that you reject the bill to ban potato futures which is the subject of this hearing.

STATEMENT OF RAY LAMOREAU, PRESQUE ISLE, MAINE

My name is Ray Lamoreau and I have been farming in Presque Isle, Maine for 25 years. I grow 750 acres of potatoes primarily for processing. I do pack some at different times of the year but my major emphasis is on processing markets. I am the past-president of the Aroostook County Extension Service and a former director of both the Maine Farm Bureau and the Maine Potato Council. I am presently a director of the Northern National Bank, one of the larger banks in the State of Maine.

I have been using the futures market for over 20 years. I'd like to list some of the benefits I feel that futures trading of potatoes offers. One—when I negotiate for pre-season contracts with one or two processors I use the futures market as a guide to know what I should expect for the current year's potatoes. For example, this spring on a pre-season contract prior to planting the processor was reluctant to price at a level I felt I needed to meet costs and make a small profit. I looked at the futures and could see at that moment I had the alternative of shifting varieties and growing a round white instead of the russet. Either the processor should pay me the fair market price or I have the option to grow round white potatoes, set the price for the bulk of them with the Exchange and be guaranteed that price. This year the processor held out until half way through planting before he finally accepted what I felt was a reasonable sales contract.

Another important benefit of futures trading is immediate market sensitivity. There are a lot of times I am out in the field and am not abreast of the market.

Certain conditions will change concerning the potato market which I wouldn't know unless I could call and find the price on the Exchange. Immediately, through the Exchange, market conditions are reflected in the price. Now all I have to find out is why the price has risen or dropped. I am as current as anyone else and in a better condition to bargain prices. For example, in 1976 when in other areas the potato price was depressed, Maine had a potential for export. The futures market was sensitive to this fact and allowed me to sell the bulk of my potatoes for more money.

The third advantage of dealing in futures is that it gives me price protection. If I sense that the market may decline I can immediately lock in a price for part of my crop. In futures trading the price is determined by many buyers and sellers, and gives a true market price level. In the potato industry in Maine today the number of major buyers is limited to less than a dozen. Without the price disclosure of the futures market these self-interested buyers would seldom post a price that reflected the true market attitude.

I use the futures market not only for short hedging but also on occasion for hedging long. There are certain times of the year when I may want to buy potatoes to protect my seed purchases. Also, I may have condition factors that force me to move potatoes early. If I still want to maintain an inventory, so to speak, to sell during the later months I can do this by making a purchase of futures contracts.

Criticism of potato futures trading often is based on the perishability of the commodity. The modern contract with its provisions for truck delivery and multi-point delivery adequately answers these questions. The contract as it has evolved over the years accurately reflects the trade practices in the round white potato industry.

I thank the Committee and would be happy to answer any questions you might have.

STATEMENT OF LOUIS WYSOCKI, PRESIDENT, NATIONAL POTATO COUNCIL

I am Louis Wysocki, president of the National Potato Council, with offices located in Denver, Colorado.

The National Council is a voluntary, non-profit trade organization representing the approximately 13,000 producers of Irish potatoes, throughout the continental United States, with a stated purpose of protecting, expanding and improving the general welfare of the potato industry.

The National Potato Council has a long standing position, first taken in 1965, of being for the elimination of futures trading of potatoes and reiterates its position here today.

The fundamentals of futures trading of any commodity demands that it be marketable, available and there be a large enough market in it to provide liquidity, and further, that a contract to be traded begin first with a hedge of the actual, deliverable, product.

When these fundamentals are applied to potatoes, it is found that individual aspects of each are absent in varying degrees, which, when subjected to manipulative practices, result in the disruptive reactions evidenced in the default of the 1976 May contract and again by the suspending of trading in the April and May, 1978 contracts.

Attempts have been made to compensate for the lack of these fundamentals by numerous rules and regulations, whose patchwork maze leaves the commodity being traded, bearing little resemblance to its original state.

The National Potato Council supported the creation of the commodity futures trading commission in hopes that it would solve the irregularities of futures trading by greater regulations and enforcement of mercantile trading rules. The record shows that it has failed miserably in its efforts. The creation of the rules and regulations being proposed by the New York Mercantile Exchange, are only additional band-aids, which will only make the original commodity more obscure. Due to this unrecognizability, the Chicago Mercantile Exchange Russet Contract, has not even gotten off the ground.

The reason for the potato not possessing the fundamental requirements for futures trading is its perishability.

Initially the term "perishable" denotes the rapid loss of quality by such factors as decay, unless stored in a controlled environment for whatever causes a particular decrease of quality and then at best, it can maintain its optimum quality for a limited period of time.

Perishability as it applies to potatoes and the trading of them in the futures market, goes beyond that in many ways.

(1) The maximum that a potato can be stored economically under the "present state of the art", regardless of the environmental control used, is approximately 10 months. This means that the available supply annually, reduces to zero and depending on given growing conditions during a particular year, the supply can disappear in an even shorter period, thus leaving questionable or no availability of the commodity backing up the trade, leaving the contract open to speculation on both sides.

The potato, as a commodity being traded, is unique in itself in this aspect.

(2) For a potato to be in its deliverable state, it must first be removed from its storage state, physically handled, graded, packaged and delivered, and be marketed in a matter of hours in order for it to retain its quality and meet its future's contract specifications. Proof positive of this, is the rejections of contract deliveries of the March, 1978 contract, when they reached their delivery point.

It is this perishability and lack of storability, that cause the cash marketing problems that disrupt orderly marketing.

No other commodity has to enter retail trade channels immediately in order to maintain its value. Orderly marketing is further disrupted, when these deliveries fail to retain their quality and subsequently their value, and enter trade channels as distressed merchandise.

In other commodities, long hedges are of times desirous of accepting delivery of the actual product; to be held, either in its present location or its delivered location or for delivery to a yet to be determined location, to meet a future business commitment. Annually, we witness violently, unwilling acceptors of delivery. This is caused by the potatoes inability to meet the above stated need.

In a popular card game, the necessity of the ability to "call" is what makes the game what it is, a willing bettor can only bet as long as there is a willing bettor on the other side and each participant can make the other participant "deliver" or show their cards by announcing he is "calling".

Such lack of the ability to "call" by all the aspects affecting the ability to deliver, are what results in the unworkability of potato futures and no patchwork of rules and regulations can replace the very simple, all encompassing singular control factor that, that card game has and is known as "call".

Cash market movement and prices are affected by futures price fluctuations, which occur during trading, again caused by the lack of a control factor such as "call" in that card game. When the ability to deliver or "call" is missing the bidding becomes speculative and is the reason the cash and future prices fail to move together and converge at the contract close.

The National Potato Council appreciates this opportunity to appear before you and request that you alleviate our industry from these disruptive outside influences, by a recommendation for the prohibition of futures trading of potatoes.

STATEMENT OF ALBERT M. JOHNSON, VICE PRESIDENT, PUBLIC AFFAIRS, POTATO GROWERS OF IDAHO

Mr. Chairman and members of the Senate subcommittee, I am Albert M. Johnson, a potato grower from Idaho. I am a member of the Executive Committee of the Potato Growers of Idaho and a grower member of the Idaho Potato Commission. I am here representing Potato Growers of Idaho. Written testimony has been submitted to this hearing by the Idaho Potato Commission and I also concur in the reasons set forth by the Commission in that testimony.

I will not bore you with facts and figures, just down-to-earth reasoning why we oppose futures trading on potatoes. Most of my remarks will be directed toward the Russet Contract and how it affects Idaho.

First, I would like to state that Idaho has its own marketing order. We pack a premium package and therefore command a better price in the retail market. The futures contract tends to put all russet potatoes in the same category, thereby attempting to reduce some of the price advantage that Idaho maintains.

To our knowledge, the potato is the only perishable and fresh vegetable traded on the commodities exchange. Unlike wheat, it cannot be stored for long periods of time and therefore is subject to deterioration.

Futures trading on potatoes is made only on carton-count packages. With Idaho's marketing order, less than 50 percent of potatoes sold fresh are packaged. Of this amount, only about 35 percent go into cartons. Therefore, only about 15 percent of a grower's potato crop can be traded on a futures contract. The grower still has to market nearly 85 percent of his crop in another manner.

Most of the trading on the futures contract is done in the month of May. May also is one of Idaho's highest volume shipping months so our fresh pack sheds are usually at full capacity. Rail car and truck demand is at a peak and many times in short supply. In Idaho, most growers do not pack and ship potatoes. This is done mostly by individuals or companies who specialize in that type of business. I realize that the idea of futures trading is not to deliver the product; however, the product must be delivered for futures trading to work correctly. With most Idaho shippers operating at capacity, a grower would have great difficulty finding a shipper willing to curtail his own sales and shipments just to free him of trouble should he need to deliver his futures contract. This generates another problem—potatoes delivered on the futures contract would add extra pressure to normal trade because, in all reality, there probably would be no destination or sale thus causing the potatoes to become what we call "rollers." When the potatoes reach their terminal market, in order to get them moved, the price would no doubt be discounted because of demurrage and perishability pressure. This puts downward pressure on the normal market.

The planting time for Idaho potatoes is late April and the month of May. Manipulation of the futures contract can affect planted acreage by increasing it; thereby, we have a negative effect on the price of the crop being planted.

Commodity trading is intended to be another marketing tool for the producer and, I would agree, this is the case for wheat. However, we do not believe it is beneficial for potatoes. Many times potato futures are traded only 5 times a day. I don't believe that anyone could claim this small amount of trading as another marketing tool to a multi-million dollar industry. There is no reason to keep a contract in force that has not traded more volume in the last couple of years.

We are not interested in further revision of the contract. Several revisions have been made in recent years and have resulted in no better working conditions on the contract.

For the reasons I have stated, we in Idaho oppose futures trading on potatoes, and we join Senator Church, Senator Muskie, Senator Young, and Senator Burdick in supporting Senate Bill 770 to ban potato futures trading.

[The following material was submitted by Mr. Albert Johnson:]

STATEMENT OF POTATO GROWERS OF IDAHO, BLACKFOOT, IDAHO, AUGUST 3, 1979—
TO THE COMMODITY FUTURES TRADING COMMISSION

REVIEW OF THE CME POTATO CONTRACT, COMMENTS ON POTATO FUTURES TRADING
AND PROPOSALS TO THE CFTC

Introduction and summary

The Potato Growers of Idaho presents the following comments and proposals to the Commodity Futures Trading Commission regarding potato futures trading.

This presentation incorporates views expressed by Idaho growers and dealers during recent visits to Idaho by Chairman Stone and Clayton Yeutter, President of the Chicago Mercantile Exchange.

Some of the comments pertain to the new CME contract, specifically delivery allowances, position and delivery limits and loopholes which can lead to market manipulations.

Other comments relate to the Idaho potato, its competition with other Russet Burbank states, the volatility of trading May futures, the perishability of potatoes, whether the contract serves the interests of producers and how the interest of brokers may be at variance with the interests of producers.

This report concludes with proposals for consideration by the CFTC which involved its position on banning potato futures trading and steps the CFTC can take to prevent injury to growers should futures trading of potatoes continue.

An appendix to the report contains recent articles covering the visits of Mr. Stone and Mr. Yeutter and the new CME contract.

THE NEW CME CONTRACT

Delivery allowances

Analysis was made of the May, 1975-79, carton prices, the availability of cash market quotations and of price changes during May for potatoes shipped from the five states. This information is summarized on the following three tables:

COMPARISON OF MAY IDAHO PRICES¹ FOR 50-LB CARTONS OF RUSSET BURBANK POTATOES WITH
WASHINGTON, OREGON, COLORADO, AND WISCONSIN

[1974-78 crops]

	Washington	Oregon	Colorado	Wisconsin
1978.....	\$0.50	\$0.26	\$0.21	NA
1977.....	1.54	2.37	1.53	NA
1976.....	2.04	1.68	.90	NA
1975.....	1.75	1.50	(.23)	NA
1974.....	1.51	3.72	.25	NA
Average.....	1.47	1.92	.61	NA
Maximum.....	2.04	3.72	1.53	NA
Minimum.....	.50	.26	(.23)	NA
CME allowance.....	1.25	1.00	.25	\$0.75
Variance with average.....	.22	.92	.36	NA

¹ Source: Federal State Market News. Where a different price was reported for 100-count cartons it represented half the weight in the average. Price differentials are based on monthly averages using all available quotes.
NA-Not available.

QUOTES AVAILABLE FROM STATES OTHER THAN IDAHO DURING MAY 1975-79 AS A PERCENTAGE OF
AVAILABLE IDAHO QUOTES FOR 50-LB CARTONS 80, 90, AND 100 COUNT

[In percent]

	Idaho	Washington	Oregon	Colorado	Wisconsin
1979.....	100	95	47	89	0
1978.....	100	100	100	64	0
1977.....	100	90	60	45	0
1976.....	100	71	59	41	0
1975.....	100	95	55	55	0

PRICE CHANGES FOR 50-LB CARTONS FROM THE BEGINNING OF MAY TO THE FINAL MAY QUOTATION
DAY, IDAHO AND OTHER CME SHIPPING POINT STATES

	Idaho	Washington	Oregon	Colorado	Wisconsin
1978.....	+\$1.12	-\$0.12	+\$0.25	-\$0.37	NA
1977.....	+4.19	+4.00	+2.50	+2.00	NA
1976.....	+.25	+.50	+.37	0	NA
1975.....	+1.64	+.12	+.32	0	NA
1974.....	+1.12	+1.00	+1.00	+1.12	NA
Average.....	+1.66	+1.10	+.88	+.57	NA

NA-Not available.

Among the points to consider:

1. Using a five year average of May cash prices for 50-pound cartons, the new CME allowances understate the value of Idaho potatoes, relative to Washington, Oregon, Colorado and Wisconsin potatoes, by 22 to 92 cents per cwt. The old allowances overstated the Washington and Oregon values and understated the Wisconsin and Colorado values.

2. The range of May cash price differentials for any one season is between minus 23 cents/cwt. (Colorado, 1975) to \$3.72 per cwt. (Oregon, 1974). This wide range raises a serious question whether any historical data can properly be used to establish allowances.

3. There are no cash quotations available from Wisconsin for May deliveries and quotes from Colorado and Oregon are usually available less than two thirds of the time during May. This complicates the job of establishing allowances that are an accurate reflection of the market.

4. Prices for Idaho cartons increased an average of \$1.66 per cwt. between the beginning and end of May compared to an average increase of 85 cents per cwt. for the other four states. Only May, 1977, did the Idaho price fail to increase more than \$1.11. This price trend during the delivery period makes the selection of a single price differential for each pair of states inappropriate.

Position limits

The new contract limits the position of a speculator to 150 contracts. This corresponds to the output of nearly 3,000 acres of potatoes in eastern Idaho. There are very few farmers in the five states who would need to trade more than this many contracts for hedging purposes. Also, this is a large holding in relation to the quantity that can be delivered in May.

In fairness, the bonafide hedger should be subject to position limits and he can live with a limit of 100 contracts as well as the speculator.

The CME contract should also provide a means to lower this limit should a holding of 150 contracts represent a dominant position.

Delivery limits

Should a contract expire with several hundred or more open interest, the delivery of more than a few cars a day will seriously damage the cash market. Buyers will resell the unwanted carlots, especially unwanted if the pack is not up to trade standards, and a price lowering auction will take place. For each dollar that the Idaho price is lowered, the industry loses more than two million dollars.

The contract should be amended to either prevent such an open interest or to limit deliveries to three carlots per day.

Loopholes in the CME contract

The contract is susceptible to at least two possible abuses not counting attempts at monopolizing trade. A trader in a long position can create a squeeze while a short trader can deliver or threaten to deliver a commercially undesirable carlot of potatoes.

Long traders need only know the logistics problems involved in making delivery and with 150 contracts could disrupt the entire process of closing out the contract market. For example:

1. Many grower-shippers will have shut down for the season by May so they can attend to the business of planting the new crop.

2. Even growers who might deliver through a fresh packer will be limited by

- a. Demands on his time to plant the new crop.

- b. Difficulty or impossibility of getting an arrangement with a shipper to run his potatoes. Only two percent of the growers in Idaho are shippers.

3. Fresh shippers are heavily committed in May to delivering on a heavy volume of cash market orders and would be generally unwilling to deliver on a future contract even for their own account.

4. The average output of cartons per Idaho shipper is less than one carlot per day. In a delivery period of twelve business days the average output of cartons from all delivery states is 907 carlot equivalents. The delivery on 150 contracts held by one trader would require 17 percent of the output of the entire five states. A substantial majority would probably refuse to handle any of this business and the remainder would limit their response to one to four cars for the delivery period. Their regular cash customers have priority.

5. To deliver one carlot of carton-count potatoes, an average-sized shipper would have to handle 4571 cwt. of potatoes and find a different home for 82.5 percent of this quantity. It would not take too many deliveries of these contracts to create a glut of non-size A potatoes on the market at a great financial sacrifice to the shipper and his grower-supplier. He would avoid this kind of involvement.

Any holder of a short position facing this prospect would be under great pressure to offer a most attractive settling price to the "long" trader.

Short traders could circumvent the intention of the contract by delivering cartons which contain the requisite number of potatoes but which include potatoes as small as 4 ounces and as large as 28 ounces or more. The delivery would be far less in value on the cash market than the conventional carton pack expected by the trade. Such carlots would have to be repacked and the process of unloading these would cause a cash market disaster.

COMPETITION FACTORS

Distinctive features of the Idaho potato

Idaho potatoes have an outstanding reputation among consumers and dealers. Consumers are willing to pay a premium for this product and dealers and grocers realize higher margins on the sale of fresh Idaho potatoes. Even potatoes processed in Idaho earn a premium.

There is substance behind the market position of the fresh Idaho potato. Idaho shippers pack well within standards for U.S. Number One and they subject their deliveries to the most stringent marketing order of any state and to mandatory Federal shipping point inspections. The more highly developed Idaho potato industry makes the most complete use of the potato crop of any major state and the higher returns on the fresh dealer's by-products relieve him of the pressure to pack close to the minimum standards.

Production of a quality crop is encouraged by pre-season contracts that pay the grower extra sums for growing and delivering better potatoes. Each increase in the U.S. Number One percentage brings an additional three to four cents per cwt. and each increase in the percentage of count-carton size potatoes brings an additional two to five cents per cwt. Nearly four million cwt. of potatoes are purchased on contract by Idaho fresh dealers, which is well over half the volume contracted in the five states by fresh dealers.

The shorter growing season and the fewer alternate crops, due to the higher elevation, as well as the distance to major markets, are economic disadvantages to the fresh Idaho producer. His growing climate causes him to realize a smaller yield of fresh market potatoes than any of the five states. He depends upon a premium price for count-carton Idaho potatoes in order to keep his investment a viable one. His fresh market prices have an important bearing on the prices paid to processing potato growers.

The Idaho producer's advantages include a stable, adequate and controllable water supply from one of the largest underground aquifers, relative freedom from drought and damaging harvest rains, a very high percentage of sunny days, less exposure to crop damage from hot days, healthier plant development made possible by our cooler nights and less crop damage from infestation and diseases due to the cold winters. His competitors have one or more of these disadvantages and, with higher percentages shipped by grower-shippers from the other states, they are under greater pressure to pack close to tolerance with their less developed by-product market.

The superior product of Idaho growers and shippers is recognized by the trade. In a national survey of potato receivers last year, which made no reference to varieties or states, five of the six highest rated fresh shippers were Idaho firms.

Of course, we don't keep our qualitative advantages a secret. The Idaho potato is the object of greater advertising outlays than the combined outlays of the other four states.

Idaho growers and shippers are concerned that public and trade perceptions of these distinctive features of the Idaho potato are being blurred by the trading of a Russet Burbank future contract which implies that potatoes from these states differ only by a somewhat un-representative allowance.

The fact that the original request to broaden the Idaho contract as well as the second request to trade only cartons both came from Wisconsin trade interests indicates one of the states that is benefitting at the expense of Idaho. Idaho potato producers do not appreciate this intervention by the CME into the cash market competition between the Russet Burbank states, especially when there is no offsetting benefit.

Possible effects of trading the Russet Burbank contract on cash market competition

The cash potato markets for Colorado and Wisconsin might have been enhanced by trading of the first Russet Burbank futures contract of the CME at the expense of Washington and Oregon and, to a lesser extent, Idaho. Consider the following:

1. Idaho's share of the fresh shipments in May was highest when there was an Idaho futures contract (1976), second highest when there was no contract (1979) and lowest when the first Russet Burbank contract was traded. (1977 and 1978)

2. Market shares of Wisconsin and Colorado increased five percentage points in May, 1977, nine percentage points in May, 1978, the two years of trading the first Russet Burbank contract, then declined three points in 1979, when there was no trading. This could have been due to the delivery allowances, which understated the price of Wisconsin and Colorado potatoes and possibly stimulated demand for deliveries from these states in May.

3. These changes in market share in May have taken place notwithstanding a slight decrease in the Colorado-Wisconsin share of the fresh market for the entire season. Since futures trading is primarily on the May contract, the impacts appear to be limited to the spring cash market and on plantings.

4. Colorado and Wisconsin acreage increased in 1979 by one percent while acreage in Idaho, Washington and Oregon decreased by eight percent. This shift in acreage could be due in part to the competitive advantages of the futures contract enjoyed by these two states.

The following tables, which show May and season to May 31 shipments for these states, help to illustrate these points:

SHIPMENTS OF FRESH POTATOES FROM PRINCIPAL RUSSET BURBANK STATES, MAY 1976-79

	Volume (in thousand hundredweight)				Percentage			
	1979	1978	1977	1976	1979	1978	1977	1976
Idaho.....	2,604	1,874	1,876	2,057	57	55	52	63
Washington.....	481	381	637	473	11	11	18	14
Oregon.....	295	213	335	387	6	6	9	12
Wisconsin.....	301	445	170	124	7	13	5	4
Colorado.....	899	599	580	386	20	17	16	12
Total.....	4,580	3,432	3,598	3,273				

SHIPMENTS OF FRESH POTATOES FROM PRINCIPAL RUSSET BURBANK STATES, SEASON TO MAY 31, 1976-79

	Volume (in thousand hundredweight)				Percentage			
	1979	1978	1977	1976	1979	1978	1977	1976
Idaho.....	18,607	16,746	13,967	13,213	40	40	29	29
Washington.....	5,502	4,575	7,770	7,723	12	11	16	17
Oregon.....	3,050	2,794	5,591	5,362	7	7	12	12
Wisconsin.....	11,941	11,495	13,492	12,379	26	27	28	27
Colorado.....	7,377	6,446	7,674	7,279	16	15	16	16

Interests of brokers

We are concerned about the representations by brokers about futures trading as "price insurance" a "hedging opportunity" and their claims that a grower can cross-hedge on the Round White futures contract.

Since a substantial majority of growers in the five Russet Burbank states do not have the facilities to deliver on this contract, they cannot hedge under any circumstances. Those who do and those who sell into a rising price must pay margin calls and face major losses. For them, this is hardly insurance because they are not indemnified.

The concept of a cross hedge requires the consent of the other party to the contract—a long trader. He can demand delivery or an extremely high "Exchange for Physical" price.

A number of brokers advise use of the market for only a portion of the storage season. While this reduces the risk of loss during the period covered by futures trading, it exposes the grower to the cash market during the potentially volatile months. Also, it leaves the broker unconcerned with the problems that occur in the cash market when the futures contract matures.

ASSESSMENT OF POTATO FUTURES TRADING

Volatility

Cash potato markets are volatile because of the inelastic demand for potatoes. Consumption rates do not vary nearly as much as production levels, with the result that small changes in supply are associated with large changes in price. The USDA Economic Research Service has identified the ratio as minus three; that is, a one percent decrease in production is associated with a three percent increase in season

average price paid growers for the spring market. In the year after harvest, the ratio increases to more than minus five.

Cash markets in the Pacific Northwest are less volatile because of pre-season contracting and because of a strong orientation to institutional processed and fresh potato markets whose unit sales are less subject to fluctuations.

Futures markets are more volatile than cash markets for the five states because of their emphasis on the trading of fresh potatoes for May delivery and because of large variations that occur in the supply of fresh pack quality, particularly carton-count quality, so close to the end of the season.

When both supply and crop quality factors are considered, the volatility appears to be much greater. For example, 1976 production was 13 percent greater than 1975, but the April 1 supply of carton-count potatoes was approximately 40 percent higher. Also, 1977 production was 4 percent lower, while the April 1 carton-count supplies was 14 percent lower.

YEAR TO YEAR PERCENTAGE VARIATIONS, 1973-78

	1978	1977	1976	1975	1974	1973
Production	5.9	(4.0)	13.2	7.2	8.7	4.7
March 1 stocks	6.9	(1.3)	14.6	11.9	25.9	2.2
April 1 stocks	9.3	(.2)	19.6	¹ 6.8	32.0	1.4
Percent U.S. 1 (Idaho)	7.8	(7.7)	11.1	(9.5)	(12.3)	(4.7)
Percent 6-14 oz U.S. 1 (ID)	5.2	(7.7)	17.0	18.5	(16.7)	(.5)
Combined variation of April 1 stocks and percent 6 to 14 oz U.S. 1:						
Variation, percent	15.0	(14.1)	40.0	26.6	10.0	0.9

¹Trade observers believe this USDA figure to be in error by 2 to 3 million cwt (stocks understated).

An attempt will be made to illustrate this in the following tables. The volatility of the futures market influences cash market psychology by creating additional, often extraneous and irrelevant, news. When potato buyers are actively trading in both cash and futures markets, a result has been downward pressure on April and May prices in both markets.

Without a May futures contract, the cash market can be characterized as a high volume month with gradually rising prices. It is one of the best months in the season for Idaho.

Some relief would be provided by prohibiting the trading of contracts after March when there is still more than forty percent of the crop on hand. This can be seen in comparing the year to year variations in March 1 stocks with production and April stocks variations. The degree of relief would not be such as to eliminate adverse impacts on the produce market. Contract negotiations between growers and processors would still be affected.

By comparison, grain futures prices are stabilized by the ability to hold stocks well over a year. No potatoes are sold more than a year after they are harvested.

The first table shows a seven-year pattern of production, late season stocks and utilization for the five states of Idaho, Washington, Oregon, Wisconsin and Colorado. During the period of 1972-78 production increased at an annual rate of 4 percent while utilization to March 1 increased at a rate of 3 percent. March utilization increased at an annual rate of 5 percent and April 1 stocks increased at an annual rate of 8 percent. This is due mostly to a longer marketing season in the processing states and to the incentive available to processors to pay less for raw product late in the season in years when the crop is long. Fluctuations in demand for cartons deliverable on the CME contract have little to do with these supply factors.

PRODUCTION, LATE SEASON STOCKS AND UTILIZATION FOR FIVE RUSSET BURBANK STATES

[In million hundredweight]

	1978	1977	1976	1975	1974	1973	1972
Production (stocks):	203.2	191.8	199.8	176.5	164.6	151.4	144.6
Mar. 1	86.2	80.6	81.7	71.3	63.7	50.6	49.5
Apr. 1	67.3	61.6	61.7	51.6	48.3	36.6	36.1
May 1	46.2	NA	NA	NA	NA	NA	NA

PRODUCTION, LATE SEASON STOCKS AND UTILIZATION FOR FIVE RUSSET BURBANK STATES—
Continued

[In million hundredweight]

	1978	1977	1976	1975	1974	1973	1972
Utilization:							
Season to Mar. 1	117.0	111.2	118.1	105.2	100.9	100.8	95.1
March	18.9	19.0	20.0	19.7	15.4	14.0	14.4
April	21.1						

The next three tables indicate the quantities on hand April 1 and May 1 in each of the states delivering on futures contracts except for round white states other than Maine. Idaho inventories are 65 percent of the five-state total while the three northwest states hold 94 percent. Idaho inventories are more than four times that of Maine yet they were deemed inadequate to sustain a futures contract in 1976. Also, Idaho's share of the five-state inventories is subject to much less fluctuation (15 percent) than Maine's share of the U.S. Stocks has shown (43 percent).

ANALYSIS BY STATE OF APRIL 1, POTATO STOCKS FOR CROP YEARS 1972-78

[Quantity in million hundredweight]

	1978	1977	1976	1975	1974	1973	1972
Idaho	41.0	37.5	35.5	34.0	32.0	26.0	27.0
Washington	14.5	11.3	15.2	10.0	8.9	5.5	4.2
Oregon	7.7	8.4	7.5	4.1	3.4	2.5	2.2
Wisconsin	2.3	2.2	1.4	1.6	1.7	.9	.8
Colorado	1.8	2.2	2.1	1.9	2.3	1.7	1.9
Subtotal (5)	67.3	61.6	61.7	51.7	48.3	36.6	36.1
Maine	9.0	11.0	8.4	9.4	13.0	9.3	11.4
United States	95.3	89.0	81.9	71.6	75.9	55.9	58.3

STATE PERCENTAGE OF 5-STATE HOLDINGS ON APR. 1, 1972-78 CROPS

	Average	Maximum	Minimum
Idaho	65	75	57
Washington	18	25	12
Oregon	9	14	6
Wisconsin	3	4	2
Colorado	4	5	3
5 States as percent of United States	68	75	62
Maine as percent of United States	14	20	9

QUANTITY AND PERCENTAGE OF MAY 1, 1979, STOCKS OF THE 5 RUSSET BURBANK STATES

	Idaho	Washington	Oregon	Wisconsin	Colorado
Quantity (million hundredweight)	29.5	9.5	5.65	0.9	0.65
Percentage of 5 State total	64	21	12	2	1

Crop quality factors can have an important bearing on the deliverable supplies. The next table shows how the percentages of U.S. Number One potatoes and of 6-14 ounce U.S. Number One have varied for eastern Idaho in the past seven years. The first factor relates to deliverable supplies on the previous CME contract and the second relates to deliverable supplies on the new contract. Deliverable supplies on the new contract are subject to fluctuations due to quality and size factors alone of 22 percent while supplies on the contract have fluctuated up to 17 percent.

PERCENTAGE OF U.S. NO. 1 AND 6 TO 14 OZ. U.S. NO. 1—EASTERN IDAHO, 1972-78

	1978	1977	1976	1975	1974	1973	1972
U.S. No. 1.....	57	53	57	51	57	65	68
Deviation from average.....	-2	-9	-2	-12	-2	+12	+17
6 to 14 oz. U.S. No. 1.....	30	29	31	26	32	39	39
Deviation from average.....	-6	-9	-3	-19	0	+22	+22

Source: Idaho Crop Reporting Service, from Sample Diggings in Representative Fields. 6 to 14 oz. U.S. No. 1 percentage is descriptive of the supply of count-carton stock.

Perishability

Even with the best possible handling and storage management practices potatoes will lose quality and weight between harvest and delivery out of storage. Loss of quality from harvest to early in the storage season is an average of around eight percentage points in U.S. Number One grade. Additional losses occur over the storage season and from handling where some U.S. Number One potatoes fall out of grade from bruising and other mechanical damage; thus can cause a carlot to pass inspection at shipping point and fail at delivery point. Weight loss is of the order of 7-8 percent from harvest to May.

The rate of deterioration and weight loss of the stored potatoes accelerates during the spring. Potatoes with latent defects caused by unfavorable growing or harvest conditions will often break down during the spring. Breakdown is also occasioned by warm weather which raises the temperature in even an air conditioned storage above proper levels and sprouting follows. In areas with higher amounts of rainfall such as Wisconsin, excessive moisture late in the growing season can result in water rot and early breakdown of many lots.

Nearly all other commodities traded through futures contracts are not subject to this problem. The few who are in some way perishable are not subject to such massive change in market conditions from deterioration of the product. Perhaps this is why no fruits and vegetables are traded in futures and why many feel that potatoes should not be traded in futures contracts.

Does futures trading serve the Pacific Northwest grower?

Based on the assumption that 97 percent of the inventories and 74 percent of the May fresh shipments are from the Pacific Northwest, this question is asked.

In the Pacific Northwest, more than 55 percent of the crop is purchased on pre-season contracts. Only 7 percent is delivered to the cash market in the form of count carton potatoes. With a heavy orientation to pre-season contracts, which provide both buyer and seller with a hedge, and to potato processing, this CME contract and its predecessors is of little value to the industry.

The few growers and processors who trade futures contracts tend to take contract positions opposite to those that would normally be held by a hedger. They are speculating.

Side effects of futures trading in April and May have resulted in lower growing prices and have interfered with contract negotiations.

For these and other reasons set forth elsewhere in this report, 84 percent of Idaho growers oppose futures trading. Even larger growers, with 500 or more potato acres, oppose futures trading by a 70 percent majority.

PROPOSALS TO THE CFTC

In view of our experiences with potato futures trading our finding that such trading has injured the producer's market position without providing offsetting benefits, we propose that:

1. The CFTC join potato producers in Idaho and all over the United States and endorse legislation to ban the trading of potato futures contracts.
2. Until such time that legislation can be adopted, the CFTC use its regulatory powers to avoid as many instances of adverse cash market impacts as possible by advising the exchanges to make amendments toward that end.
3. That a potato industry advisory committee of the CFTC be formed to help assure that potato futures trading, as long as it exists, is conducted properly and with due regard for the cash market.
4. That any and all potato contract revisions be brought to the attention of the potato industry for review and comment at hearings before such revisions are adopted.

We appreciate your consideration of these proposals and the interest shown by Chairman Stone in these matters.

[APPENDIX]

[From the Times News, Twin Falls, Idaho, May 15, 1979]

NEW SPUD CONTRACT HITS SNAG

CHICAGO.—Spud futures trading has become such a political hot potato that the Chicago Mercantile Exchange has been forced to postpone the introduction of its new (and, it hopes, improved) potato futures contract.

The new Merc contract, calling for delivery of premium russet burbank spuds harvested in the Pacific Northwest, Wisconsin and Michigan, had been slated for launching today. But that date has been scrapped and it will be up to the governors of the exchange on May 21 to decide whether to reschedule the kickoff of wait some more.

The uncertainty results from the furor touched off at the other Mercantile Exchange—the New York Mercantile Exchange, which trades futures in round, white potatoes produced in Maine. The New York Merc in March concealed trading in its contracts for delivery this spring, because a severe shortage of deliverable spuds was leaving the market open to manipulation.

The emergency at the New York Merc whipped to new heights the long-standing opposition of potato growers, who denounced the futures market Wednesday and Thursday in hearings on the mess called by the Commodity Futures Trading Commission in Presque Isle, Maine.

The state's agricultural commissioner read a statement from Gov. Joseph E. Brennan calling on the CFTC to ban Maine potato futures. And Sen. Edmund Muskie (D-Maine) sent an aide to report that suspicions are "not unfounded" that the spud market is being manipulated by futures speculators.

Responding to the criticism, New York Merc chairman Michel Marks said this spring's problem was an isolated incident and that the exchange was right to half trading, rather than see futures prices depart from the true economic value of the potatoes.

Even before the hearings were started, however, potato futures were in hot water. Muskie had joined Sen. Frank Church (D-Idaho) in introducing a bill to outlaw spud futures altogether.

"It's the third year in a row that these senators have introduced such legislation," said one insider at the Chicago Merc. "In the past, it has been as a courtesy to their constituents and not something they really pushed. But this time it could be different. We really can't tell."

The present contract—introduced in January 1976 and eventually dropped within months for lack of interest—calls for the delivery of 80,000 pounds of potatoes packed in equal amounts of 10-pound mesh bags and 50-pound boxes. The contract also permits delivery in 100-pound bags.

The variety of ways to deliver potatoes under the old contract made it possible for Idaho growers to hedge half of their anticipated crops by preselling the potatoes at the Chicago Merc. The new delivery requirements will make it impossible for them to hedge more than 20 percent of their crop, he said.

At the Chicago Merc, Steve Rukin, chairman of the new potato contract committee, said the contract had to be revised to limit delivery to 50-pound boxes.

[From the Times News, Twin Falls, Idaho, May 25, 1979]

MAINE POTATO PRICE FIXED

NEW YORK (UPI).—The New York Mercantile Exchange board of governors unanimously approved a special committee recommendation late Wednesday to set the settlement price on the outstanding March 1979 Maine potato futures at \$6.34 per hundredweight or \$3,170 per contract.

The exchange said this is the price at which the contract was originally settled. There are 50 contracts unsettled from the March delivery period, which expired March 23.

During this period the Mercantile Exchange halted trading in March 1979 potato futures because about 90 percent of the Maine potatoes offered for delivery against March contracts failed to meet quality specifications.

[From the Post Register, Idaho Falls, Idaho, May 25, 1979]

CFTC MAY HOLD HEARINGS IN IDAHO ON SPUD CONTRACT

Sen. Frank Church, D-Idaho Falls, said while in Idaho Falls Wednesday afternoon that the Commodities Futures Trading Commission has indicated it will grant his request to hold public meetings in Idaho on the proposed revision of the Russet Burbank contract on the Chicago Mercantile Exchange.

Church said here he had suggested to the CFTC that it hold a public hearing or meeting in Pocatello Saturday, June 16.

"I expect to have definite word this week," Church said, "and I expect the corporation will agree to the plan I have proposed."

The Chicago Mercantile Exchange contract governs the conditions of trading in potatoes on the exchange and is regulated by the CFTC, a federal agency. The new contract proposes several changes.

Church last week, noting that Idaho growers had a significant interest in the contract revision, asked the CFTC to schedule a hearing in Idaho.

Idaho and neighboring states produce 58 percent of the U.S. Russet potato crop and Church said the Idaho growers "should have the opportunity to speak their piece on this contract."

The Idaho hearing has been sought by the Idaho Potato Growers Idaho Potato Commission, and the Idaho Grower-Shippers Association, among others.

[From the Times News, Twin Falls, Idaho, June 10, 1979]

RUSSETS TRYING AGAIN ON CHICAGO EXCHANGE

(By Lonnie Rosenwald)

POCATELLO.—The Russet potato is again trying to conquer the unpredictable Chicago Mercantile Exchange.

Trading of Russet Burbank potatoes opened Tuesday under new rules which commodities officials hope will stimulate the lethargic contract, which hasn't seen any action since mid-1978.

"The success of the contract depends on having good production and a lot of price volatility," said CME researcher Lennart Palme. "We've had a lot of industry people say they're anxious to use it."

Since 1968 the Idaho potato has been traded on the Chicago Mercantile Exchange through a futures contract—a commitment to buy or sell potatoes at a future date at a set price.

Since its introduction, the contract has floundered like a dying fish, and in mid-1978 it stopped altogether.

NO one is sure why.

A competing contract in Maine enjoyed more business until recently, when trading was suspended because of delivery problems. The CME hopes to take advantage of the Maine lull to spark new interest in Russets.

CME officials believe a major flaw in the Russet contract was that buyers didn't want the obsolete 100-pound sack, so they have eliminated it. They have also changed a system of discounts for potatoes delivered outside of Idaho, a move they hope will bring futures prices closer to cash market prices.

Revisions on delivery and packaging on the potatoes, proposed by the exchange in an effort to boost trading activity, took effect Tuesday. New or revised contracts are a risk, according to CME officials. The revisions try to win new traders by offering higher quality potatoes and greater discounts for Washington, Oregon and Wisconsin potatoes.

The changes are:

Limiting the delivery unit to 50-pound cartons. Formerly the contract could include 50-pound cartons, 10-pound sacks and 100-pound sacks.

Increased discounts for potatoes delivered in Washington and Oregon, decreased discounts in Colorado and Wisconsin, and elimination of delivery in the Red River Valley and Minnesota. CME officials say the adjustments should better match price differences in the cash market.

Some Idaho growers don't like the modified contract, which they say will damage the reputation of the Idaho spud.

Officials of Potato Growers of Idaho, a growers bargaining group which would like to see potato futures trading banned entirely, say the changes limit the worth of the contract as a hedge, a mechanism allowing the grower to insure his crop by selling it on contract. If the price drops, he still gets the futures price. If it rises, he can sell his crop in the cash market and buy potatoes to deliver on the contract.

The mixed delivery allowed the grower to trade 50 to 60 percent of his crop, while the 50-pound carton limit reduced the percent to 15 to 20 percent, according to PGI General Manager Gerry Murphy.

Murphy said increased trading of the 50-pound carton will pull the rug out from under cash market sales of the carton, a unit which has become the mainstay of Idaho's potato reputation.

"Contract trading of this premium unit does tend to imply it can be found anywhere at the same quality and reliability we have here," Murphy said.

Some critics say future trading adversely affects cash market prices.

While supporters of the contract admit cash prices often follow futures prices, they say the effect isn't always negative.

"There have been as many—or more—increases in the price caused by futures than decreases," says Walt Burdick, a broker with Sinclair and Co. of Twin Falls.

Burdick says Idaho growers and processors want to trade the CME contract.

One advantage of the Russet contract, compared to the Maine potato contract traded on the New York Mercantile Exchange, is that Idaho growers can sell their crop on the futures exchange. In Maine trading, only Maine grown potatoes are eligible for delivery.

Although the Commodities Futures Trading Commission (CFTC) has already approved the changes, Commission Chairman James Stone will meet with growers, shippers and processors in Pocatello June 16 to discuss the revisions.

The meeting, arranged at the request of Sen. Frank Church, has been billed as a round table discussion, and downplayed by the CFTC. A CFTC spokesman said the commission doesn't plan to amend the contract.

[From the Blackfoot News, Blackfoot, Idaho, June 12, 1979]

POTATO FUTURES TRADING RULES

A press conference for James M. Stone, Washington, D.C., chairman of the Commodity Futures Trading Commission, is scheduled for Friday at 2 p.m. in the office of Potato Growers of Idaho, 800 W. Judicial St., Blackfoot.

Stone is in Idaho at the request of U.S. Sen. Frank Church, D-Idaho, to receive potato industry views on new potato futures trading rules, and revisions in the Russet-Burbank potato contracts on the Chicago Mercantile exchange. Stone will conduct a round table discussion of potato futures trading Saturday at 10 a.m., in the Federal Building, 250 S. 4th, Pocatello. The meeting is open to all potato growers, shippers and processors.

Friday's activities will begin with a 7:30 a.m. breakfast and preview of the industry tour at the Pocatello Hilton Inn, followed by tours of the Albert M. Johnson potato farm north of Pocatello, and of the Lamb-Weston French Fry Processing Plant at American Falls.

At noon that day Stone will visit the potato research center at the Aberdeen Research Center, and will lunch with Walter Sparks, University of Idaho potato industry coordinator. That afternoon Stone will visit the Teepee Potato Company's fresh pack operation, and American Potato Company's dehydration processing plant at Blackfoot.

[From the Post Register, Idaho Falls, Idaho, June 15, 1979]

POTATO FUTURES TRADING DUE AIRING WITH COMMISSION HEAD

James M. Stone, chairman of the Commodity Futures Trading Commission; Washington, D.C., will conduct a roundtable discussion on potato futures trading Saturday, at 10 a.m. in the Federal Building, 250 S. 4th St. in Pocatello.

This meeting is open and all potato growers, shippers and processors have been invited, said Gerald L. Murphy, general manager of Potato Growers of Idaho.

He said Stone is visiting Idaho to consider potato industry views on the subject of potato futures trading.

Friday he will participate in an orientation tour of Eastern Idaho. It will include a visit to Albert M. Johnson's potato farm at Pocatello, a tour of Lamb-Weston French Fry Processing Plant at American Falls, a visit to the Aberdeen Potato Research Center and lunch with Walter Sparks, University of Idaho potato industry coordinator.

Following an afternoon press conference at the office of the Potato Growers of Idaho in Blackfoot, Stone will visit Teepee Potato Co., Fresh Pack Plant at Blackfoot and the American Potato Company Dehydration Processing Plant.

Murphy also announced that Dr. Clayton Yeutter, president of the Chicago Mercantile Exchange, will meet with the PGI board of directors June 21 at 2 p.m. in the

Rodeway Inn at Boise. Yeutter will discuss with the board the revised CME potato contract, which began trading on June 5, and to solicit directors' comments on potato futures trading. A special industry dinner in his honor is planned for the evening.

[From the Post Register, Idaho Falls, Idaho, June 17, 1979]

CASH, FUTURE POTATO MARKET COMPARED AT CONFERENCE

(By Reta Howell)

BLACKFOOT.—James M. Stone, chairman of the Commodities Futures Trading Commission, discussed potato futures in a conference in Blackfoot, Friday, at the Potato Growers of Idaho office.

In answer to questions by the media, Stone discussed the difference between the cash market and future markets. He said, "If the market is honest, everyone should benefit."

Inclined manipulation has occurred in the past, he said, and could happen again.

He said he thinks the cash market in Idaho is more concentrated.

Stone was asked if the farmer can be hurt by the futures market. He said a farmer in Idaho cannot deliver on the futures market because shippers have customers who they have to serve first.

"If the futures market is operating honestly, it's beneficial to the farmer, but futures markets tend to hedge and cover rather than deliver. Both the cash and futures markets work perfectly, if they work together."

There should be a broad common futures market, he said, and it's important to have a contract broader in one sense and narrower in another.

He told of several instances involving a potato market over a period of time and the grower commission should look carefully to find if any manipulating practices are taking place.

The government should have no need to stop the illegal practices, if the market is honest, he said.

"There can be an honest future market with a broad common future judgment," he said.

There is no future contract for spring grown potatoes.

John Milkie, economist with market surveillance, Angus Crane, and Randy Furren, aide to Sen. Frank Church, attended the meeting.

Stone was appointed to the position of chairman of the Commodities Futures Trading Commission by President Carter earlier this year. He formerly was administrator of a state insurance commission.

[From the Idaho State Journal, Pocatello, Idaho, June 17, 1979]

FEARFUL OF MANIPULATION—SPUD GROWERS LEERY OF COMMODITY MARKET

Eastern Idaho spud growers may be interested in participating in a potato futures market, but they want some assurance their product and price won't be subject to manipulation by a few large traders.

In a round table discussion Saturday morning at the Federal Courthouse here, James M. Stone, chairman of the Commodity Futures Trading Commission, also heard that growers face problems in shipping May potatoes on futures contracts and that Chicago Mercantile Exchange potato futures trading has too low a volume to properly protect hedging farmers.

The meeting of Stone, potato growers and commodity brokers was arranged by Sen. Frank Church, D-Idaho. Church, at the request of eastern Idaho growers, has introduced into the Senate a bill prohibiting trade in potato futures. Sen. Edmund Muskie, D-Maine, is a co-sponsor.

Mel Anderson, Pocatello, of the Idaho Growers and Shippers Association, said "our members will continue to ignore and not use the futures market," citing the small volume of that commodity market.

Anderson said if farmers elect to use the futures market as a hedge, they still face delivery problems in May because not enough shippers are willing to interrupt their regular distribution systems to send potatoes east. Shippers also fear alienating their regular buyers, he said.

Richard A. Beach of the Chicago Mercantile Exchange countered that the futures market can be made to work effectively. He said the CME is considering computer monitoring of transactions to forestall large speculation and prevent pre-delivery squeezes in supply.

He said the CME is also considering stricter speculation limits on the size of futures traders' positions prior to delivery months.

American Falls potato farmer Seth Neibaur told Stone he favors using spud and grain futures markets as crop hedge, but feels the market is too thin. Neibaur contended the low volume makes the market too susceptible to cornering by one speculator. The same position has been adopted by the Idaho Farm Bureau, he said.

Trading in potato commodities was defended by Wayne Nelson of Primary Commodities, Salt Lake City, and by Tom Moers of Merrill Lynch Pierce Fenner & Smith Inc., Boise.

On Friday, Stone, who was sworn this May as chairman of the CFTC, met with representatives of the Potato Growers of Idaho at Blackfoot and toured potato farms, research projects, and processing and packing plants in Bingham County.

Stone, a former Massachusetts insurance commissioner, said the purpose of the two-day trip was to familiarize himself with the potato industry and producer and processor attitudes.

Trading in potato futures was suspended by the New York Mercantile Exchange March 9 because of uncertainty over supplies of April and May Maine round white potatoes. The CME futures market is confined to Russet Burbank potatoes but is in danger of folding due to a lack of volume and grower confidence.

The CFTC is currently investigating the suspension of the NYME market.

Futures are contracts under which a certain volume and grade of a commodity, like potatoes, are agreed to be delivered at a certain time and at a pre-agreed price.

Farmers can sell futures contracts to guarantee a certain return and a sure sale on all or part of their crop. Many farmers contract part of their crop in futures and gamble the rest on the market price improving.

Brokers buy futures contracts during a growing season, also with the expectation that prices for potatoes will be higher at the agreed delivery time than they were at the time the farmer made the contract.

[From the Blackfoot News, Blackfoot, Idaho, June 18, 1979]

CFTC CHAIRMAN COMES FOR FIRSTHAND LOOK

(By Emily Hone)

The new chairman of the Commodity Futures Trading Commission says he's trying to lace his education with a knowledge and understanding of agriculture in order to better understand his job.

James Stone, Washington, D.C., a former professor of economics at Harvard, was appointed chairman of the CFTC in January, and is the first person from outside the mercantile exchange industry to hold the position. He was in Blackfoot Friday.

Stone was in Idaho to solicit opinion from persons in the potato industry on potato futures trading. The commission chairman said trading of Russet Burbank futures was suspended after the CFTC filed charges of manipulating the market against some men involved in futures trading. The futures contract was modified, and trading on the new contract began June 5, from f.o.b. Pocatello, Stone said.

The principal change in the contract is in packaging, said Potato Growers of Idaho general manager Gerald Murphy. He said the contract provides for delivery of 80, 90 and 100 count 50-pound cartons. Bags were dropped, decreasing the chance of speculators putting a squeeze on, Murphy said.

Stone said he came to Idaho at the request of U.S. Sen. Frank Church after growers expressed concern over trading of potato futures. He said they fear that futures trading will hurt the cash market because there's too much chance for manipulation. "It's not a good idea for me to sit in Washington and judge whether they're right or wrong," Stone said, "so I came out to have a firsthand look."

In spite of grower fears, Stone said, an honest futures market will help the cash market, but it's important to have a contract that will prevent manipulation. If abuses occur over and over, he said, the government will probably decide that potatoes can't be traded without manipulation. As the regulatory agency involved, it's up to the CFTC to see that the market is honest, he said.

Stone said one way of keeping the market honest would be to make the market positions of all large traders public, but this would take congressional action.

Murphy said a survey taken by PGI showed 84 percent of Idaho growers were opposed to trading of potato futures. "They fear that trading of contracts will dilute the market position of the Idaho potato," he said. Less than five percent of Idaho growers engage in futures trading, Murphy said, and most of these are speculating.

"Futures trading is called a hedging opportunity," he said, "but the market is

extremely volatile and subject to large price fluctuations, and because it's so risky, it's not a good hedging device."

Stone said the question of potato futures trading is in the exploration stage right now, with no decisions pending. However, Church has introduced legislation into Congress to ban the futures trading of all potatoes.

As part of Stone's attempt to acquaint himself with agriculture, he toured a potato farm, a fresh packing plant and a processing plant. He also visited the research projects at the Aberdeen Research Center and moved a line of sprinkler pipe.

[From the Post Register, Idaho Falls, Idaho, June 18, 1979]

IN FUTURES MARKET—IDAHO GROWERS SKEPTICAL OF SPUD PRICE MANIPULATION

POCATELLO, IDAHO (AP).—Eastern Idaho potato growers may be interested in participating in a potato futures market, but they say they'd like some assurance their product and its price won't be subject to manipulation by a few large traders.

In a discussion here Saturday, James M. Stone, chairman of the Commodity Futures Trading Commission, was also told growers face problems in shipping May potatoes on futures contracts to the Chicago market. Growers also told him the Chicago Mercantile Exchange potato futures trading has too low a volume to successfully protect hedging farmers.

The meeting of Stone, potato growers and commodity brokers was arranged by Sen. Frank Church, D-Idaho. Church, at the request of eastern Idaho growers, has introduced into the Senate a bill prohibiting trade in potato futures. Sen. Edmund Muskie, D-Maine, is a co-sponsor.

Mel Anderson, Pocatello, an Idaho Growers and Shippers Association spokesman, said, "Our members will continue to ignore and not use the futures market," citing the low volume involved.

Anderson said if farmers elect to use the futures market as a hedge, they still face delivery problems in May because there are not enough shippers willing to interrupt their regular distribution system to send contracted potatoes east. He said shippers also fear alienating their regular buyers.

Richard A. Beach of the Chicago Mercantile Exchange said a futures market can be made to work effectively. He said the CME is considering computer monitoring of transactions to forestall large speculation and prevent pre-delivery squeezes in supply.

He said the CME also is considering stricter speculation limits on size of futures traders' position prior to delivery months.

American Falls farmer Seth Neibaur told Stone he favors using potato and grain futures markets as a crop hedge, but feels the market is too thin. He also said the low volume makes the market too susceptible to cornering by one speculator. He said the same position has been adopted by the Idaho Farm Bureau.

On Friday, Stone, who was sworn in this May as chairman of the CFTC, met with representatives of the Potato Growers of Idaho at Blackfoot and toured potato farms, research projects, and processing and packing plants in Bingham County.

Stone said the purpose of the two-day trip was to familiarize himself with the potato industry and producer and processor attitudes.

Trading in potato futures was suspended by the New York Mercantile Exchange March 9 because of uncertainty over supplies of April and May Maine round white potatoes. The CME futures market is confined to Russet Burbank potatoes.

[From the Idaho Statesman, Boise, Idaho, June 22, 1979]

CHICAGO MERC OFFICIAL ASSURES SPUD FARMERS—FUTURES PROTECTION VOWED FOR GROWERS

(By Charley Blaine)

The president of the Chicago Mercantile Exchange said Thursday that the exchange would not allow traders in russet burbank potato futures contracts to manipulate prices at the expense of growers.

Clayton Yeutter said that although growers had been hurt by futures trading, the trading offered farmers protection from price volatility.

Yeutter visited Boise to meet with directors of the Potato Growers of Idaho, which has supported the banning of all potato futures trading.

Yeutter said the exchange would use its enforcement powers to force traders to divest excessive interest in the markets and to fine those who did not.

He said the exchange had improved its ability to detect trends in trading activity. He said the exchange's goal was to solve problems with traders before problems reached the press.

The Chicago Board of Trade made national headlines last winter when the Commodity Futures Trading Commission, which regulates the U.S. futures industry, ordered wheat trading suspended. Some traders, including an exchange governor, had been trying to corner the wheat market.

Yeutter said the Board of Trade should have better regulated the trading.

The Mercantile Exchange's Associated Mercantile Market has just started trading in a russet burbank potato futures contract approved in April by the CFTC.

Idaho potato growers have opposed the latest contract because it specifies 80,000-pound deliveries. The deliveries are to be in 50-pound cartons with 80, 90 or 100 potatoes a carton.

Al Johnson, a PGI vice president, said the delivery specifications limited the contract to the best 15 percent of a growers' crop. He also said the contract, which allowed delivery of potatoes from states other than Idaho, would hurt the price advantage now enjoyed by Idaho growers.

He said a contract for May delivery could cause price manipulation as growers try to sell the remainder of their crops before storage problems destroyed the potatoes.

The exchange has had trading in russet potato futures in one form or another since the 1930's. None of the contracts has been successful, in part because many growers take preseason contracts to grow potatoes for processors and shippers.

Yeutter said the exchange decided to use the 50-pound carton in its contract because effective futures trading demanded access to cash market prices. The Department of Agriculture publishes daily potato market reports based partly on 50-pound carton prices, he said.

He also said discounts on potatoes grown in other states would help protect the Idaho price advantage.

Yeutter said he would recommend abandoning the russet futures contract if it did not generate enough trading volume. He would not say, however, when he might make that decision.

Yeutter, a former Assistant secretary of Agriculture under Presidents Richard Nixon and Gerald Ford, owns a farm in Nebraska, where cattle, corn and wheat are raised. He said he always included futures trading in his operating plans.

Farmers and others, including food processors, use futures trading as price insurance. Speculators invest money in futures to try to make profits off the price changes.

Futures trading is the buying and trading of contracts that obligate sellers to deliver specific quantities of commodities to buyers at specified dates.

A farmer can take the selling side of a contract to deliver his crop at a specific price in the future. Before the contract comes due, the farmer usually will take a buying position. The reversing move clears the farmer of further obligation in the market.

If the price of the contract (and his crop, too) has gone up at the time of reversal, the farmer pays the difference. He makes up the loss with the premium price he gets on his crop.

If the price goes down, he keeps something akin to his earlier price with the profit made off the reversing settlement.

But Yeutter said 95 percent of the problems with futures occurred when deliveries had to be made. As a result, he said, the exchange works constantly to try to settle contracts and prevent deliveries.

Idaho's J. R. Simplot was banned from futures trading for 6 years and fined \$50,000 in 1977 because he defaulted on futures contracts to deliver Maine potatoes in May 1976.

The futures industry has grown in the 1970s as trading has expanded to cover treasury notes, orange juice, lumber, precious metals and currencies. Yeutter said 20 million contracts were traded at his exchange a year with a value of \$2 trillion.

Yeutter said the exchange was working on a new contract for CFTC approval—trading in the future level of the Standard and Poore's Index. He said institutional investors, such as pension funds, banks and investment funds, could use the contract as hedges to protect the value of entire securities portfolios. Speculators will be investors who like to risk large amounts of money, he said.

[Times News, Twin Falls, Idaho, June 22, 1979]

MERCANTILE EXCHANGE HEAD DEFENDS NEW SPUD CONTRACT

BOISE (UPI).—The president of the Chicago Mercantile Exchange said Thursday the exchange did not launch a new potato futures trading contract for its own benefit but because of its importance to American agriculture.

Clayton Yeutter told Idaho Potato Growers, "whether you trade potatoes is not so important to us (Chicago Mercantile Exchange), but I think it is to you and to U.S. agriculture."

Al Johnson, vice president in charge of legislation for the growers, said the group had never favored futures trading.

The major cause of disapproval of the contracts was the effect of futures trading on Idaho's price and quality level as compared to that of other states.

"It (futures trading) depletes Idaho's image and price advantage in the market," Johnson said.

Yeutter agreed that futures trading would be disadvantageous to the Idaho potato grower.

"It is going to serve as a disadvantage by bringing other states to Idaho's level," Yeutter said. "But right now, I can't defend Idaho's contract. A broader contract is more appealing to us than just an Idaho contract."

[From the Post Register, Idaho Falls, Idaho, June 23, 1979]

SPUD FUTURES DEFENDED BEFORE IDAHO GROWERS

BOISE, IDAHO (AP).—The president of the Chicago Mercantile Exchange says the exchange won't allow traders in russet Burbank potato futures contracts to manipulate prices at grower expense.

Clayton Yeutter met in Boise Thursday with directors of an industry group, Potato Growers of Idaho. The growers want to ban potato futures trading. They claim the trading allows manipulation of spud prices.

But Yeutter contended that although some growers have been hurt by futures trading, futures contracts give farmers protection against rapid price change.

He said the exchange will use its enforcement powers to force traders to cut back when they get too much of the market, and to fine those who do not.

The Merc has improved its ability to detect trading trends, Yeutter said.

The Merc's Associated Mercantile Market has just started trading in russet Burbank potato futures contracts. The contract was approved in April by the Commodity Futures Trading Commission.

Idaho growers oppose the latest contract because it specifies 80,000 pound deliveries in 50-pound cartons with 80 to 100 spuds per carton. Al Johnson, Potato Growers of Idaho vice president, said the specifications limit contracts to the best 15 percent of a grower's crop.

Johnson said the new contract allows delivery of potatoes from states other than Idaho and that would cut Idaho's price advantage.

The exchange has had trading in russet potatoes since the 1930s—but they haven't been popular. Many growers like preseason contracts with processors for an assured income.

Yeutter said the exchange decided to base prices on the 50-pound carton because an effective futures trading market depends on access to cash market prices. The U.S. Department of Agriculture compiles potato prices daily based partially on 50-pound carton prices.

He said he recommends abandoning the russet futures contract if it doesn't generate enough volume.

Yeutter said he owns a farm in Nebraska, raising cattle, corn and wheat. And he said he always included futures trading in his operating plans.

Futures trading protects a farmer against price changes. A farmer under a futures contract agrees to sell his crop at a certain price at a fixed date. But generally instead of delivering, the farmer will buy somebody else's contract to settle his original obligation.

Prices balance out with the farmer either losing money on his crop and making it on the futures contract, or losing money on the contract and compensating with a higher price for his produce.

Yeutter said 95 percent of the problems with futures contracts come when actual deliveries have to be made. As a result, the exchange works constantly to settle contracts and prevent deliveries.

Idaho potato king J. R. Simplot two years ago was banned from futures trading for six years and fined \$50,000 because he defaulted on contracts to deliver Maine potatoes in May, 1976.

[South Idaho Press, Burley, Idaho, July 23, 1979]

NEW RUSSET CONTRACT "ISN'T DOING SO HOT"

BOISE, IDAHO (AP).—A new Russet potatoes futures contract hasn't bruised Idaho growers as much as some expected. But neither has it been a great financial success, as commodities dealers hoped.

A new contract on Russet potato futures was offered for trading on the Chicago Mercantile Exchange for the first time in mid-June. But so far there hasn't been much interest.

"It's not doing so hot," said Chicago commodities analyst Allen Semenchuk of Siegel Trading Co.

Seventy carloads of potatoes have been sold since trading began a month ago. There's no way to compare that with sales of other commodities, but Semenchuk said Russet futures aren't doing as well as expected.

Merc president Clayton Yeutter has said he'll cancel the contracts if there's little interest in them. But Semenchuk said he doesn't expect that to happen.

"As long as there's some sort of open interest in it, they'll keep trading it," he said.

Twin Falls commodities broker Alex Sinclair believes the contract will improve. "It takes a while to get them off the ground. It's getting more active every day.

"I think we'll be able to get a fairly good contract," he said.

Sinclair said Idaho farmers have bought Russet futures as an investment, but have not sold their crops as a hedge. A futures hedge is like insurance.

It guarantees a farmer he will get paid a certain price for his potatoes when he delivers them at an agreed future date. When farmers sell a contract, they pledge a supply of potatoes at a guaranteed price. Speculators buy contracts with hopes of selling the potatoes later at better prices.

"We have told farmers not to hedge," said Sinclair. "We have told them to wait until the price goes up."

The current price is \$12.50 to \$13 for a 50-pound carton. Sinclair said farmers can expect to profit by hedging when the price reaches \$15.

Representatives of Idaho potato marketing groups, who had feared the contracts would hurt growers, now say trading is too light to be harmful.

"If trading ran into the thousands, there might be problems," said Gerald Murphy, general manager of Potato Growers of Idaho, Blackfoot.

The group has complained in the past the contract would hurt potato sales by making the 50-pound carton a mass market product. Idaho shippers consider the carton the specialty of the state.

But so far the contract has had almost no impact on the cash market, Murphy said.

Mel Anderson, director of the Idaho Growers-Shippers Assn., another opponent of futures contracts, agrees:

"It's not going to influence the cash market much."

Unless, of course, futures contracts suddenly sprout a flurry of activity.

[From the Business Week, July 2, 1979]

A FRESH EYE ON POTATO FUTURES

Former Chairman William T. Bagley of the Commodity Futures Trading Commission (CFTC) frequently was accused by those he was charged with regulating of being more interested in politics and publicity than in the problems that confronted the volatile industry. That charge is far less likely to fit Bagley's successor, James M. Stone. Although on the job little more than a month, the former Massachusetts insurance commissioner is immersing himself in one of the industry's hottest problems—the growing opposition to potato futures.

On June 15, for example, Stone began a three-day visit to Idaho to study potatoes, ostensibly to educate himself on the producing end of the potato industry. He hefted 50-lb. sections of irrigation pipe through muddy fields and toured shipping and processing facilities. But, more important, he listened to growers' escalating complaints that futures markets for potatoes provide more opportunities for price manipulation than they do for hedging crops.

The Idaho trip is one of several for Stone. Recently he spent several days working on an Iowa hog farm. And in early July he will drive a combine during the Kansas wheat harvest. Such activities obviously have vast public relations potential, but Stone—aware of the charges against Bagley—insists that is not their purpose. "I am not trying to call attention to myself," he says. "I am trying to learn." Indeed, the only advance notice of Stone's Idaho journey was a two-sentence mention in a routine CFTC calendar of events.

ABRUPT HALT

Unlike his other travels, however, Stone's Idaho visit put him in the middle of an emotional debate about the value of futures. Growers and dealers long have argued that futures markets provide opportunities for manipulation, but their opposition rose to a boil in March after the New York Mercantile Exchange abruptly halted trading in two potato contracts to avert a feared squeeze brought about by a lack of deliverable supply. (Earlier, several truckloads of Maine potatoes had failed federal inspection.) The halt reportedly caused severe losses for some traders, and it may have stopped a seasonal rally in cash potato prices.

Not surprisingly, then, a large number of Idaho producers and dealers do not want any futures to be traded on potatoes. Aside from the risks of market manipulation, they also contend that there is a serious logistics problem posed by a shortage of packing and shipping facilities in the state. To be sure, only a small proportion of futures traders ever take delivery of the actual commodity. But if farmers who hedge their crops cannot deliver potatoes even on those rare occasions, growers contend that they can be exploited by speculators who know the hedgers will have to close out their futures positions before contract expiration regardless of price. "Futures trading disrupts the orderly marketing of fresh potatoes," charges manager Melvin Anderson of the Idaho Growers Shippers Assn. "Our members will continue to ignore futures."

Opposition also comes from the 3,500-member Potato Growers of Idaho, one of the nation's largest producer groups. It recently persuaded Senator Frank Church (D-Idaho), who is running for reelection, to introduce a bill that would ban all potato futures. Church, who accompanied Stone during part of the Idaho visit, says he will shelve the bill until the CFTC has considered the issue. But Church adds that, aside from the ban, "I am not convinced there is another solution." Meanwhile, his proposal is backed by legislators from two other key potato states: Senator Milton R. Young (R-N. Dak.) and Senator Edmund S. Muskie (D-Maine).

DOUBTS

Stone also came away from the visit with doubts "Certainly some concerns were raised in my mind about the ability of this market to be manipulated," he says. But he wants to examine alternatives for revising the contracts before deciding whether to press for an end to potato futures. And with the CFTC's agenda currently filled with other matters, including its new budget, it may be fall before any decisions are made.

If the degree of difficulty of Stone's task is high, so too are the stakes involved, because the proposed ban threatens contracts at exchanges in both Chicago and New York. The Chicago Mercantile Exchange, the nation's second largest, on June 5 began trading a new contract that is aimed squarely at Idaho's Russet Burbank potato industry. Volume so far has been erratic, and exchange officials concede that selling futures to Idaho growers is hard. Says President Clayton Yeutter: "We face a 'Missouri show me' attitude."

But while the Chicago exchange has a number of other highly successful contracts to fall back on, the New York Mercantile Exchange does not. Trading in round white potato futures accounted for 49 percent of its total volume in 1978 and represents a critical source of revenue for the nation's seventh-largest futures mart. After the exchange suspended activity in its April and May contracts on Mar. 9, its total potato futures volume plunged to about 20 percent of last year's peak of 500 contracts a day.

Since then, New York Merc staffers have been working to design a new potato contract based on production from 15 states, rather than just from Maine. But some exchange members wonder whether there will be a New York Merc when the contract is ready. In recent weeks, the exchange has talked about a possible merger with the affluent Commodity Exchange Inc. (Comex), the third-largest exchange and primarily a precious metals market. Merc Executive Vice-President Howard A. Gabler says the talks were not spurred by potato problems. But he adds that if a

merger takes place, "The new name certainly is more likely to be Comex than Merc."

STATEMENT OF DOROTHY KELLEY, EXECUTIVE VICE PRESIDENT, MAINE POTATO COUNCIL

Senator Stewart and Members of the Committee, my name is Dorothy Kelley. I am Executive Vice President of the Maine Potato Council, an organization representing all potato growers of five acres or more within the state of Maine. The state has 951 potato farm units and we presently have 1,363 growers on our membership list. The reason for the number of growers and fewer farms is the fact that Maine has many family farms whereby the son and father form a partnership and actually Maine is made up of small family farms with the average acreage being only 109 acres. In other words, Maine has many potato producers of less than 70 acres.

With your permission, I would like to give you a little background for the reason that the Maine Potato Council representing potato growers has actively worked for twenty-one years for the elimination of futures trading on Maine potatoes. During this twenty-one year period we have had four anti-potato futures bills in the legislature in the years of 1958, 1963, 1965, and 1971. Also seven grower referendums have shown that from 73 to 93 percent of all growers favor elimination. Attached to this report is a summary of the legislative action during these years.

You will find from this hearing as well as previous hearings that there are two segments that have completely different attitudes toward futures trading. Through the years farmers have maintained that futures trading was harmful and destructive to their ability for marketing potatoes while some dealers maintain that futures trading is constructive for their business. Many of those who favored futures trading in the past you will find are now opposed strongly to futures trading. This has occurred through the continuous deterioration of futures trading in the 1970's. During this twenty odd years every major farm organization in the country, such as the American Farm Bureau Federation, the Grange, the National Farmers Organization, and the National Potato Council have supported our action to eliminate all potato futures trading.

It is very difficult for potato producers across the United States to understand why we are still saddled with potato futures trading. Recently an aide to one of the Commissioners of the Commodity Futures Trading Commission made the statement, "some people use potato futures trading in their business and they have the right if this is a free enterprising economy". Futures brokers and exchanges are in favor of futures because it yields a profitable commission. In 1972 it was estimated that futures commissions alone averaged in the excess of three million dollars per year, and that has probably increased since that date. This isn't such an impressive figure by current standards but in the eyes of 1363 growers who are trying to eke out a livelihood from producing potatoes in the state of Maine, it looks pretty big. I ask you, gentlemen, where is the potato producer's right to carry on his business without the exploitation of his commodity by gamblers and speculators. Even within Dr. Paul's finalized report he states "many enterprises within the state of Maine use the potato futures contract" please note Dr. Paul says "enterprises" and not producers.

I have read Dr. Paul's report in its entirety and it is very well done, historically, but it leaves many questions still to be answered. You will find that the potato futures contract has been studied more than any other commodity contract, however little study has been done since the 1970's and this is the period during which potato futures contract have deteriorated substantially. I would compare Dr. Paul's report on potato future contracts to that of a serious cancer with Dr. Paul the researcher who is willing to try anything to cure his patient, however, if his various remedies do not work the patient will die and in this report Dr. Paul so states.

Dr. Paul states "this study considers criteria by which any commodity futures trading should be judged." The Maine Potato Council believes that futures trading of commodities is an economic, valuable institution within the United States, however potato futures trading is unique in its perishability and short supply. We have no desire or intent to eliminate other commodity contracts. At the present the New York Mercantile Exchange has many other contracts which are traded such as U.S. silver coins, palladium, imported lean beef, platinum, heating oil, and gold. In the past the potato futures contract has been the economic stability for the New York Mercantile Exchange, however, that is no longer true and, therefore the elimination of the potato futures contract would not be a great economic blow to the New York Mercantile Exchange.

Dr. Paul's report deals with several principal issues and I, too, would like to speak to these issues from the standpoint of the producers which I represent.

Whenever Maine talks of abolishment of potato futures trading, immediately the question is asked how would Maine ever price her potatoes. At the present time there is a large variety of daily, weekly and monthly prices available for potato producers from several different locations. During recent years, the bargaining associations throughout the nation as well as the national organizations representing producers have become united in their effort to improve their pricing situation. The Agricultural Bargaining Council which represents Maine growers in bargaining for prices at the processing plants meets quarterly with other bargaining associations throughout the United States and Canada and at this time they discuss their various situations regarding production and price. Decisions are made during these seminars to work together for a processing contract to the benefit of all areas. These bargaining associations no longer need or use the pricing mechanism within the potato futures contract because the potato futures prices are no longer realistic or reliable.

Attached to this report please find the price range and volume of trading from May, 1974 on Maine potato futures from the date of March 1st to May 7, 1974. You will find that the price runs up and down in successive trading days amounting to a total of downs of \$1.70 a cwt. five days; up a \$1.00 a cwt., next two days; down \$1.85 a cwt. the next four days; up \$1.65 a cwt. the next four days. Later a run up of \$3.55 a cwt. in nine days followed by a down of \$3.00 a cwt. in six days. You can be assured that the cash market made nowhere near this type of movement during the same period.

We presently have a proposal within the state of Maine to stabilize the price back to the producer. This proposal will go to hearing in December. It calls for a marketing board which would set a daily price between the local dealer and the packer. The dealer would pay the floor price to the producer and all producers and packers would know this daily price. In order to support the marketing board all growers would commit a small volume of their potatoes to the board. These small shipments would be prorated back to the growers to allow for orderly marketing. Any pre-price contracts such as processing or seed contracts would be exempt from the authority as well as an exception would be made for distressed potatoes. The floor price established by the marketing board would be a realistic price as the board would have the authority to contact several other areas throughout the United States to establish this daily price. Since we have a large number of dealers within the state, this would prevent the nickle and diming the price down during the day and would establish a minimum price which a producer would know he should receive for his potatoes, thereby, the producer would have a better idea of the supply, demand, quality and price he should receive.

Dr. Paul states in his report "there is little or nothing that can be accomplished through organized futures trading in a commodity that cannot be accomplished without it". Dr. Paul states without hedging, a futures contract will die, and he also opines that the problems of hedging during the past seventies has become more difficult. In the past some of our financial institutions have looked at grower hedging as a type of loan carrying a relatively low risk when supported by a deliverable potato inventory. This has not been true in recent years. Some of our lending agencies will presently only loan for the month of November, others will not loan for grower hedging for any month and one agency will allow grower hedging if the grower is financially able to do this on his own. I am sure you gentlemen are well aware that it is much easier to get a loan at the bank if you really don't need the money. 700 farmers are presently financed by the Farmers Home Administration which will loan absolutely no funds for hedging on the potato futures contract. Lending agency statements hereto attached.

You may well ask why it is difficult to hedge. The great concern for hedgers is the growing difference in the closing Mercantile price and the cash price. For example as of the closing day of the May '74 contract, May 7th the Exchange closed at \$15.15 a cwt. while the Maine price f.o.b. New York with a weak \$13.00. This is true because the future commitments may so exceed the supply of the commodity available to satisfy the outstanding contracts, that the price becomes distorted. This may cause a partial or complete default on delivery.

This was true in May '76 default as one party who was long on the board was in the area contracting to buy potatoes supposedly for export, therefore, when the board closed the shorts on the board had to default stating that they could not buy potatoes in the area. Later on in my testimony I will show that this was a false statement. This practice has occurred during the 1970's in many different months. In fact the Maine Potato Council, January, 1979, met with the Commodity Futures

Trading Commission and warned the agency that the March delivery might become a larger fiasco than the 1976 May default. Our reasoning was the fact that certain parties were advertising to buy up the stock available, and therefore, shorten the supply of potatoes. These rumors did cause the board to increase and, therefore, squeeze out the hedger so that all he could do was try to deliver his potatoes. As the record shows 52 loads of potatoes were delivered to Hunts Point under the March contract and 46 failed to meet the grade of US No. 1's. During this time, Maine had half of one percent rejection on the fresh market.

The Maine Potato Council maintains that several million dollars were lost due to the Board of Governor's decision to close out trading on April and May contract. One company lost over a million dollars plus the fact that twenty-two growers and industry people came into my office and reported that they had lost from \$5,000 to 50,000 dollars in the board action. One large grower reported that he had sold March and due to the squeeze play decided that he would not deliver on the March's and, therefore he rolled into April when the Board of Governors decided to close out the April and May, this decision cost him well over \$100,000.

Manipulation such as the 1976 default does have an affect on the price received. As before stated, in 1976 the growers had sold potatoes to the longs involved in the board at a very good price of \$9.50. After the default they had to resell these potatoes at \$2.00 per barrel. I personally filed claims well over 2 million dollars for the growers involved in the May default through selling their actual potatoes to the longs. One claim was in the amount of \$465,000 while another company which I filed a claim against the amount of \$74,000 did personally pay all the growers involved, however, that particular company is presently in bankruptcy.

Potato producers can no longer live with a futures contract that is not deliverable and has the potential of squeeze plays or manipulation that will work in favor of the New York traders and speculators.

On August 30, 1978, the Wall Street Journal carried an article which I quote "it has been discovered that 95.4 percent of all farmers do not use futures markets, and those who do less than half hedge their own produce, the rest are speculators." If this statement is true of the 13,000 potato producers throughout the United States, only 600 use the futures market for their business.

The number of trades on the New York Mercantile Exchange potato futures contract has decreased greatly since the Board of Governor's action in March. Hereto Attached to this statement is a comparison from October 24, 1977 and October 24, 1979 through November 9, 1979. You will note only $\frac{1}{3}$ the number of trades for double the price in 1979. This will give you an idea of the deterioration and lack of confidence in the New York Mercantile potato futures contract. There is no way for me to tell the number of producers that might be hedging at this time, however, please understand that you do not have to be a producer of potatoes to hedge on the futures contract. As a matter of fact, that is one of the problems in Maine with the futures contract as we have many people some of our dealers who are selling potatoes that they do not have and then they try to work the price down for their own interest. I find this to be a conflict of interest in regard to a dealer-seller of potatoes. It certainly does not help the industry or the orderly marketing of potatoes.

The potato growers of Maine have recently made several important moves toward improving their ability to market actual potatoes. The Maine Potato Council introduced legislation last year to have nothing but certified seed planted in the state of Maine. This will give us the opportunity to improve the quality of our potatoes and also the ability to export potatoes to foreign countries.

Exporting potatoes is very difficult when you have potato futures contract hanging over your head. The reason being that the rumor of export has a tendency to make the board price increase and, therefore, it is very difficult to purchase the potatoes at the quoted price you have given to the foreign country. For example, two years ago the Maine Potato Council received many inquiries from foreign countries in regard to exporting potatoes. I worked through one dealer who normally exports potatoes and I learned that he would not make a bid due to the fact that he happened to be short on the board, and no way did he want the price to increase.

Maine growers recently voted to have a state marketing order to control their shipment of russet type potatoes. Maine has a new variety of which we are very proud and presently a good 30 percent of our acreage is now russet type potatoes.

Dr. Paul relates in his report that not all of Maine's problems are caused by futures trading and I would have to agree with that statement, however, a good many things that we are trying to do to help ourselves cannot be accomplished as long as we have futures trading.

Since delivery is a very big problem within the potato futures contract, Dr. Paul's recommendations call for financial settlement in view of delivery. May I suggest, gentlemen, that you discontinue the trading of potato futures throughout the United States and allow those who so desire to trade in silver coins and gold which would be the same thing as allowing financial settlements instead of delivery in the potato futures contract.

I apologize for the length of my testimony, however, this is a very serious, critical problem to the potato producer throughout the United States. It took Dr. Paul one hundred and seventy-three pages to tell you that if improvements were not made in potato futures then the banning of trading might be considered. Since many changes have taken place down through the years in the hopes of improving the potato contract, I urge you to vote in favor of S. 770 to eliminate all potato futures contract and, thereby allow the potato producer to go about his business of selling actual potatoes and not paper. Thank you for allowing me the opportunity to address this subject.

HISTORY OF ANTIPOTATO FUTURES LEGISLATION

House

85th Congress.—H.R. 10282 by Congressman McIntire—1958—died in committee.

88th Congress.—H.R. 904 by Congressman McIntire—1963—favorable reports, subcommittee and committee; Rules Committee approved 8-7, then reconsidered and disapproved the same day—died in Rules Committee.

89th Congress.—H.R. 6006 by Congressman Hathaway—1965—died in committee.

92nd Congress.—H.R. 7287 by Congressman Hathaway—1971—approved by subcommittee 6-2. Now pending full committee action.

Senate

88th Congress.—S. 332 by Senator Muskie—1963—passed after hearing.

89th Congress.—S. 1477 by Senator Muskie—passed without hearing.

92nd Congress.—S. 1947 by Senator Muskie—1971—pending.

SUPPORT BROAD AND DEEP

Every major farm organization in the country supports abolition of potato futures trading, including:

American Farm Bureau Federation.—1964 Policy: "We continue to favor legislation to eliminate potato futures trading from the various commodity exchanges." Reaffirmed for 1971 when AFBF delegates "voted to support the elimination of futures trading in Maine potatoes on the New York Mercantile Exchange."

Grange.—1970 National Session: "... speculation in potato futures contributes to extreme fluctuations of the market in which the interests of neither producer nor consumer are well served."

National Farmers Organization.—Charles L. Frazier, before the Domestic Marketing and Consumer Relations Subcommittee, March 17, 1972: "We do not condemn all futures trading. We believe, however, that the case is strong for termination of exchange trading on potatoes. It urged that favorable action be taken on H.R. 7287."

H.R. 7278 is supported by potato industry associations in all potato-producing states, including: California, Colorado, Delaware, Florida, Idaho, Maine, Michigan, Minnesota, New Jersey, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Virginia and Wisconsin.

In 1963, Governor John H. Reed (R) of Maine said, "I would like to register my support of pending legislation to eliminate the trading of Maine Potatoes on the New York Mercantile Exchange." Former Governor Reed reaffirmed his position during the hearing on H.R. 7287, January 20, 1972.

On March 16, 1972, Governor Kenneth M. Curtis (D) of Maine testified on H.R. 7278 before the Subcommittee on Domestic Marketing and Consumer Relations: "We hope you will approve the legislation before you that will ban this unsatisfactory and harmful practice once and for all."

The One Hundred Second (1965) and One Hundred Fifth (1971) State of Maine Legislatures unanimously passed Memorials to Congress urging the abolishing of potato futures trading.

APPENDIX A.—1974 PRICE RANGE AND VOLUME OF TRADING OF MAY 1974 POTATO FUTURES,
MAR. 1—MAY 7, 1974

[Dollars per hundredweight]

Date	High	Low	Close	Change from previous close	Range during day	Volume of trading (carlots)
March:						
1.....	16.38	16.00	16.00	—0.50	0.38	2,067
4.....	15.74	15.50	15.50	— .50	.24	773
5.....	15.00	15.00	15.00	— .50	0	106
6.....	15.50	14.50	14.95	— .05	1.00	2,608
7.....	15.35	14.75	14.80	— .15	.60	2,204
8.....	15.00	14.56	14.81	.....	.44	1,949
11.....	15.30	15.30	15.30	+ .50	0	67
12.....	15.80	15.80	15.80	+ .50	0	117
13.....	16.30	15.40	15.45	— .35	.90	3,212
14.....	15.35	14.95	14.95	— .50	.40	2,163
15.....	14.95	14.45	14.45	— .50	.50	1,740
18.....	14.20	13.95	13.95	— .50	.25	1,243
19.....	14.45	13.45	13.92	.....	1.00	3,503
20.....	14.45	14.05	14.45	+ .50	.40	2,019
21.....	14.75	14.45	14.60	+ .15	.30	2,473
22.....	15.10	14.50	15.10	+ .50	.60	3,054
25.....	15.60	15.41	15.60	+ .50	.19	1,526
26.....	15.84	15.10	15.10	— .50	.74	3,739
27.....	15.49	14.84	15.23	+ .10	.65	3,515
28.....	15.70	15.27	15.70	+ .50	.43	3,065
29.....	16.20	15.95	16.20	+ .50	.25	1,843
April:						
1.....	16.62	16.23	16.55	+ .35	.39	3,104
2.....	16.80	16.15	16.67	+ .10	.65	3,280
3.....	17.15	16.76	17.15	+ .50	.39	3,592
4.....	17.65	17.27	17.65	+ .50	.38	2,912
5.....	18.15	18.10	18.15	+ .50	.05	828
8.....	18.65	18.65	18.65	+ .50	0	257
9.....	19.15	18.15	18.15	— .50	1.00	3,386
10.....	18.59	18.01	18.46	+ .35	.58	3,153
11.....	18.65	18.00	18.00	— .50	.65	2,295
15.....	17.80	17.50	17.50	— .50	.30	1,101
16.....	18.00	17.10	18.00	+ .50	.90	3,349
17.....	18.29	17.50	17.50	— .50	.79	3,129
18.....	17.00	17.00	17.00	— .50	0	184
19.....	16.85	16.50	16.50	— .50	.35	1,667
22.....	16.20	16.00	16.00	— .50	.20	413
23.....	15.70	15.50	15.50	— .50	.20	404
24.....	15.00	15.00	15.00	— .50	0	245
25.....	15.50	14.50	15.48	+ .45	1.00	3,351
26.....	15.81	15.00	15.03	— .40	.81	2,318
29.....	15.43	14.55	15.00	— .05	.88	2,504
30.....	15.40	15.04	15.37	+ .35	.36	1,363
May:						
1.....	15.54	14.92	14.99	— .40	.62	1,163
2.....	14.90	14.50	14.51	— .35	.40	837
3.....	14.40	14.12	14.40	— .10	.28	594
6.....	14.90	14.17	14.90	+ .50	.73	486
7.....	16.40	15.25	15.50	+ .85	1.15	2,502

Source: Daily Futures Trading Report by N.Y. Merc.

AROOSTOOK COUNTY,
PRODUCTION CREDIT ASSOCIATION,
Presque Isle, Maine, November 13, 1979.

Senator DONALD STEWART,
Chairman, Subcommittee on Agricultural Research and General Legislation,
Washington, D.C.

DEAR SENATOR STEWART: The Aroostook County Production Credit Association has for many years now, provided financing for our members who have availed themselves of the opportunity of hedging their potato crops on the New York Mercantile Exchange. We had, prior to the latest incident, advocated the practice based on a formula to make sure sufficient potatoes would be available to meet the requirement if the hedge were not liquidated prior to maturity.

Since last March, however, we have not advocated its use. We have, however, continued to provide funds for those of our members who qualified for such funds in accordance with our policies. For all practical purposes, we are lending money on an unsecured basis to our most credit-worthy accounts and are not looking to the assignment of contract as primary security in these cases. We are relying on the judgment of our individual members to best make their own analysis of the situation and react accordingly.

This matter has been discussed at our Board of Directors meetings and the Aroostook County Production Credit Association is watching very closely but has not taken a firm position.

If I can answer any question or be of any assistance in this matter, please feel free to call on me.

Very truly yours,

GARY B. SIROIS, *General Manager.*

AROOSTOOK TRUST CO.,
Caribou, Maine, November 13, 1979.

Mrs. DOROTHY KELLEY,
Executive Director, Maine Potato Council,
Presque Isle, Maine.

DEAR MRS. KELLEY: At the present time we have no hedge commitments to farmers because we have had no requests to do so from our farm customers.

Yours truly,

T. B. TORNQUIST, *President.*

MAY CLOSE 1977 AND 1979, OCT. 24 TO NOV. 9

Date	Close	Change	Trades	Open interest total
May 1977:				
October:				
24.....	\$6.27	-3	1,809	9,259
25.....	6.35	+8	1,722	9,342
26.....	6.19	-16	2,366	9,364
27.....	6.07	-12	3,974	9,491
28.....	5.75	-32	5,375	9,409
31.....	5.66	-9	2,293	9,323
November:				
1.....	5.72	+6	1,167	9,522
2.....	5.65	-7	1,342	9,793
3.....	5.69	+4	1,178	10,009
4.....	5.66	-3	564	10,067
7.....	5.58	-8	1,322	10,207
8.....	5.38	-20	1,659	10,253
9.....	5.37	-1	2,126	9,920
May 1979:				
October:				
24.....	9.90	-30	630	4,760
25.....	9.83	-7	742	4,809
26.....	9.83	0	866	4,779
29.....	9.92	+9	434	4,935
30.....	9.79	-13	391	4,643
31.....	10.02	+23	668	4,729

MAY CLOSE 1977 AND 1979, OCT. 24 TO NOV. 9—Continued

	Date	Close	Change	Trades	Open interest total
May 1979—Continued					
November:					
1.....		\$10.05	+3	428	4,898
2.....		9.94	-11	387	4,956
5.....		10.20	+26	635	4,924
6.....		10.24	+4	439	5,035
7.....		9.99	-25	612	5,076
8.....		10.08	+8	391	4,838

STATEMENT OF HON. MICHAEL CARPENTER, MAINE STATE SENATOR

Senator Stewart and Members of the Committee, gentlemen, I wish to thank you very sincerely for the opportunity to come here today and address this issue which is of such great concern to myself and my constituents. My name is Michael Carpenter, I am a state senator from the state of Maine, the county of Aroostook. Make no mistake about where I stand! I despise the New York Mercantile Exchange and the futures contract for what it has done to my potato growers. Although I am not engaged in farming, I come from a farm family and have been schooled in the futures business for the past 32 years. I have seen what the New York Mercantile Exchange has done to a once proud industry. It has been absolutely sinful. Time after time, the growers have rejected the futures industry through carefully conducted grower polls and time after time their wishes have gone unheeded. We have rejected the futures "business" not out of ignorance but rather because we understand it too well. Manipulation of the "board" is as old and as much a spectator sport in Maine as high school basketball. We sit around and "speculate" about how far down the brokers will depress the market this year. We knew in January of 1979 that later in the spring there was going to be an attempt to break the market. There was and they did and my growers had to suffer the consequences of headlines screaming "Rotten Main Potatoes." What do you think those results were? The cash market crashed right along with the futures market. As the board goes down, so does the real market. The potato brokers use the board's action to blackmail the growers into selling cheap potatoes. Yet no one can tell me what makes the board go up and down.

Howard Gabler of the New York Mercantile Exchange answered that question this way last spring—"Not even God himself can answer that question"! Mr. Dennis Avery, staff economist for the CFTC answered the same question equally honestly by saying "I can't answer that."

The abuses and manipulations of the Mercantile and its potato contract are well documented, as you have heard today. Why then will no responsible authority heed our voices and rid us of this unwanted contract?

I would like to briefly explore this question. Last spring, the CFTC indicated to me that as long as there were "legitimate business interests" involved in the futures contract, they would continue. I wish someone would define these "interests" for me—I know that the CFTC met with these people last spring but not a word was heard from them at the public hearing into the March 9th disaster. I know how much money is involved in the futures business as well. Being a politician, I am very well aware of the influence that evolves from centers of great wealth. Are these financial interests, beneficial to non-agricultural persons sufficient reasons to thwart the wishes of the majority.

The supreme Court has ruled that power in this country must be apportioned on the basis of one-man, one-vote. Why does this not hold true for potato growers? It is obvious to us that as long as there is the promise of easy money, there will be gamblers or if you prefer speculators. What determines the higher priorities assigned to these "legitimate financial interests"? Because of influence, power, wealth, etc. do they automatically cancel the best interests of my growers? I think this should not be the case in our society. Yet it has been this way and threatens to remain so.

A true futures market guarantees a steady flow of the commodity at a future date at a known price. I would argue that once these basic economics principles are violated, there is no way to maintain a viable, true futures market. Gentlemen, these principles were violated many years ago in the Maine potato contract and

continue to be violated each year. What then is the function of this so-called market? I submit to you that it no longer has a function—except purely as a gambling device. We came here today to ask you to consider the greater need—that of the unwilling pawn in this game, the potato grower.

Gentlemen, I beg you, I plead with you, I implore you to heed the wishes of the people who grow the commodity. Allow these men and women to determine their own destiny. My growers and I deeply believe that our ability to enjoy “life, liberty and the pursuit of happiness” is severely jeopardized by the New York Mercantile Exchange. Do we not have the basic American right to decide our own future?

Someday I will witness the death of the New York Mercantile Exchange potato contract in Maine. Toward that end I am totally committed. I can only hope and pray that you will help make that day soon. Thank you.

STATEMENT OF MERLE S. JOHNSTON, FORT FAIRFIELD, MAINE

Senator Stewart and Members of the Committee, my name is Merle S. Johnston from Fort Fairfield, Maine. I am a graduate of the University of Maine with B.S. degree in Agriculture Economics and Farm Management. I have been a potato farmer, shipper and starch manufacturer involved in the Maine potato industry for 28 years. I have been president of a 1,200 member Farm Cooperative, president of the Sugar Beet Growers of Maine and a state legislator. I was the manager of the Information Office of the New York Mercantile Exchange from 1970-77.

My farming operation consists of a 500 acre farm in Fort Fairfield which my sons are leasing at the present time. I grew from 150-200 acres of seed potatoes as well as buying and shipping some 200 to 300 carlots of potatoes from many growers in the Fort Fairfield area from 1950-1975.

Over the past 25 years there has been many major changes in the Maine potato industry, and many of the production and marketing tools of the past have gone through drastic changes because of new technology in these respective fields. One of these tools of marketing has become a growing cancer on the Maine potato industry because of its inability to remain a viable part of the potato marketing process. As an individual who has been involved in the many facets of the Maine potato industry for 28 years, I have made a full cycle and am now completely and sincerely convinced that only more harm can come to the potato industry if futures trading is allowed to continue. For many years I felt that the potato industry could benefit from futures trading and as a farmer and shipper I used the futures market as a tool in my operation. In the 1950's through the early 1970's the New York Mercantile Exchange operated a futures market that was fairly stable and somewhat reflective of what a futures market should be but in the last several years it has become “volatile” in nature and definitely not reflective of the principal of a futures market. This is not only disastrous to the potato industry but also to the consuming public as well. This has been brought about by several factors over the last several years.

I would like to give you several substantial reasons why this marketing tool has outlived its useful purpose. The production of potatoes in Maine has been declining, while the production of all potatoes in the United States has been increasing. Moreover, in recent years an increased proportion of Maine potato acreage has been planted to early maturing potatoes that have poorer storability than the late maturing varieties. Consequently, the quantity of round white potatoes carried late into the marketing years in Maine—hence, deliverable on April and May futures contracts—has decreased. At the same time, a growing demand coupled with a diminishing supply of deliverable stocks provides more possibilities for squeezes and other manipulative behavior late in the storage season as futures contracts mature.

Secondly, the large volume of trading in the May contract in recent years has increased the volatility of prices and therefore, made the Maine cash market totally disruptive.

Another very important factor that there is clear evidence of, is that the difference between the cash market and the futures market has become more variable and an ever increasing tendency whereby the cash market and futures market won't come together at or near the end of trading. This has been a major concern to the Maine potato farmer and consequently the hedging aspect of this tool has become a complete disaster. The Maine farmer no longer can get financial backing from the financial institutions for an effective hedge position for his crop. Every major financing institution in Maine has turned away from supporting or promoting hedge positions on the New York Mercantile Exchange. The credibility of this institution has been totally destroyed by defaults, suspension of trading, rule

changes, inspections, and other manipulative practices such as have occurred in the 1976, 1979 years.

I have to ask you, as legislators, how can we allow this type of a futures market to continue? How long can the Maine potato farmer endure if such practices continue and in all probability continue to get worse. There may be remedies suggested to improve this market but I have seen these proposed only to be destroyed by selfish, greedy interest. Again I ask you how long can potato farmers live with a potato futures contract that is not workable, has more potential every year of squeezes, and price manipulations and that will be weighted more every year in favor of New York traders and speculators. The potato industry cannot suffer any longer with a marketing tool that has outlived its usefulness, has lost its integrity, and continues to be used as a price manipulated mechanism that benefits only New York speculators.

An average of 85 percent of the Maine potato farmers have supported this legislation for many years. As a representative of the New York Mercantile Exchange for 7 years, I advocated, defended, promoted, educated, and in general, disagreed with this 85 percent but today I stand before you a "converted believer" in this legislation. This has got to be passed at this time because every year things are getting worse not better in the futures market. Volatility is predominant, credibility is completely destroyed, manipulation has become more effective for the sophisticated trader, delivery has become impossible, market disruption by daily maneuvers have become predominant in the futures market. Our marketing people have become disarrayed and disorganized by this marketing tool. The integrity of the contract has been totally destroyed.

Every year since 1976 the problems of delivery have become overwhelming and will not allow the convergence of the futures market and the cash market at maturity of the contract. The potato farmers of this country cannot await the natural death of this market. You must act now!

You will undoubtedly hear testimony today that some farmers still believe in the futures market, but I must say they are fast becoming a rare, extinct breed with capital resources that aren't totally derived from potato farming. As you might be aware, over 90 percent of the Maine potato farmers have become mortgagees of the Farmers Home Administration and this agency has no funds available to finance a hedge program for Maine farmers. Therefore, this legislation must be enacted in 1980. Many years back the onion growers were given this opportunity and they have survived and prospered over the years. Now I say give the potato growers of this country the same opportunity. We will survive and the New York and Chicago Exchanges will survive with these other futures contracts that they have created and promoted. Let them have futures marketing on commodities that aren't perishable such as they have today in silver, gold, platinum etc. and that work somewhat like a futures market should.

The Maine potato industry has many avenues to pursue to rebuild a strong, vigorous, successful potato marketing economy and will do so with your help by passing this legislation.

In closing let me urge this committee to report this Bill S. 770 out of committee as "ought to pass unanimously". Thank you.

STATEMENT OF BASIL FOX, WASHBURN, MAINE

Senator Stewart and Members of the Committee, my name is Basil Fox. My sons and I raise 300 acres of potatoes in Washburn, Maine.

I appreciate the opportunity to appear before you to urge favorable consideration of S. 770, introduced by two outstanding Senators and co-sponsored by two other fine Senators, to eliminate futures trading of all Irish potatoes.

For over twenty years in the state of Maine an overwhelming majority of potato growers have asked the Congress for relief from this burden. Today you have heard growers, our grower's representative, and officials from Maine state government tell you why futures trading is damaging to our potato industry and to we farmers . . . without any resulting benefits to the consumer. To be truthful, the consumer may receive poorer quality potatoes than she would if there were no potato futures trading. As you have heard others state before me some of the plans the state hopes to initiate to help market better quality potatoes. These ideas will not change the price to the consumer as the farmer does not have the control over the price the consumer pays at the supermarket.

After what our industry has been put through this past spring, as a result of Mercantile action, it is very difficult for me to understand why we would want to continue with the present or any re-issued contract offered by the Mercantile.

Having more areas included in a round white contract will not guarantee that potato growers will not have a recurrence of the present situation. This spring's action by the board cost growers untold dollars, and the rumors that accompanied the Mercantile action gave the state a black eye. Why would any other state want to be saddled with rumors, manipulations and possible non-delivery?

Many of our leading agencies have stated that they will not finance margin money for hedging on potato futures. Without hedging you don't have a futures contract. I truly hope you gentlemen realize that it is not always the producer who is doing the hedging. Many hedge who do not own any potatoes . . . if they manage to get off the board with a little profit, all well and good, they think. If they can't get off then they try to buy and deliver . . . of course there is always E.F.P. if they can't find the potatoes and last but not least . . . they can default.

Dr. Paul in his study suggests many remedies . . . One being daily price fluctuations, this has been changed through the years but it has not been a remedy and in no way the past few years has it brought the contract price and cash price together as a good futures contract should do.

Also suggested is a limitation on individual traders positions. This too has been tried with no limitation on the number of hedge positions . . . that may explain why Dr. Paul's study finds more hedging than speculating being done in later years. Margin calls can be changed at any time during the contract. Matter of fact, in November of 1977, I believe, one day the margin call was placed at the value of the entire carlot. The value at that time was over \$2500 and I know of one grower who had 100 cars on the board. His hair turned grey and he has been trying to change the rules ever since that day.

You can't change the rules and make the contract better. It has been tried through the years, each time manipulation, default or squeeze-plays appear. The potato futures contract is built on greed, and some of the players are brilliant enough to outsmart one another. Deception in futures effects trading, and it doesn't take much of a rumor to change the position up or down.

I am convinced that futures trading of potatoes operates to the disadvantage of we growers; that it does not promote orderly marketing of our crop. It is, therefore, a detriment to the entire farming community and to the economy of our state.

Dr. Paul states that potatoes futures is not the only problem in the Maine potato industry, and I have to agree with that statement. However, I am happy to see that he recognizes that potato futures trading is a problem.

Considering all the burdens facing the potato growers today in their struggle to stay on their farms, which I believe ought to be encouraged, they are entitled to be relieved of a burden they have never asked for and which they have always overwhelmingly rejected.

I hope your committee and Congress will finally hear the producers plea. I thank you for your time and consideration of my remarks.

STATEMENT OF GLENN MANUEL, COMMISSIONER, MAINE DEPARTMENT OF INLAND FISHERIES AND WILDLIFE

Senator Stewart and Members of the Committee, my name is Glenn Manuel. I am presently commissioner of Inland Fisheries and Wildlife for the state of Maine, and I also produce potatoes with my son in Littleton, Maine.

There are many objections to the New York Mercantile Exchange potato futures contract which will be dealt with by other people here today, however, I will deal with the incompatibility in regard to orderly marketing.

It is one thing to produce a crop, however, it is quite another thing to market it and this is where I differ sharply with the theory of futures trading on a perishable vegetable such as the potato. Most commodity futures markets are very important to our economy, however, potato futures allows for manipulation due to the lack of stocks during the finalizing of the contract.

As we all know potatoes are consumed the year around, therefore, producers should gear their operation to achieve this goal. I agree with Dr. Paul in his study when he states that refrigerated storages would increase Maine's marketability of potatoes. Prior to the introduction of futures trading Maine shipments started in late August, and continued through June in an orderly manner. Shipments were heavy in the fall months, sometimes nearly half the crop would be moved by January. This was advantageous in that it lowered the inventory early, moved potatoes when they were in the best possible condition, and brought in early monetary returns, reduced insurance costs, and cut down on shrinkage.

When the Board became active in the early 1950's this orderly movement began to change, and now we have slipped into marketing to later months when these

perishable potatoes are in much poorer condition, and the problem is further compounded by forced tonnage shipments in a compacted amount of time due to the shortage of trucks.

You may well ask why did this happen? The answer is simple. Historically futures prices in March, April and May have been much higher than in November. Farmers, bankers, fertilizer, chemical, machinery companies and speculators select the later months for higher profits. Thus these potatoes must be held to cover the short positions. If the short manages to get off the Board, then the potatoes must still be moved to market in competition with other May deliveries.

In 1946 Maine harvested 219,000 acres and in 1978 Maine harvested 119,000 acres according to the Statistical Reporting Service, and twenty-five percent of this acreage is planted to russet type potatoes. Thus the available supply of potatoes has decreased.

Dr. Paul in his report maintains that potato futures is not the only problem in Maine and we truly agree with that statement, however, it is impossible to change our system of marketing as long as the potato futures contract hangs over our head. We have some 120 dealers in the state of Maine that use the potato futures board constantly. It is practically impossible in the area where my farm is located to get a price quote before ten o'clock when the Board opens or after two o'clock when the Board closes for the day's trading. It is impossible to build a market when half the dealers are short while the others are long on the Board. Those that are short are trying to work the price down while the longs are attempting to work the price upward. You can hardly call this orderly marketing! As related in the study by Dr. Paul the quantity of potatoes produced in Maine has declined since the mid-fifties, and this gives us fewer potatoes in storage. Also Maine growers have shifted to early maturing varieties which are less storable late in the season. The reason for the shift to early maturing varieties is the short growing season we have in Maine approximately 90 to 100 days. Many of these new varieties have a tendency to yield much higher than some of our older varieties, therefore, growers can start their harvest earlier, and with a higher yield the grower reduces his cost of production. This is extremely important since the cost of production is some \$900 per acre in recent years. These early maturing varieties actually benefit Maine's ability for orderly marketing as these early varieties should move to market early in the season and give Maine an excellent deliverable potato at that time.

In order to have a viable potato industry in Maine, since we are primarily a one crop area, we need a good fresh market and an export market on seed as well as our domestic seed market and the processing industry. We do not need a paper market.

We should plant the early varieties for early markets and we need to treat with a sprout inhibitor all potatoes going into the commercial market after February. Most growers are presently treating their potatoes. This gives us a supply of late season potatoes for the fresh market at home and also for our processing plants located within the state.

Last year Maine growers through legislative action moved to plant only certified seed within the state and this seed would meet our certified seed requirements. This will improve the quality of our potatoes for whatever use and it will enable us to meet the Fido duty regulations for shipment to foreign countries. Maine's russet growers recently voted to have a state marketing order on russet type potatoes. These are two steps in the right direction made by the producers in order to give the consumer a better quality potato.

Maine has port facilities that are totally adequate to meet the export challenge and the ability to export will prove a big benefit to the Maine potato industry.

Due to our geographic location, potato growers in Maine have a big advantage over other areas due to the increased energy costs. We are only 650 miles from New York City and it is a mere 160 miles to the Atlantic Ocean from Central Aroostook. This is just a few of the things the Maine potato producer is doing to help himself.

Dr. Paul in his study says that the potato future contract of the New York Mercantile is sick and we, the Maine potato producers, have been sick of the potato futures contract for nearly twenty years. We would like very much to be rid of the paper market and get back to actually selling potatoes. You may well ask what would the Maine potato producer do without the futures market. First, we would have future contracts and future sales such as we had a few years ago. At that time we had many buyers within the area who would come into the storages in the fall and often times purchase his entire potato house full of potatoes. The producer at that time made his deal, his own personal deal, with the outside buyer. For example, not too many years ago the Atlantic & Pacific Co. buyer came into the county and purchased large quantities of potatoes. They had several local packing houses located within the state and these potatoes were delivered to those houses. They

were owned by the A&P, they were packed by the A&P, and they were sold at a good price and profit by the A&P and there was no way that the A&P tried to work the price down. If we do not have the futures market many of our before-mentioned dealers will have to get out into the storages, buy potatoes, and sell those potatoes, and in no way will they be trying to drive the price down. This will give us constant movement of Maine potatoes into the market and there will be no one trying to get a lower price.

The key is to orderly marketing throughout the entire area, and past history makes it perfectly clear that this is not possible under a futures market with this wild fluctuations which disrupt the orderly marketing.

In conclusion I should like to say that no matter what is done in regard to correcting the operation of the Exchange, it will not work. We had the 1976 May default and the Exchange immediately came out with a new contract which has not proven to be any better than the previous contract. They are presently proposing an increased area round white contract and this will not solve any of the problems since the state of Maine has the bulk of round white potatoes in April and May. As Dr. Paul states in his study, this increased area contract would provide more potatoes in November and March but even he was not sure that it would improve the April and May round white situation without refrigerated storages in many of the other areas. Since hedging on the potato futures contract has not proven beneficial in recent years, it is very unlikely that any grower would build a refrigerated storage just to cover his hedge on the potato futures market. Therefore, since Maine potato producers desire to build actual orderly marketing of potatoes which cannot be done under the potato futures contract, it is my hope that you will recommend permanent elimination of all futures trading on potatoes.

Thank you for the opportunity to address this subject.

STATEMENT OF DUANE A. SMITH, EXTENSION ECONOMIST, COOPERATIVE EXTENSION SERVICE, UNIVERSITY OF MAINE, ORONO, MAINE

Since 1971, my responsibilities have been to serve the educational needs of the Maine potato industry. For most of this period, I had specific responsibilities in the area of potato marketing. This includes teaching proper hedging techniques or the use of futures as a farm management tool.

To this end I have worked closely with the New York Mercantile Exchange. Following the default of 1976 and the resulting change in contract, Dr. Allen Abrahams and I developed training materials on hedging and the new contract. We proceeded to offer this information to potato growers in Maine. Five evening courses were attended by approximately 250 growers. While I had suspected the potato futures were at least in part detrimental to the industry, up to this point I also realized that hedging was a successful farm management tool to many individual growers.

The series of problems which besieged potato futures, caused me to have great problem with justifying hedging as a reasonable farm management tool.

In 1974, March futures closed with a \$1.25 basis unfavorable to grower hedges, this on a 1.66/cwt cash price. This represents a basis of 75 percent of the cash prices.

Then in 1977 we had the major default and a new contract. Now in 1979 trading was discontinued and hedging again negated.

At this rate I think it has been aptly demonstrated that farmer hedging on potato futures is not a feasible farm management tool. The theory of hedging to reduce price risk no longer exists. Potato futures as currently offered and administered have no economic benefit to the Maine potato industry. I see nothing in the newly proposed contract to change this.

The New York Mercantile Exchange says that they are going to communicate and work closer with the Maine potato industry. They have said this after each problem. Yet almost all the decision and rule changes made appear to have been an effort to increase the volume of trades rather than to serve the industry for example:

1. New higher daily limits; 2. Adding an additional year in the future; 3. Insisting on retaining May as a trading month.

The CFTC to date has appeared to be unable to properly regulate Maine potato futures trading in a manner such that hedgers are protected.

Many seem to feel that the Maine potato industry could not exist without potato futures. I do not share this concern. Probably 70 percent of the potatoes produced in the U.S. are not of the round white variety including 20 to 30 percent of Maine's production. Many of these growers are fairing as well or better than round white producers.

Financiers in Maine have recently indicated an unwillingness to finance hedging accounts. This is necessary for hedging. As an educator and agricultural economist, I am constantly besieged with comments on the need and requests to aid improvement of Maine's potato marketing. Maintenance of an obviously imperfect futures trading system will not enhance the opportunity to improve our potato marketing efforts.

STATEMENT OF JACK SCHWAGER,¹ DIRECTOR OF COMMODITIES, SMITH, BARNEY,
HARRIS & UPHAM, OSSINING, N.Y.

The following is a list of the key facts which should be considered regarding the proposed bill to ban trading in potato futures:

Fact 1.—Historically, potato prices have been determined by supply and demand not speculative activity. Low potato prices have consistently occurred in seasons of large supply, while high prices have occurred in seasons of low supply—the exact price action predicted by classic economic theory. Chart 1 depicts the average price level of March futures (adjusted for inflation) and total per capita supply and Maine production. As can be seen in the chart, the futures price is inversely related to total per capita supply, with Maine production also helping to explain some of the season-to-season price variation. (Maine production carries greater weight than production in other areas since the futures contract specifies delivery of Maine potatoes. However, the primary price influence is the overall total supply level.)

Fact 2.—The use of futures for hedging is a form of insurance. Hedgers are risk averters, in direct contrast to speculators who are risk takers. Actually, producers who do not forward contract in the cash market or offset their cash position in the futures market are in a very real sense speculators; producers who use the futures market to hedge are not. (An illustrative example is provided in Appendix 1.)

Fact 3.—The relationship between Maine cash prices and futures prices is relatively stable (see Table A and accompanying study.)

Fact 4.—An examination of the relationship between Maine futures prices and Maine cash prices demonstrates an excellent pattern of convergence as futures approach expiration (see Table B and accompanying study). This is a key criteria for a viable futures market.

Fact 5.—Although the evidence is not conclusive, the weight of historical studies suggest that speculators (risk assumers) actually tend to modify price fluctuations rather than exacerbate them. This would appear to be particularly true for a commodity such as potatoes, which is harvested during a short time span and then must be stored for gradual use throughout the season. Without speculative participation in such a situation, prices would be more likely to be excessively depressed during harvest time.

Fact 6.—Commodity futures markets are among the best examples of "perfect competition" in our economy. Such markets are highly efficient and, generally speaking, very beneficial to the economy.

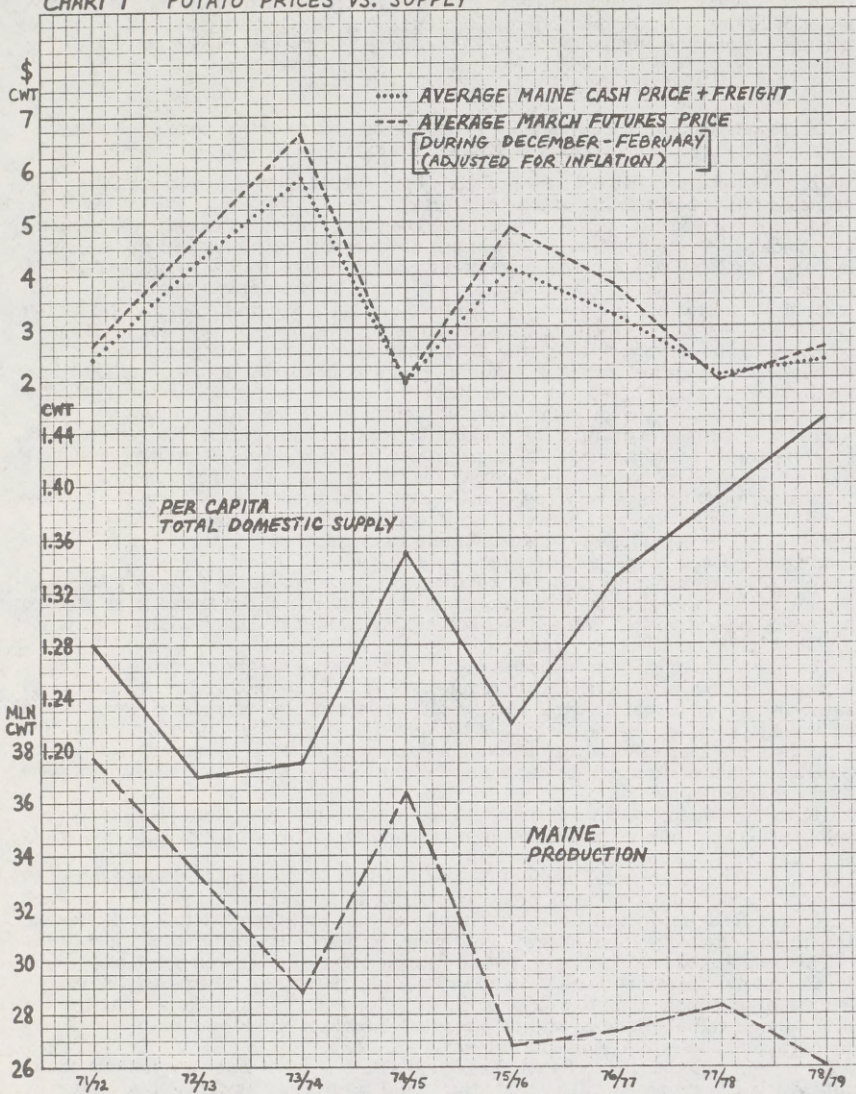
Fact 7.—The commercial users of futures markets in the United States tend to be among the most efficient and productive in their respective industries. For these producers, hedging in futures represents a key risk-management tool and is essential to the efficiency, productivity, and even the very survival of their operations.

The proposal to ban trading in potato futures is based on emotion not fact. There is absolutely no evidence that banning trading in potato futures would benefit (substantively rather than psychologically) those who favor such action. On the other hand, the abolition of the potato futures market would eliminate a business management tool which is useful to many.

As a final note, it should be emphasized that the issue at hand transcends potato futures. If the proposed bill is passed, it could pave the way for similar action in other futures markets. Such a trend would be a major step backwards, since commodity futures markets represent one of the most efficient segments of our economy. At a time when there is an ever growing consensus that the health of our economy depends upon measures aimed at increasing competition, it is ironic that a bill which, in essence, seeks to reduce competition is even being seriously considered.

¹The opinions expressed herein and in accompanying material, as well as those expressed verbally to this committee, are solely my own and should not be construed in any way as representing the opinion of Smith, Barney, Harris, Upham & Co.

CHART 1 POTATO PRICES VS. SUPPLY



APPENDIX 1

EXAMPLE: THE GROWER'S HEDGE

It is July, and a Maine grower expects he will harvest approximately 20,000 cwt of potatoes. The prevailing price of March futures is \$9.00/cwt. The price of futures includes freight to New York which equals approximately \$2.00/cwt. Thus the implied return to the grower is approximately \$7.00/cwt. The Maine potato grower estimates his cost at approximately \$5.00/cwt. Thus, by selling March futures he can lock in a net profit of about \$40,000. He cannot sell his crop in the cash market because it is not yet harvested. If the producer chooses to wait until the crop is harvested, in effect, he is speculating on the price trend until harvest and during the marketing season. He could make an even larger profit if prices during the marketing period exceed the current futures price (adjusted for freight). On the other hand, if prices moved lower his profits could be reduced, or even totally eradicated. In summary, the producer who uses futures chooses to lock in an approximate price rather than speculate on the future price trend.

TABLE A.—MAINE POTATOES: FUTURES ¹ AS AGAINST F.O.B. PLUS FREIGHT

[Futures premium (+); discount (-); in hundred weight]

Season	October	November	December	January	February	March	April
1970-71.....	-\$0.78	-\$0.41	-\$0.20	-\$0.23	-\$0.26	-\$0.12	+\$0.20
1970-72.....	-.11	+.16	+.28	+.35	+.22	+0	+.06
1970-73.....	-.37	+.32	+.96	+.32	+.42	+.44	+.93
1970-74.....	-.76	-.68	+1.55	+1.33	+.88	+1.21	+1.93
1970-75.....	+.12	+.16	+.22	-.05	-.04	+.07	+.15
1970-76.....	+.66	+.88	+1.72	+1.03	+1.38	+1.30	+1.63
1970-77.....	-.09	+1.23	+1.70	+.71	+.73	+1.66	+1.07
Average 1970-71 to 1976-77.....	-.19	+.24	+.89	+.49	+.48	+.65	+.85

¹ Average of monthly previous close, high, low, and close for nearest futures.

TABLE B.—FUTURES VERSUS CASH EQUIVALENT DURING LAST 5 TRADING DAYS

Contract	Average futures close during last 5 trading sessions	Maine f.o.b. during corresponding period	Freight	Maine f.o.b. plus freight	Futures versus f.o.b. plus freight (Futures premium (+); discount (-))
1972:					
November.....	3.96	3.18	0.98	4.16	-.020
1973:					
March.....	7.27	5.83	.98	6.81	+.47
April.....	6.86	5.88	.98	6.86	0
May.....	8.14	6.51	.98	7.49	+.65
November.....	6.01	5.14	1.00	6.14	-.13
1974:					
March.....	10.90	9.50	1.00	10.50	+.40
April.....	13.30	11.22	1.00	12.22	+1.08
May.....	14.86	12.00	1.00	13.00	+1.86
November.....	3.70	2.61	1.17	3.78	-.08
1975:					
March.....	2.96	1.90	1.17	3.07	-.11
April.....	2.90	1.73	1.17	2.90	0
May.....	4.22	2.60	1.17	3.77	+.45
November.....	6.36	4.95	1.34	6.29	+.07
1976:					
March.....	8.70	6.34	1.34	7.68	+1.02
April.....	8.66	6.75	1.34	8.09	+.57
May.....	9.25	6.95	1.34	8.29	+.96
November.....	5.30	3.55	1.49	5.04	+.26
1977:					
March.....	6.90	4.90	1.49	6.39	+.51
April.....	7.26	5.28	1.49	6.77	+.49

TABLE B.—FUTURES VERSUS CASH EQUIVALENT DURING LAST 5 TRADING DAYS—Continued

Contract	Average futures close during last 5 trading sessions	Maine f.o.b. during corresponding period	Freight	Maine f.o.b. plus freight	Futures versus f.o.b. plus freight (Futures premium (+); discount (-))
May	8.72	6.30	1.49	7.79	+ .93

[The following material was submitted by Mr. Schwager:]

POTATO FUTURES AS A HEDGING VEHICLE—A FEASIBILITY STUDY

SPECIAL NOTES

1. This study and the accompanying set of Tables were prepared two years ago to analyze the viability of potato futures as a hedging vehicle. Although this report was not directly prepared for this hearing, the subject matter is very relevant to the proposed bill.

2. At present, a revised futures contract, which permits delivery of nearly all fall harvested round white potatoes, has been submitted for CFTC approval.

The need for price protection

A grower who does not either forward contract in the cash market or hedge in futures (sell futures against expected production or existing stocks) is in a very real sense a speculator. In effect, he is long on his expected production or inventory without any offsetting position in cash or futures. Thus, he has no protection against any possible future price decline. In surplus seasons he could even find himself in the unenviable position of prices declining to below the cost of production. Furthermore, since potatoes are a perishable crop, the grower has only a limited time during which he can store his crop awaiting better prices.¹

Similarly, a processor who does not cover his forward requirements either through forward cash contracts or the purchase of futures, is also a speculator. In effect, such a processor is short potatoes, since he will have to purchase a given quantity of potatoes at a later date, at an unknown price, in order to keep his plant operating and meet forward marketing commitments. An unexpected price increase, prior to his actual purchase of the raw commodity, could result in negative profit margins (if he has forward contracted sales of his end product), or place him in a poor competitive position in the marketplace.

In summary, marketing tools which make it possible for the grower (or processor) to protect himself against possible adverse price movements are desirable, if not essential, in running an effective business.

Forward contracting, or hedging in futures, should really be thought of as another form of insurance.

Why use futures?

The grower or processor may well ask, "Why should I use futures at all when I can use cash forward contracting to protect against possible future adverse price moves?" Indeed, if a satisfactory cash contract can be transacted, there may well be no reason to use futures. However, there are three basic reasons why futures should, at least, be considered as part of a hedging program:

(1) It may not be possible to establish a forward contract, at desired prices, at the time the grower or processor wishes to do so. In such a case, futures can be used as an interim hedging vehicle until a satisfactory forward contract can be arranged. Even if the basis—difference between relevant cash price (e.g., Idaho F.O.B.) and futures—is subject to wide variations, an imperfect hedge may still be far better than no hedge at all.

(2) Even if it is possible to establish a forward contract, at times, futures may offer a significantly better hedging opportunity. For example, the approximate price a grower can lock-in by selling futures (after allowing for basis differences and distortions) may be substantially higher than the forward price offered by the processor—even though the latter may still assure him of a reasonable profit. Of course, at other times, forward cash contracting may offer the better hedging opportunity. The point is that both alternatives should be considered.

¹The months for which futures are traded directly conform to the peak marketing season.

(3) Futures allow far greater flexibility. To begin, since it is not necessary to find a specific buyer or seller, a position in futures can be initiated or offset on virtually any business day (the infrequent exception being days in which the futures market is locked limit-up or limit-down). In addition, a hedge in futures can easily be lifted and reinstated. For example, if following a sharp price decline, a grower who has sold futures as a hedge, decides that further downside risk is limited, he can buy in his short futures position, looking to reinstate the hedge sale on a possible rally. (Although he remains unhedged during the interim, we have assumed that prices have already declined to levels where additional downside risk is judged as very limited. Also, the hedge has already done a good part of its job through the profits generated on the short sale of futures, roughly offsetting the loss in potential cash sales). In a similar situation, a grower who had forward contracted his crop could not cancel his contract looking to establish a new contract on a possible price rebound.

Again, it should be emphasized that using futures for hedging is not speculating; on the contrary, not using futures (when forward cash contracting is not feasible) is speculating.

THE KEY PROBLEM

The key problem in using futures as a hedging vehicle in potatoes is that at present the only active futures contract is the Maine potato futures contract.² As a result of simultaneous trends of reduced production in Maine and sharply expanded output in the West, Maine now only accounts for approximately 10 percent of the total U.S. fall crop. This would not present a major problem if price relationships between Maine potatoes and potatoes in other areas were relatively stable. However, the lack of uniformity of the crop and the relative high cost of shipping potatoes to distant areas results in a wide range of price differences between Maine potatoes and potatoes in other areas. While for producers outside of Maine this situation presents a major problem in using futures for hedging, the problem is not insurmountable. In this study, we will take a close look at the relationship between futures and various key cash prices, in an attempt to evaluate the viability of using futures as a hedging vehicle.

MAINE CASH VERSUS FUTURES

A reasonable starting point is an examination of the relationship between Maine cash prices and futures. Table 1 lists the average monthly F.O.B. price for Maine potatoes during recent seasons. Table 2 adds the freight charge to these figures as the futures contract incorporates the cost of transportation.³ Table 3 lists the average monthly futures price. Table 4 indicates the difference between the average monthly futures prices in Table 3 and the average F.O.B. plus freight prices indicated in Table 2. As is readily apparent in even a surface glance at the table, with the exception of October, futures normally maintain a moderate premium to the equivalent cash price. The premium of the average nearest futures prices to cash is largely a consequence of the time differential between the expiration of futures and current cash prices. Since futures implicitly contain the additional cost and risk of storing potatoes for a period of time, they are likely to trade at a premium. A close parallel can be drawn to the normal spread structure of futures, in which more distant months invariably maintain a premium to nearby contracts.

Another more subtle observation possibly by examining Table 4 is that the premium of futures to cash tends to be wider in high-priced years.

Since potatoes are a perishable crop, largely harvested at one time, stored for later use, and totally consumed well before the next harvest, in seasons of short supply, the tightest situation will exist towards the tail-end of the marketing season. As a result, in high-priced years the more distant contracts will tend to expand their premiums to nearby futures and cash.

The differences between futures and cash indicated in Table 4 are relatively moderate in comparison to the overall range of price swings. In addition, the variation between futures and cash is subject to some relatively consistent patterns—normal premium of futures; wider premium in high-priced years.

A perhaps even more direct means of determining the viability of futures as a hedging vehicle is an examination of the convergence between cash and futures at expiration. This relationship is examined in Tables 5 and 6: Table 5 focuses on the

² A Western Russet Burbank potato contract is traded on the Chicago Mercantile Exchange; however, to date, volume and open interest have been extremely small. Consequently, this study will focus upon the Maine futures contract.

³ Freight allowance basis delivery to Harlem River Yards, N.Y.

last five trading sessions, while Table 6 examines the relationship on the last trading session. Overall, these two tables reflect a fairly reliable convergence of cash and futures towards expiration. Here, too, there appears to be a tendency for futures to reflect at least a modest premium over the theoretical equivalent cash price. The deviation between cash and futures towards expiration exceeded \$1.00 in only a few instances—all of them reflecting a premium of futures to cash and occurring in high-priced years.

Basis the tables presented in this section, it appears the relationship between cash and futures is sufficiently consistent to suggest futures can be used as an effective hedging vehicle for producers and users of Maine round white potatoes. The tables allow for a relatively close approximation of the expected basis between futures and cash. It is always prudent in hedging to assume the basis will be adverse to one's position.

An example may help to clarify the various considerations discussed so far: After considering production costs and evaluating the likely price outlook for the season (basis known fundamental information—e.g., intentions, acreage estimates, etc.) a grower of Maine round white potatoes decides he wishes to lock in an F.O.B. price of \$6.00–\$7.00 for potatoes he plans to market during the February/March period. Assume the freight rate for a given season is \$1.60. Examining Tables 4, 5, and 6, it appears that futures during that period can be expected to maintain a premium of roughly \$.50 to the equivalent cash price. Deviations in excess of \$1.00 have been witnessed and should be allowed for in high-priced seasons. To be prudent, the grower may assume a premium of \$.75 of March over cash; if a high-priced season were anticipated, he should allow for a wider premium—e.g., \$1.25 (Our example focuses on the producer; a buy hedger should assume a price relationship adverse to him—e.g. cash and futures will be approximately equal at the time of his cash purchase). To lock in to the desired goal price of \$6.00–\$7.00, the producer in our example would place hedge sales of March futures in the \$8.35–\$9.35 area. How is this number obtained? The hedge sale price range (\$8.35–\$9.35) = the desired F.O.B. price (\$6.00–\$7.00) + freight (\$1.60) + assumed premium of futures to cash (\$.75).

What happens if March futures eventually climb to \$11.00? In this instance the grower will lose \$2.15 per cwt. on his total futures position (difference between \$11.00 and mid-point of \$8.35–\$9.35); however, the price he will receive from his cash potatoes should average roughly \$8.50, or about \$2.00 above his original price objective. While with the benefit of hindsight the grower would have been best off doing nothing in futures, it is critical to realize that the hedge in futures is aimed at locking in an approximate profit. Or put it another way, the hedge in futures provides price protection against a subsequent price drop prior to marketing. For example, if instead of rising to \$11.00, futures declined to \$5.00 and cash to approximately \$3.00, the grower will still have locked in an approximate \$6.00–\$7.00 F.O.B. price—the gain in futures will roughly offset the loss in cash sales.

In summary, for producers and users of Maine round white potatoes, the Maine futures contract appears to offer an effective, reliable hedging vehicle.

OTHER EASTERN CASH PRICES VERSUS MAINE CASH PRICES

Because they are in very direct competition with Maine potatoes, cash prices for other Eastern potatoes are very closely correlated to Maine cash prices. The average monthly F.O.B. prices for Long Island potatoes and New York Upstate potatoes are summarized in Tables 7 and 9, respectively. The comparison between these cash price series and Maine cash prices is contained in Tables 8 and 10.

As clearly indicated in these tables, average price differences between Long Island and Maine and Upstate and Maine are confined to a relatively narrow range. Devising a hedging program for potatoes from these areas requires an additional step: One must estimate the expected price difference between cash prices in these areas and Maine cash prices. Once this is done, the hedging procedure would be similar to that described in the previous section.

Returning to Tables 8 and 10, note that both Long Island and Upstate potatoes seem to invariably trade at a premium to Maine potatoes. The premium of Long Island to Maine seems to be largely concentrated in the \$.75–\$1.25 area while the premium of Upstate to Maine is largely concentrated in the \$.90–\$1.75 area. Again, to be prudent, the hedger should assume a disadvantageous price difference. For example, a Long Island potato grower using futures for hedging might assume Long Island cash prices will only exceed Maine prices by \$.75.

Once the producer has made an assumption regarding the relationship between his cash price and Maine, the decision-making process is the same as for a Maine grower.

Example: Long Island producer: Assumes \$.75 premium of Long Island cash to Maine cash; assumes premium of Futures to Maine cash—\$.75; Price objective—\$7.00 F.O.B.; freight rate implicit in futures—\$1.60. In this case, the producer would sell futures at approximately \$8.60.

This price is derived as follows: Price of hedge sale (\$8.60)=desired F.O.B. price (\$7.00)+expected premium of futures to Maine cash (\$.75)+freight (\$1.60)—expected premium of Long Island cash to Maine cash (\$.75).

While the use of Maine futures for hedging Long Island and New York Upstate potatoes involves an added complication, the close cash price relationship between these areas and Maine as vividly reflected in Tables 8 and 10 strongly suggests the viability of using Maine futures to hedge potatoes from these areas.

CENTRAL CASH PRICES VERSUS MAINE CASH PRICES

The two price areas we focus on in this section are Red River Valley round red prices and Wisconsin Russet Burbank prices. The variation between Red River Valley prices and Maine prices is quite substantial. As indicated in Table 12, average monthly F.O.B. prices have ranged from a Red River Valley premium of \$2.00 to a discount of \$2.57. However, price differences seem largely concentrated in the area of \$1.00 premium Red River Valley to \$1.00 discount.

Wisconsin Russet Burbank potatoes tend to maintain a premium to Maine cash prices but, on an average monthly basis, price differences have ranged from a premium of \$3.26 to a discount of \$.50. Primarily, Wisconsin cash prices have ranged between \$.50–\$2.50 premium to Maine cash prices.

The wider variation between Central cash prices and Maine cash prices significantly reduces the effectiveness of using Maine futures as a hedging vehicle. Nevertheless, as long as a hedger is careful to allow for an adverse price difference, futures can still be used for hedging. For example, a Red River Valley producer could assume that prices in his area will average \$2.00 below Maine cash prices, a difference near the extreme of the recent historical range. Such an assumption would significantly limit hedging opportunities but would at least offer reasonable assurance to the producer of roughly locking in his price objective. An example is provided below:

Example: A Red River Valley producer wishes to lock in a price of \$6.00; freight cost implicit in futures equals \$1.60; assumes futures premium over Maine cash will equal \$1.75; assumes \$2.00 discount of Red River Valley cash to Maine cash. In this case, the grower would look to initiate hedge sales at around \$10.30. This is obtained as follows: Futures hedge sale (\$10.30)=desired cash price (\$6.00)+assumed discount of Red River Valley F.O.B. to Maine F.O.B. (\$2.00)+assumed premium of futures to Maine cash (\$.75)+freight (\$1.60).

Note that by using this conservative approach, the producer aiming for a \$6.00 cash price return does not place his hedge until futures reach \$10.30. Of course, this is a very conservative approach as we have used a relatively extreme assumption regarding the price relationship between Red River Valley prices and Maine. A producer willing to accept more risk resulting from an adverse movement of Red River Valley prices relative to Maine prices, in order to increase the chances of placing the hedge, could place the hedge significantly lower. Also, in the instance of Red River Valley potatoes, note that the extreme discount relative to Maine prices occurred in April. Thus, a reasonable extreme assumption prior to that time would be that Red River Valley potatoes would witness an average discount of \$1.00 to Maine potatoes. The key point is that producers should specify the assumptions underlying a hedge and understand their implications prior to initiating the hedge.

WESTERN CASH PRICES VERSUS MAINE CASH PRICES

Average monthly F.O.B. prices for Idaho and Washington Russet Burbank potatoes are summarized in Tables 15 and 17, respectively. The relationship between these two cash price series and Maine cash potatoes are indicated in tables 16 and 18. Table 16 indicates that Idaho cash prices almost invariably maintain a premium to Maine cash prices. This premium seems largely concentrated in the \$1.00–\$2.50 area. Once again, hedgers should assume an adverse price difference to maximize the likelihood that the hedge will at least roughly lock in the intended price objective. For example, although the premium of Idaho potatoes over Maine potatoes tends to average near \$1.75, to be conservative, an Idaho grower could assume the premium will only be about \$1.00. A processor, on the other hand, might assume the premium will be \$2.50.

Table 18 indicates that Washington potatoes normally maintain a premium over Maine potatoes, although significant discounts occasionally occur. Prices for Wash-

ington potatoes are generally contained within a \$.50 discount to a \$1.50 premium to Maine prices.

CASH PRICES IN OTHER AREAS

The previous sections have reviewed the relationship between key cash prices across the country versus Maine cash prices. Even hedgers from areas which were covered may be concerned with different varieties, grade or packaging specifications than those specified for the price series examined in that area. Such hedgers will have to first determine the normal range of price differences between the potato cash series they are concerned with and the most closely related series covered in the preceding sections. Thus, the procedure would be as follows:

1. Determine price relationship between the potatoes they are concerned with and most closely related price series.
2. Determine relationship between most closely related cash price covered in preceding tables and Maine cash price.
3. Determine normal relationship between Maine cash and futures for anticipated marketing period.

If conservative assumptions regarding price differences are made, the use of Maine futures for hedging is still quite feasible. Admittedly, if this conservative approach is employed, potential hedging opportunities may be significantly limited. Nevertheless, there would still be occasions where futures may offer an attractive hedging opportunity. The key point is that all the alternatives should be considered.

TABLE 1

MAINE POTATOES: AVERAGE F.O.B. PRICE*
(\$/cwt.)

<u>Season</u>	<u>Oct.</u>	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	<u>Apr.</u>	<u>May</u>
1970/71	2.50	2.12	1.92	2.00	1.98	1.98	2.18	3.20
1971/72	1.92	1.80	1.86	1.92	1.88	1.82	1.76	1.76
1972/73	3.24	3.22	3.60	4.40	4.96	5.86	6.04	7.08
1973/74	5.44	5.48	5.68	7.60	9.40	9.90	12.10	11.64
1974/75	2.76	2.56	2.38	2.22	2.00	1.68	2.22	3.36
1975/76	5.16	4.66	4.66	6.98	6.52	6.60	6.74	7.16
1976/77	3.60	3.52	3.70	5.08	4.98	4.86	6.34	7.16

* Aroostook County, Round Whites, 50 lb. sack, unwashed, U.S. No. 1, Size A, 2" minimum (prices converted to cwt. basis).

TABLE 2

MAINE POTATOES: F.O.B. PLUS FREIGHT *

<u>Season</u>	<u>Oct.</u>	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	<u>April</u>
1970/71	\$3.40	\$3.02	\$2.82	\$2.90	\$ 2.88	\$ 2.88	\$ 3.08
1971/72	2.82	2.70	2.76	2.82	2.78	2.72	2.66
1972/73	4.22	4.20	4.58	5.38	5.94	6.84	7.02
1973/74	6.44	6.48	6.68	8.60	10.40	10.90	13.10
1974/75	3.93	3.73	3.55	3.39	3.17	2.85	3.39
1975/76	6.50	6.00	6.00	8.32	7.86	7.94	8.08
1976/77	5.09	5.01	5.19	6.57	6.47	6.35	7.83

* 1970/71 - \$.90; 1971/72 - \$.90; 1972/73 - \$.98; 1973/74 - \$1.00; 1974/75 - \$1.17; 1975/76 - \$1.34; 1976/77 - \$1.49.

TABLE 3

MAINE POTATO FUTURES: MONTHLY AVERAGE OF NEAREST FUTURES *
(\$/cwt.)

<u>Season</u>	<u>Oct.</u>	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	<u>Apr.</u>
1970/71	2.62	2.61	2.62	2.67	2.62	2.76	3.28
1971/72	2.71	2.86	3.04	3.17	3.00	2.72	2.72
1972/73	3.85	4.52	5.54	5.70	6.36	7.28	7.95
1973/74	5.68	5.80	8.23	9.93	11.28	12.11	15.03
1974/75	4.05	3.89	3.77	3.34	3.13	2.92	3.54
1975/76	7.16	6.88	7.72	9.35	9.24	9.24	9.71
1976/77	5.00	6.24	6.89	7.28	7.20	8.01	8.80

* Average of monthly previous close, high, low and close.

TABLE 4

MAINE POTATOES: FUTURES*vs. F.O.B. + FREIGHT

(futures premium (+); discount (-))
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
1970/71	-\$.78	-\$.41	-\$.20	-\$.23	-\$.26	-\$.12	+\$.20
1971/72	- .11	+ .16	+ .28	+ .35	+ .22	-0-	+ .06
1972/73	- .37	+ .32	+ .96	+ .32	+ .42	+ .44	+ .93
1973/74	- .76	- .68	+ 1.55	+ 1.33	+ .88	+ 1.21	+ 1.93
1974/75	+ .12	+ .16	+ .22	- .05	- .04	+ .07	+ .15
1975/76	+ .66	+ .88	+ 1.72	+ 1.03	+ 1.38	+ 1.30	+ 1.63
1976/77	- .09	+ 1.23	+ 1.70	+ .71	+ .73	+ 1.66	+ 1.07
Average 1970/71-76/77	- .19	+ .24	+ .89	+ .49	+ .48	+ .65	+ .85

* Average of monthly previous close, high, low, and close for nearest futures

TABLE 5

FUTURES vs. CASH EQUIVALENT
DURING LAST FIVE TRADING DAYS

Contract	Average Futures Close During Last 5 Trading Sessions	Maine F.O.B. During Cor- responding Period	Freight	Maine F.O.B. Plus Freight	Futures vs. F.O.B. Plus Freight (Futures Premium (+); Discount (-))
Nov. 1972	3.96	3.18	.98	4.16	- .20
Mar. 1973	7.27	5.83	.98	6.81	+ .47
Apr. 1973	6.86	5.88	.98	6.86	-0-
May 1973	8.14	6.51	.98	7.49	+ .65
Nov. 1973	6.01	5.14	1.00	6.14	- .13
Mar. 1974	10.90	9.50	1.00	10.50	+ .40
Apr. 1974	13.30	11.22	1.00	12.22	+ 1.08
May 1974	14.86	12.00	1.00	13.00	+ 1.86
Nov. 1974	3.70	2.61	1.17	3.78	- .08
Mar. 1975	2.96	1.90	1.17	3.07	- .11
Apr. 1975	2.90	1.73	1.17	2.90	-0-
May 1975	4.22	2.60	1.17	3.77	+ .45
Nov. 1975	6.36	4.95	1.34	6.29	+ .07
Mar. 1976	8.70	6.34	1.34	7.68	+ 1.02
Apr. 1976	8.66	6.75	1.34	8.09	+ .57
May. 1976	9.25	6.95	1.34	8.29	+ .96
Nov. 1976	5.30	3.55	1.49	5.04	+ .26
Mar. 1977	6.90	4.90	1.49	6.39	+ .51
Apr. 1977	7.26	5.28	1.49	6.77	+ .49
May 1977	8.72	6.30	1.49	7.79	+ .93

TABLE 6
FUTURES vs. CASH EQUIVALENT ON LAST TRADING DAY

Contract	Midpoint of Futures Range During Last Trading Day	Maine F.O.B. Price or Corresponding Day	Freight	Maine F.O.B. Plus Freight	Futures vs. Maine F.O.B. Plus Freight (Futures Premium (+); Discount (-))
Nov. 1972	4.00	3.15	.98	4.13	- .13
Mar. 1973	7.43	5.85	.98	6.83	+ .60
Apr. 1973	6.62	5.85	.98	6.83	- .21
May 1973	8.20	6.50	.98	7.48	+ .72
Nov. 1973	6.09	5.25	1.00	6.25	- .16
Mar. 1974	10.67	9.45	1.00	10.45	+ .22
Apr. 1974	14.72	12.00	1.00	13.00	+ 1.72
May 1974	15.82	12.20	1.00	13.20	+ 2.62
Nov. 1974	3.88	2.60	1.17	3.77	+ .11
Mar. 1975	2.75	1.90	1.17	3.07	- .32
Apr. 1975	3.08	1.95	1.17	3.12	- .04
May 1975	4.37	2.75	1.17	3.92	+ .45
Nov. 1975	6.45	4.95	1.34	6.29	+ .16
Mar. 1976	8.84	6.50	1.34	7.84	+ 1.00
Apr. 1976	7.94	6.60	1.34	7.94	-0-
May 1976	9.90	7.40	1.34	8.74	+ 1.16
Nov. 1976	5.53	3.55	1.49	5.04	+ .49
Mar. 1977	6.57	5.50	1.49	6.99	- .42
Apr. 1977	5.30	5.85	1.49	7.34	+ .96
May 1977	8.26	6.25	1.49	7.74	+ .52

TABLE 7

N.Y. - L.I. POTATOES: AVERAGE F.O.B. PRICES*
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
1970/71	2.84	2.86	2.80	2.98	2.94	2.84
1971/72	2.78	2.72	2.60	2.72	2.68	2.78
1972/73	4.14	4.38	4.56	5.30	5.62	6.72
1973/74	6.52	6.78	6.92	8.46	10.52	10.72
1974/75	3.84	3.60	3.56	3.24	3.12	2.96
1975/76	6.58	5.82	5.80	7.50	7.28	7.00
1976/77	4.22	4.50	4.60	6.10	6.00	6.00

* Round Whites, 50 lb. sack, U.S. No. 1, Size A, 2" minimum mostly washed (all prices converted to cwt. basis).

TABLE 8

N.Y. - L.I. vs. MAINE: AVERAGE F.O.B. PRICES
(N.Y. - L.I. Premium (+); discount (-))
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Season Average
1970/71	+ .34	+ .74	+ .88	+ .98	+ .96	+ .86	+ .79
1971/72	+ .86	+ .92	+ .74	+ .80	+ .80	+ .96	+ .85
1972/73	+ .90	+ 1.16	+ .96	+ .90	+ .66	+ .86	+ .91
1973/74	+ 1.08	+ 1.30	+ 1.24	+ .86	+ 1.12	+ .82	+ 1.07
1974/75	+ 1.08	+ 1.04	+ 1.18	+ 1.02	+ 1.12	+ 1.28	+ 1.12
1975/76	+ 1.42	+ 1.16	+ 1.14	+ .52	+ .76	+ .40	+ .90
1976/77	+ .62	+ .98	+ .90	+ 1.02	+ 1.02	+ 1.14	+ .95
Average 1970/71-76/77	+ .90	+ 1.04	+ 1.01	+ .87	+ .92	+ .90	+ .94

TABLE 9

N.Y. - UPSTATE POTATOES: AVERAGE F.O.B. PRICES*
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
1970/71	2.80	2.84	2.78	2.90	2.90	2.84	3.16
1971/72	3.02	3.04	3.02	2.92	2.94	2.96	3.06
1972/73	4.62	4.76	4.80	N.A.	7.28	7.56	7.84
1973/74	6.52	6.66	6.92	8.70	10.66	11.12	13.50
1974/75	3.76	3.66	3.44	3.36	3.28	3.12	3.14
1975/76	6.98	6.30	6.38	8.40	8.38	8.10	8.38
1976/77	N.A.	4.96	5.18	6.48	6.74	6.82	8.62

* Western and Central New York, Round Whites, 50 lb. sack, U.S. No. 1, Size A, washed (all prices converted to cwt. basis).

N.A. = Not available.

TABLE 10

N.Y. - UPSTATE vs. MAINE: AVERAGE F.O.B. PRICES
(N.Y. - Upstate premium (+); discount (-))
(\$/ cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	Season Average
1970/71	+ .30	+ .72	+ .86	+ .90	+ .92	+ .86	+ .98	+ .79
1971/72	+ 1.10	+ 1.24	+ 1.16	+ 1.00	+ 1.06	+ 1.14	+ 1.30	+ 1.14
1972/73	+ 1.38	+ 1.54	+ 1.20	N.A.	+ 2.32	+ 1.70	+ 1.80	+ 1.66
1973/74	+ 1.08	+ 1.18	+ 1.24	+ 1.10	+ 1.26	+ 1.22	+ 1.40	+ 1.21
1974/75	+ 1.00	+ 1.10	+ 1.06	+ 1.14	+ 1.28	+ 1.44	+ .92	+ 1.13
1975/76	+ 1.82	+ 1.64	+ 1.72	+ 1.42	+ 1.86	+ 1.50	+ 1.64	+ 1.66
1976/77	N.A.	+ 1.44	+ 1.48	+ 1.40	+ 1.76	+ 1.96	+ 2.28	+ 1.72
Average 1970/71-76/77	+ 1.11	+ 1.27	+ 1.25	+ 1.16	+ 1.49	+ 1.40	+ 1.47	+ 1.33

TABLE 11

NORTH DAKOTA-MINNESOTA -- AVERAGE F.O.B. PRICES*
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
1972/73	3.41	3.33	3.21	4.71	4.70	4.80	5.40
1973/74	4.62	4.88	4.91	6.72	8.44	9.30	9.53
1974/75	4.82	3.78	3.08	3.16	2.99	2.52	2.38
1975/76	5.99	5.54	5.23	6.11	6.32	5.91	6.10
1976/77	3.77	3.37	3.21	3.93	4.94	4.36	4.47

*

Red River Valley, Round Reds, 100 lb. sack, washed, U.S. No. 1, Size A.

NOTE: Price data for this series not available prior to 1972/73.

TABLE 12

NORTH DAKOTA/MINNESOTA (RED RIVER VALLEY)* vs. MAINE **: AVERAGE F.O.B. PRICES
(Red River Valley premium (+); discount (-))
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
1972/73	+\$.17	+\$.22	-\$.39	+\$.31	-\$.26	-\$1.06	-\$.64
1973/74	- .82	- .60	- .77	- .88	+ .96	- .60	- 2.57
1974/75	+ 2.00	+ 1.22	+ .70	+ .94	+ .99	+ .84	+ .16
1975/76	+ .83	+ .88	+ .57	- .87	- .20	- .69	- .64
1976/77	+ .17	- .15	- .49	- 1.15	- .04	- .50	- 1.87
Average							
1972/73 to 1976/77	+ .47	+ .29	- .08	- .33	+ .29	- .40	- 1.11

* Red River Valley, Round Reds, 100 lb. sack, washed, U.S. No. 1, Size A.

** Aroostook County, Round Whites, 50 lb. sack, unwashed, U.S. No. 1, Size A,
2" minimum (all prices converted to cwt. basis).

NOTE: Price data for this series not available prior to 1972/73.

TABLE 13

WISCONSIN POTATOES: AVERAGE F.O.B. PRICES*

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
1970/71	2.75	2.74	2.72	2.89	2.84	2.66
1971/72	2.57	2.86	2.88	2.88	2.88	2.80
1972/73	3.68	4.12	4.12	4.64	4.80	5.36
1973/74	6.11	6.39	6.62	8.11	10.49	10.77
1974/75	6.02	5.52	4.72	4.22	3.62	3.12
1975/76	6.81	6.88	6.78	6.89	7.22	7.23
1976/77	4.27	4.26	4.38	5.34	5.83	5.88

* Central and North Central Wisconsin, Russet Burbanks, 100 lb. sack, washed, U.S. No. 1, Size A.

TABLE 14

WISCONSIN vs. MAINE: AVERAGE F.O.B. PRICES
(Wisconsin premium (+); discount (-))

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
1970/71	+ .25	+ .62	+ .80	+ .89	+ .86	+ .68
1971/72	+ .65	+ 1.06	+ 1.02	+ .96	+ 1.00	+ .98
1972/73	+ .44	+ .90	+ .52	+ .24	- .16	- .50
1973/74	+ .77	+ .91	+ .94	+ .51	+ 1.09	+ .87
1974/75	+ 3.26	+ 2.96	+ 2.34	+ 2.00	+ 1.62	+ 1.46
1975/76	+ 1.65	+ 2.22	+ 2.12	- .09	+ .70	+ .63
1976/77	+ .67	+ .74	+ .68	+ .26	+ .85	+ 1.02
Average 1970/71-1976/77	+ 1.10	+ 1.34	+ 1.20	+ .68	+ .85	+ .73

TABLE 15

IDAHO POTATOES: AVERAGE F.O.B. PRICE*
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May
1970/71	3.39	3.29	3.14	3.21	2.96	2.96	3.02	3.92
1971/72	3.32	3.71	3.53	3.57	3.32	3.14	3.37	3.67
1972/73	4.52	4.82	4.90	5.43	5.60	6.50	6.77	9.09
1973/74	7.05	7.39	7.20	9.38	11.84	11.42	12.97	--
1974/75*	6.41	5.84	5.76	5.55	4.70	4.35	6.47	6.17
1975/76*	7.76	6.70	6.02	6.96	8.17	8.14	7.64	8.35
1976/77*	5.16	5.02	5.00	5.76	6.57	6.21	7.04	8.85

* Upper Valley -- Twin Falls -- Burley, Russet Burbanks, U.S. No. 1, Size A, washed, 2", or 4 oz. minimum; 1970/71 - 1973/74 -- 100 lb. sack; 1974/75 - 1976/77 -- baled, 10 lb. sack, non-size A (all prices cwt. basis).

TABLE 16

IDAHO vs. MAINE: AVERAGE F.O.B. PRICE
(Idaho premium (+); discount (-))
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May
1970/71	+ .89	+ 1.17	+ 1.22	+ 1.21	+ .98	+ .98	+ .86	+ .72
1971/72	+ 1.41	+ 1.91	+ 1.67	+ 1.65	+ 1.44	+ 1.32	+ 1.61	+ 1.91
1972/73	+ 1.28	+ 1.60	+ 1.30	+ 1.03	+ .64	+ .64	+ .73	+ 2.01
1973/74	+ 1.61	+ 1.91	+ 1.52	+ 2.28	+ 2.44	+ 1.52	+ .87	--
1974/75	+ 3.65	+ 3.28	+ 3.38	+ 3.33	+ 2.70	+ 2.67	+ 4.25	+ 2.81
1975/76	+ 2.60	+ 2.04	+ 1.36	- 0.02	+ 1.65	+ 1.54	+ .90	+ 1.19
1976/77	+ 1.56	+ 1.50	+ 1.30	+ .68	+ 1.59	+ 1.35	+ .70	+ 1.69
Average 1970/71 to 1976/77	+ 1.86	+ 1.92	+ 1.68	+ 1.45	+ 1.63	+ 1.43	+ 1.42	+ 1.72

TABLE 17

WASHINGTON POTATOES: AVERAGE F.O.B. PRICE*
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
1970/71	2.74	2.76	2.76	2.74	2.63	2.58	N.A.
1971/72	2.92	3.72	N.A.	N.A.	N.A.	N.A.	N.A.
1972/73	3.84	4.27	4.02	4.33	4.28	5.28	N.A.
1973/74	6.23	7.10	7.08	7.82	9.41	11.16	13.54
1974/75	5.29	5.04	4.88	4.39	3.75	3.80	4.15
1975/76	5.78	5.50	4.79	5.27	5.85	6.12	5.94
1976/77	3.93	3.93	4.18	4.44	4.51	4.50	5.03

* Yakima Valley - Columbia Basin Area, Russet Burbank, washed U.S. No. 1, 2" or 4 oz. minimum; 1970/71 - 1973/74 -- 100 lb. sack, Size A; 1974/75 - 1976/77 -- baled 10 lb. bags non-Size A (all prices cwt. basis).

N.A. = Not available.

TABLE 18

WASHINGTON * vs. MAINE **: AVERAGE F.O.B. PRICES
(Washington premium (+); discount (-))
(\$/cwt.)

Season	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	April
1970/71	+\$.24	+\$.64	+\$.84	+\$.74	+\$.65	+\$.60	N.A.
1971/72	+ 1.00	+ 1.92	N. A.	N.A.	N.A.	N.A.	N.A.
1972/73	+ .60	+ 1.05	+ .42	- .07	- .68	- .58	N.A.
1973/74	+ .79	+ 1.62	+ 1.40	+ .22	+ .01	+ 1.26	+\$1.44
1974/75	+ 2.53	+ 2.48	+ 2.50	+ 2.17	+ 1.75	+ 2.12	+ 1.93
1975/76	+ .62	+ .84	+ .13	- 1.71	- .67	- .48	- .80
1976/77	+ .33	+ .41	+ .48	- .64	- .47	- .36	- 1.31
Average 1970/71 to 1976/77	+\$.87	+ 1.28	+ .96	+ .12	+ .10	+ .43	+ .32

* Yakima Valley - Columbia Basin Area, Russet Burbank, washed U.S. No. 1, 2" or 4 oz. minimum; 1970/71 - 1973/74 -- 100 lb. sack, Size A; 1974/75 - 1976/77 -- baled 10 lb. bags non-Size A (all prices cwt. basis).

** Arcostock County, Round Whites, 50 lb. sack, unwashed, U.S. No. 1, Size A, 2" minimum (all prices converted to cwt. basis).

N.A. = Not available.

STATEMENT OF GLENN WILLETT CLARK, GLENN WILLETT CLARK ASSOCIATES

Mr. Chairman, Distinguished Members of the Committee: I am Glenn Willett Clark, an Idaho farm boy who passed directly from the chores of irrigating oats, alfalfa, and row crops to the tender mercies of those who teach economics at Harvard College and government regulation of business at the Yale Law School. In time I became, in turn, an energy resource and securities and commodities lawyer, a law professor specializing in the development of energy resources at a Western law school and in government regulation of financial institutions and commodities markets at a Midwestern law school. I have been also a state securities commissioner in Iowa, and a federal government lawyer and private economic consultant working with public finance, securities markets, energy resources, agribusiness, and futures market problems. I appear here in a dual capacity: as an unaffiliated expert observer of futures markets, and as a representative of a small Midwestern firm formed to develop a technologically innovative solution to problems of both producing, pricing, and utilizing farm-produced energy to produce food.

From this perspective, which combines practical experience, sometime governmental responsibility, and a wide theoretical knowledge and understanding, I believe I can offer you both an unbiased and informed view of the quandary faced by the potato growers of my native state. I would hope I can still be numbered among them. Our shared experiences are deep and profound. My great-grandfather, under direct assignment from the great colonizer Brigham Young, whose followers established the agricultural communities of the Upper Snake River Valley, founded the Idaho hamlet in which I came to maturity. I do understand, as allegedly the buyers and sellers of paper potatoes do not, what backbreaking effort goes into the culture of row crops, and what utter dependence and helplessness the producer feels as he asks, at harvest time, "What will the price be?" The producer knows he can't dictate that price. He must accept what's given—but to say that is only to say that a perfectly competitive market, in the economist's theoretical terms, reigns supreme here.

The futures market is also a competitive market, a market for prices rather than goods. Largely impersonal forces determine the prices discovered there. The great utility of the futures market, for the producer who is properly counseled as to the techniques of its use, is that it makes available, at planting time, an opportunity to secure the extraordinarily stable predicted harvest-time price anticipated at planting. Instead of waiting to sell harvested potatoes, the farmer can, alternatively, sell cash potatoes forward, or can sell futures at planting time. If he does either, he will likely not be stung by the price-depressing consequences of a bumper crop as it develops generally. He also forgoes the occasional sizeable windfall profit arising from the happy circumstance that the potato crop fails elsewhere, but is normal on his own acreage.

Credible evidence suggests that in past decades a great many farmers located all over the map each produced a small acreage of potatoes on cash speculation. If the harvest-time price wasn't satisfactory, which it often wasn't, the spuds became fertilizer or livestock feed. If the price was something between good and great, the family's Christmas fund was happily multiplied many times over.

A wartime government price support program, whose dubious virtues I will not further discuss here, changed all this. Potato culture became largely an agricultural monoculture, meaning that a few potato growers, favorably situated in Maine, in Colorado, in Michigan, in the Red River Valley of the North, and on the Snake River Plain, grew nearly all our country's potatoes, and often grew nothing other than potatoes. Producing on a cash market speculation was no longer acceptable. Now even a minute price level shift can lead to a great reward—or to terminal ruin. During the reign of King Subsidy the CCC was the buyer of last resort, and the price was only artificially adequate.

With the return of free market conditions, the risks borne by the professional potato grower would have been quite impossible to bear except over a rather long haul by an extremely well capitalized producer. Some form of forward pricing became a necessity. A large share of Idaho potatoes today are grown on forward contract for processors—but the quoted forward price is not unrelated to the futures price.

Forward contracting was and is a rational response to a pervasive problem. It may well be that an average farmer can not improve on this solution. I do hold the view that skilled use of the tool of futures trading could even more effectively secure favorable forward prices and facilitate quick reversion to the cash potato market at such time, during the growing season, as it came to appear that the harvest would not be over-abundant—with its attendant price-depressing effect.

The wisdom of working farmers in not having recourse to futures trading in preference to cash forward contracting, however, I do understand and respect. They know their business, and their skills, better than I do, and better than any futures broker or bureaucrat ever will. If the potato grower is not, in addition to and independent of his farming skills, also skilled in playing games with price fluctuations, and skilled in arbitrage, that is, in simultaneously buying in a market where a price is temporarily too low and selling in a market where a price is temporarily too high, he may well be best advised to tend to the business he does know and understand. He accordingly restricts his activity to the culture of potatoes, relying exclusively on forward contracting for the only forward price assurances that are readily available to him locally in the farm communities of Idaho. Access to competent counsel on the use of futures is, for a variety of reasons, more widely available, and more widely utilized, in Iowa.

I think it obvious that potato middlemen and processors who might be prepared to buy on forward contracts (including many who are also producers, but whose major economic interest is, frankly, mercantile, who have an interest in buying from other producers at a low price and in selling to processors at a high price) will demand and receive an assured risk premium in connection with their forward contracting. The relatively greater aggregate return to bona fide producers that the futures trading system makes available derives from the fact that the speculators in the futures markets do not receive, up front, that same very adequate assured cut. Professional futures traders, rather, often suffer losses in the aggregate, some of which are reflected as gains to hedging potato growers. Potato shippers, the initial middlemen, do not speak from the same platform of interest as bona fide producers, qua producers. Shippers are entitled to advocate their interest—which would be to destroy every futures market, because futures markets can inform both the producer and consumer publics that the middleman's cut is greater than is the return to professional futures traders. Either the cash middleman or the professional futures trader could perform the function, pure risk-bearing, of giving assurances to producers that a targeted per/unit return will be realized. Why not employ the forward price assurance system that taxes both producers and consumers least in terms of the middleman's take?

I do not wish to make an extravagant or unrealistic claim for the workings of futures markets. At one time, with respect to onions, the best available evidence, as interpreted by brilliant academic specialists in futures, particularly Dr. Roger Gray, was that the workings of the onion futures trading system improved price stability during the crop year. That is, during the period before onion futures trading came into being, and again after it was unfortunately outlawed, onion price instability during the crop year was more exaggerated. More recent evidence, as interpreted by Dr. Aaron Johnson, is ambivalent. I do not join this argument. Nothing significant, in my judgment, depends on the outcome. My point is quite another. Futures trading in either onions or potatoes is justifiable even if price stability of the whole crop were not thereby enhanced over the crop year.

An adequate justification for futures trading in a free society of free men is given by the simple consideration that an individual grower, shipper, merchant, or processor who very privately (correctly) anticipated given price movement, when the rest of the world did not, should not be subjected to the indignity, nay, the moral outrage upon free agency, that occurs when the market opportunity to realize profit from that perception, which a free enterprise system is willing to provide, is taken away by government fiat. Should the pretentiously all-wise federal government presume to take away that free agency in many more markets, large numbers of producers and merchants will join in the complaint of the merchant quoted by Dr. Gray, whose product had no futures market:

"What a frustrating thing * * * to sit for months in a falling market and be unable to sell even though * * * you were the only one who knew it was going to fall."

Those we can regard as responsible observers of futures markets—the USDA, the CFTC, virtually every unbiased academic authority—into which category the current Chairman of the CFTC apparently does not fall, if his letter expressing his opinion in this matter be evidence, are united in their appraisal that prohibition of futures trading in potatoes is unwise and unwarranted. A prohibition is not even to be seriously contemplated in a society which still purports to honor honest commitments; to reward enterprise, daring, and risk assumption; which exalts free agency and decries dirigistic government directives.

Problems remain, which are sufficiently serious to bring us here today. I would be the last to deny that there are mechanical problems in potato futures markets. They center on delivery congestion, unnatural physical movement to satisfy delivery

in fulfillment of matured futures contracts, and on the presence, particularly with respect to past versions of the New York Merc potato futures contract, of less workable futures clearing arrangements than typically prevail in Chicago contracts. I commented at length on these problems in an article, "The Sins of Potato Speculators," published in the New York Times in 1976 as a comment on the Simplot default.

Speedy relief from these purely mechanical dysfunctions is surely called for. The protest of Idaho growers, and Maine growers also, would prove salutary if it succeeded alone in bringing both the exchanges and the regulators to their collective senses, to a recognition, now embraced in the USDA report, as I interpret it, that a literal delivery requirement in connection with maturing futures contracts in perishables is the raw material from which a price-depressing manipulation can routinely be concocted. Note clearly, however, the nature of the manipulation. Those who, by manipulation, are seeking to depress the price for their own greedy gain are doing so by way of a *cash* market manipulation. So it is nearly always. Selling a lot of futures won't alone have that effect. The would-be manipulators, rather, have to cannon ball a long trainload of rotting spuds into the geographic area specified as regular for physical delivery upon maturity of the expiring futures contract. I do not deny that this has occurred, particularly with onions, and that it could occur again. But now a simple cure is available.

The cure, may I suggest, is simplicity itself, a cure I recently had occasion to advocate for financial interest futures generally in my detailed article in the Fall 1978 Futures Symposium issue of the Emory Law Journal: Genealogy and Genetics of "Contract of Sale of a Commodity For Future Delivery" in the Commodity Exchange Act, 27 Emory L.J. 1175. Do, by all means, take away the manipulators' opportunity to play cannonball games! Require futures contract settlement, at least in a situation of developing stress, by requiring simple monetary settlement on the basis of accurately determined prevailing prices for real commodities as they move in normal commercial channels. For potatoes this surely means that futures settlements could be based on the price of potatoes loaded in Pocatello and Presque Isle rather than the price of paper potato warehouse receipts in Chicago or New York City.

It is my understanding that the Chicago Mercantile Exchange, at least, is not at all averse to such an eventuality, for either financial instruments, equity value futures (stock indexes) or perishables. Such futures settlement techniques already prevail, in principle, with respect to cotton and, in practice, with respect to iced broilers. Only the institutional lethargy and doctrinal rigidity seen at the CFTC appear now to stand in the way of adopting this much superior deliveryless settlement procedure for any futures contract with respect to a commodity, the cash value of which can be divined with commercial acceptability from an honest and accurate cash market. I will accept contradiction from those who observe these things more closely, but I do here assert that the Pocatello cash market fits that description, if it is consistent with the character and integrity of the people I know personally who take their sustenance from the soil of the Snake River Valley by the sweat of their brow—heeding literally the scriptural injunction that man should so live and work out his destiny.

There is a more fundamental problem, however, than the mere mechanical dysfunction of delivering potatoes in settlement of futures contracts at a point far out of the chain of commercial movement. It is a fundamental problem, to which I make bold to offer a fundamental solution. Dr. Gray described the problem well. Speaking of the effects of the government price support program of the 1940's he wrote:

"By 1950, when the war-induced price support program had been abandoned, the newly structured and relocated potato industry had demonstrated its capacity to produce quantities greatly in excess of market requirements at 90 percent of parity prices. In a classic example of serendipity, a program which sought nothing beyond assurance of ample supplies from an existing production complex had unveiled an entirely new production complex which was a much more efficient engine of production, but at the same time it was in fundamental disequilibrium at the stable price level which had brought it into being."

Translation: When American potato farmers produce efficiently, they produce more potatoes than we can eat—Ray Kroc and McDonalds notwithstanding. An alternative high-priority use for potatoes, especially for cull, off-grade, and damaged potatoes should be found. But it has been found!—by the Senior Senator from Idaho, Sen. Church, and by all the members of this Committee. You have all wisely embraced and encouraged a most hopeful solution. That is: Produce fuel-grade alcohol from sugar-rich field crops such as potatoes and sugar beets, and, eventually from all manner of now-wasted cellulose.

In the areas of Idaho, Oregon, and Washington, in particular, where potatoes are or can be grown, sugar beets are grown also. For complex reasons, which I will not explore here, sugar beet refineries in these areas have been forced to shut their doors. This can only intensify a local reliance on potatoes, and will make predictable an even greater persistent downward pressure on potato prices. All is going to ruin: domestic sugar beet culture, potato culture, and domestic refining of beet sugar, in the absence of a sufficient incentive to grow both beets and potatoes for purposes of fermentation and alcohol distillation. But the economics of fuel alcohol production are getting better day by day, thanks in part to American inventiveness, but thanks also (or no thanks if you prefer) to doctrinaire and despotic foreign influences that would bleed us dry if they could—and they can unless we develop, quickly, alternative sources of energy.

Even in the absence of a plethora of calculated incentives to production of alternative fuels, many are contributing to the development of alcohol fuels and to the provision of feedstocks for production of alcohol fuels. Among the most significant feedstocks—for the perpetual future—are the renewable resources of American agriculture and forestry. Among those who seek thus to contribute, and, incidentally, to offer a solution to the fundamental problem associated with potato production in the United States, are the principals of a small Sedalia, Missouri farm implement and metal working firm, VaroTech, Inc., which I represent. Many of the principals of the firm are former Idaho farm boys. The inventor of the system of interchangeable agricultural implements—combine, corn picker, windrower, et al.—associated with an alcohol-fueled turbine-electric tractor (really a mobile electric generating unit) on which patents have been granted is, however, in the best tradition of Cyrus McCormick, a young farmer from the Valley of Virginia. Jim Downing's turbine-electric tractor eliminates the differential and transmission of the conventional tractor, employs an efficient turbine-alternator running at constant speed to power both the mobile unit and all auxiliary working equipment, cutting heads, drums, flails, blades, vibrators, etc. directly at the point where motive force needs to be applied. The dangerous, unwieldy, and energy-robbing Power-Take-Off has been banished to the junk heap. The clear channel passing through the center of the unit from front to back facilitates "whole-crop" harvesting, the one-pass collection of both grain and the cellulose materials from which fuel alcohol can be derived. A solution to the need for economic gathering of cellulosic materials to be used as feedstocks for fuel alcohol production is within grasp. Because the transmission, differential, and power-take-off are gone, a near-infinite design flexibility is made possible, while the electronic variable speed control used to control application of power to either wheels or auxiliary working equipment makes possible an infinite gradation of speeds, forward and reverse. This is accomplished by utilizing the same sort of electronic marvel—the generic electronic variable speed control for alternating current motors—that was given so much publicity by Exxon's attempt to acquire Reliance Electric to manufacture and market their version of this recent development in electronic control (by frequency variation) of flow of electric current. Beyond the realm of agriculture, but destined to expand the demand for alcohol fuels produced by, say, the municipal garbage dump to fuel the fleet of municipal buses, lies the distinct possibility that the mobile electric generating unit—which dispenses with transmission and differential—can make design of a true Transbus meeting Department of Transportation specifications possible for the first time. Only thus, in all probability, can the desired low-flying profile be accomplished, thereby to make transportation of the aged, infirm, and handicapped readily possible.

If there be malaise elsewhere, yet the Yankee inventor, in the style of Cyrus McCormick or Eli Whitney, and the Yankee trader too, are alive and well in the more self-sufficient and self-confident farming communities of America. There live and work a breed of adventurous, unquenchable, driving, and self-reliant men and women. They have always lived with adversity, with dependence on forces, human and divine, that were beyond their immediate control. They learned to cope. They prospered. Their kind lives on. In their millions of small businesses, whether applying the agricultural or mechanical arts, supported and educated by our unparalleled A&M land-grant colleges, they forge forward to make the future of America as rich and rewarding as our righteous and bountiful past has been. Free men, free markets, and free choice are worth preserving. I urge you, Gentlemen, to correct rather than to kill; to promote rather than prohibit. Preserve for us all the distinctive American freedom to dare; to assume risk; to profit from it in the end, accepting with good grace the adversities of fate, the weather, the future, and the futures—all of which we encounter on the road to honest independence and prosperity in American agriculture.

[Reprint from the New York Times, Sept. 12, 1976]

THE SINS OF POTATO SPECULATORS

(By Glenn Willett Clark ¹)

In 1898 Philip Armour, mainly of meat-packing fame, set out to test his talents (in the modern sense) and multiply them (in the biblical sense) by wagering that the price of wheat would go down. Accordingly, he sold wheat futures short on the Chicago Board of Trade. He put his money where his opinion was. Others (notably one Joseph Leiter, a young man come out of the East with his father's money) held the contrary opinion, and they too cast votes that counted—in the election that is run off by taking positions in wheat futures.

The farmers' votes didn't count. They had no opinions respecting the price of 1898 wheat that they were willing to back with a commitment to buy or sell futures. If they owned (or were growing) wheat, they were subject to a price risk which they would just as soon have avoided. Perhaps the most sophisticated among them might have been taught to hedge their long position in cash wheat by selling wheat futures, thus establishing an offsetting short position in wheat futures. The simple fact is, however, that farmers didn't hedge then and don't often hedge now.

The farmers' grain elevator would routinely hedge. If the elevator owned cash grain, it would sell futures. Hence arises the bulk of the hedgers' short interest. To view the mirror image, observe the miller, grain processor or export merchant. If such a one had committed himself to resell, export or consume wheat at a certain future time, thus establishing a short position in cash wheat, he would buy wheat futures as a temporary substitute for purchase of the cash wheat that he hadn't yet (or couldn't yet) acquire, thus establishing an offsetting long position in wheat.

Mr. Armour did operate grain elevators. But, viewed in perspective, his position in 1898 was simply a speculation that prices would drop. His taking a short position was not helpful to farmers' elevators, which had to sell short in order to hedge.

Mr. Armour played by the rules. In the arena of the futures market the vote went against him. Speculative longs, whose winning vote was that the price of wheat would rise, now had Mr. Armour at bay and proceeded to sharpen their knives, securing the position with the crucial and seemingly final step in their squeeze of the Armour bear. They acquired control of virtually all cash wheat in deliverable position.

Moral: The essential instrument of this classic commodities manipulation (which, arguably, we now find repeated in the May 1976 Maine potato futures contract) was not the acquisition of a monopsonistic or oligopsonistic position in futures but, rather, the acquisition of a monopsonistic or oligopsonistic position in the cash commodity in deliverable location. In plain words, the longs bought up all the real wheat in northern Illinois.

In 1976 Jack R. Simplot, an Idaho farm boy grown fat on potato processing and phosphate fertilizer production, is alleged to have wagered that the price of Maine potatoes would go down. Accordingly, he sold potato futures short on the New York Mercantile Exchange. Now we live in the world of government regulation, where short speculators can't hold any very sizable position unless they can disguise their positions as hedges. It might appear plausible that Mr. Simplot, potato processor, has a very real need for real potatoes, and a legally acceptable excuse for acquiring and holding a very sizable long position in potato futures. So why is Mr. Simplot short?

In the court action now pending, we will surely be treated to an attempt to find out. Part of the plaintiff's allegation, judging by press accounts, appears to be that Mr. Simplot and Peter J. Taggares were indeed simply short speculators whose short sales of Maine potato futures were vastly in excess of the quantitative speculative limits imposed on those short positions are not cognizable as hedging.

In 1971 Mr. Taggares, then mainly a large potato grower, took a long position in Idaho potato futures traded on the Chicago Mercantile Exchange—scarcely the position one expects a hedging farmer to occupy. Mr. Simplot, then primarily a processor, took a short position in direct opposition, according to *The Wall Street Journal's* report of June 1, 1976. Having made peace and partnership—SimTag Farms of Boardman, Ore.—the vertically integrated odd couple now coordinate their forays.

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All this seems strangely to smack of speculation, possibly actuated by a motive to discredit, in turn, the Chicago Mercantile Exchange and now the weaker New York Mercantile Exchange.

If we assume that Mr. Simplot's short position is speculative in an economist's eyes, albeit not in contemplation of law, it might yet be asked what difference that makes—except that the admitted speculator can't take any very large position. For every short there is a long; for every long there is a short. Futures trading is a zero sum game—minus commissions.

Populist farmers might have disliked seeing Armour on their side of the market—short. They might well have objected that unsophisticated urban speculators are supposed to go long to accommodate their hedging needs, and historically they seem to have done just that. The grain trade doesn't however, and neither do the sophistates. Available evidence seems to suggest that grain trade professionals are typically net short in futures. They alone appear to be fully comfortable with short selling.

Only accidentally, and only episodically, could the sales of short hedgers be expected to match, either in timing or quantity, the purchases of long hedgers—of either grain or foreign currencies. This could partially explain the notorious volatility of the bank-to-bank negotiated forward transactions in foreign currencies that, in effect, are transacted in an over-the-counter market rather than on an exchange—an over-the-counter market from which nonbank speculators are excluded. Undue volatility is arguably the consequence of under-speculation rather than over-speculation.

Still, some misguided analysts, including the creators and administrators of the Commodity Exchange Authority, exhibited a demonstrable bias against participation of nontrade speculators in the American futures markets. Speculators and speculation were seen as evil. Commercial interests, ostensible hedgers, could do no wrong—according to the official demonology. Perhaps now we see that ostensible hedgers are capable of great mischief and that this can be the destabilizing influence.

The result of Mr. Simplot's default has been that a committee of a New York Mercantile Exchange has determined that the fair market price for Maine potatoes, in absence of default, would have been \$10.66 a hundred pounds. That Solomonic judgment satisfied nobody, and the sparring continues. Argument about the accuracy of the committee-divined price will continue—in and out of court.

Moreover, the evident inability of this market, in this instance, to report a market-determined price is sending shock waves through the entire commodities community. On July 21 it was reported that the Chicago Mercantile Exchange was seeking to revive potato futures trading there by redrafting its contract to permit delivery—not simply of Idaho potatoes but of potatoes from all major growing states west of Michigan and Wisconsin.

On Aug. 25 it was reported that the New York Mercantile Exchange's riposte was first to suggest that potatoes grown in any of seven additional Northeastern states could be delivered in satisfaction of open futures contracts—but reverted, after hearings, to a conclusion that only Maine potatoes could be delivered in satisfaction of futures contracts. More grades would be included, however, and delivery to Boston would also be acceptable.

The muddle deepens, and the focus of inquiry drifts further away from viewing the futures markets as financial markets. The most primitive function of the produce market—physical delivery—is unfortunately deemphasized. It is ironic that a result of interjecting a new, more powerful, more vigorous futures regulatory agency into the market equation may have been to render the commodity exchanges' traditional sanctions ineffective.

Mr. Simplot and Mr. Taggares have almost surely reckoned that nothing that the Commodity Futures Trading Commission could do to them would approach in severity and swiftness the results of commodity exchange self-help justice for those who default on promised delivery. But default on delivery has been—and deserves to be—the ultimate sin, for the very rationale and function of the futures market is thus undermined.

If the futures market has any reason for being, it is that prices are thus and there determined by the open, concentrated and observable action and reaction of the directly opposed longs and shorts. A committee of the New York Mercantile Exchange cannot conceivably determine accurately a price that was not determined on the floor of the exchange. To reveal a futures market unable to establish the price is to expose the idol's feet of clay.

The Maine potato futures market, we may fairly suspect, is flawed. May it be that it is too small and illiquid? That there is insufficient nontrade speculation thereon? That it has become a pawn in another game—an attempt on the part of cash potato

brokers and potato processors to discredit futures markets generally? That no realistic provision has been made for retendering of the cash commodity in settlement of open position?

Or might it be that there have also been some shenanigans on the other side? Arrayed against Mr. Armour were longs who had taken the precaution of buying up all the wheat in northern Illinois. Mr. Armour could have settled by paying—through the nose. To avoid thus paying to Mr. Leiter, he instead enriched the mariners on the Great Lakes by a heroic and successful struggle to deliver wheat from Duluth to Chicago, though every ice floe in Lake Superior had to be broken in the process. Still, failing in the attempt to deliver, one feels confident that the members of the Robber Baron generation were at least gentlemen in their gaming—and would pay off according to the rules when fairly bested.

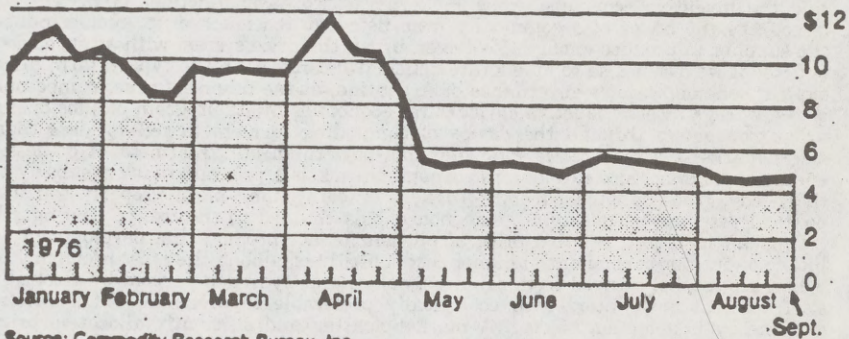
When the time for settlement came late in 1898, Mr. Armour was ever the gentleman. Mr. Simplot simply flipped over his Monopoly board. He failed, for some reason, whether excusable or not, to abide by one of the implicit fundamental covenants of the joust—that one will stay short at the final trading gong only if he does hold the actual (cash) commodity or can deliver it.

Otherwise, his obligation is to cancel out his short position, admitting that he lost, by purchasing back the contracts he had previously sold. The final equilibrium price is then established by interaction with the selling of futures contracts by longs who are also going out of the game—also reversing their position to effect a monetary settlement.

The working model of a futures market is of a market in prices, not a market in goods. To see the price-finding function of a futures market frustrated is to view a fundamental and possibly fatal flaw. When a short defaults on delivery—having had no realistic possibility of delivering and having made no heroic attempt to dynamite every ice floe in Lake Superior—he has, with malice aforethought, shifted the price-finding function of the market to a committee whose judgment cannot be accepted as correct, whatever it may be. The viability of one of the last and best of free markets is thus gratuitously called into question as it never has been before in a long and lively history. Such may be the enormity of Mr. Simplot's sin.

The Trend in Potatoes Futures Prices

(Weekly close, nearest contract)



Source: Commodity Research Bureau, Inc.

PRICING BY ROBOT—OR PRICING BY MARKET?

WHAT FUTURES MARKETS ARE, AND HOW THEY FIGHT INFLATION TWO WAYS

(By Glenn Willett Clark)

Is a very bad bit of history repeating itself? As in the German hyperinflation of the 1920's are Americans now persuaded that their Government's money in the future will invariably be worth less than money now—and, as a corollary, that gold will have an incredibly high value. If Jude Wanniski is correct (Wall Street Journal, October 1, 1979) the Fed is "unwittingly flooding the economy with money," even as it imagines that it is "tightening money" by driving the federal funds rate into double digits.

This is occurring, we suggest, because money managers have not been fully familiar with the extraordinary power and utility of private arbitrage respecting

futurity—in which future markets play a large but not exclusive role. If as Wanniski points out, the Fed attempts to target, artificially, a higher federal funds rate, private arbitrageurs will exert an insistent demand for money to exploit the temporary opportunity to receive a higher-than-market return—to profit, as arbitrageurs seek always to do, from a temporarily deviant quotation. The central bank, ever solicitous of political need, to which Arthur Burns ruefully testified in *Belgrade* (New York Times, October 1, 1979), will not hesitate to satisfy demands for credit—which it does by monetizing Treasury debt, supplying bank balances in exchange for Treasury debt instruments that are turned in. We can and do have a situation in which high interest rates are not accompanied by a credit crunch. In recent months, perversely the monetary base has expanded. If the fed had been serious about tightening money it would have sold from its hoard of Treasury debt instruments, sopping up money in circulation; but that would have inconvenienced the red-ink people who ever and always count on the Fed to monetize new Treasury debt issued to finance the government.

In contemporary practice, Wanniski argues the Fed's misguided attempt to control inflation by targeting higher interest rates only created more demand for credit, more money, and more inflation. The Fed's new dollar-rescue effort of October 6, which even *The Wall Street Journal* editorially applauded (October 8, 1979), shifted its focus from targeting a higher federal funds rate to direct control over expansion of monetary aggregates—allowing short-term interest rates to go where the market would take them hopefully terminating the guaranteed profit to speculating arbitrageurs. The now predictable greater volatility of short-term interest rates can, however, only spur both hedging and speculative interest in interest-rate future contracts.

On October 6, then, an attempt to peg the price of money was largely abandoned. Attempts to peg the price of money generally fail, or misdirect the economy if they do succeed. Attempts to peg prices for other commodities also precipitate significant misallocation of resources and diminution of real national wealth.

We may be repeating the mistake with oil. In allocating essential commodities in short supply, are we succumbing to a notion that an increased market price is the problem—rather than a large part of the solution? How extraordinary it is that pundits and Presidents now praise the Volcker hike in the price of money as a solution, but resist decisive decontrol of domestic energy prices that have long been artificially restrained, thereby subsidizing the import of OPEC crude. "There are," said the inventive economist Abba P. Lerner, "two basic functions of price: "to discourage the buyer of a commodity from using up too much of it, and to induce the supplier to produce enough." We overburden the price system with an inconsistent role if we ask it also to ameliorate deficient income, as in the typical farm price support scheme. Peron's governance of Argentina, at the other extreme, ruined one of the world's most productive agricultural economies by its program of subsidizing urban consumers through the device of compelling farmers to sell for less than world market prices. Are we following this pattern in our treatment of domestic energy suppliers? More rational, in economic terms, is a program of overt subsidy of the needy, whose anguished cry, "To heat or eat?", may more properly evoke a political response a subsidy of some households chained to the use of heating oil.

Only an increased relative price of oil can in fact promote the development of hitherto (but not permanently) higher-cost substitutes, among the most promising of which are alcohol derived from cellulose wastes and hydrogen derived by electrolysis from coal and water—both ecologically preferable to production of synthetic gasoline by liquefaction of coal. A market-clearing and efficiently allocative price will be a fluctuating price. We achieve proper allocation of scarce commodities, shifting from gasoline to fuel alcohol, say, only if prices are free to fluctuate.

This price fluctuation goes against the plodding, planning bureaucratic grain. Ministers of state seem to prefer stability at any cost. Around the precincts of Purdue and Iowa State one understands these things better. There, one knows that a free market mechanism for conducting a stable and productive business in spite of violent and erratic price fluctuations was devised long ago in the grain trade. What was there discovered should be applied today to the pricing of metals and money, of energy resources and transport services. Commodity futures trading is the mechanism that permits efficiently allocative price level changes to occur; but largely insulates hedging participants in active futures markets from their effects.

If future developments cannot be neutralized they had best be foreseen; but prophets are in short supply. The track record of forward pricing markets is good enough—better than that of Commissioners, bureaucrats, and professional economists. The economic literature even contains a modern demonstration that the forward price for Reichsmark foreign exchange uncannily anticipated and compen-

sated for the German hyperinflation of the 1920's. Futures pricing, in a process of natural evolution through intermediate stages of spot and "cash" forward markets, as, for example, Rotterdam spot oil and Mississippi River forward barge rates markets, simulates a competitive state that need not exist structurally and can, incredibly to some degree, force competitive pricing on an industry that remains highly concentrated in structure. Not without reason does Sheik Yamani, representing a present and would-be perpetual monopolist, fear and detest the Rotterdam spot oil market, and utter the demand that Western governments, representing consumers, take "drastic action to control the spot market." (Wall Street Journal, October 18, 1979).

Futures markets, then, (1) offer the best opportunity to undermine the inflationary and otherwise apparently inevitable "managed pricing" of concentrated and subtly cooperative primary producers—whether of metals, money, fuel, or food; and (2) enable producers and consumers to cope with inevitable price volatility, without inserting an inflationary wedge of charges by middlemen.

1. *Futures promote competition*

The most significant contribution that futures markets could make in promoting an anti-inflationary public policy is to undermine oligopoly "managed" pricing.

Futures—A simulation and stimulation of competitive pricing

Farmers, unlike OPEC sheiks, are subject to the risks and rewards of competitive pricing. All primary producers would be subjected to the bracing wind of honest price competition if viable futures markets in their products could be established.

The appropriate original objective of our antitrust law was to further price competition. How far we have departed from the ancestral faith! We read reports, as on the front page of the April 25, 1979 Wall Street Journal, that competing soft drink companies are complaining that "Coke and Pepsi", by engaging in competitive price cutting, "have made colas into commodities." The consumer, Heaven forbid, "has been shopping for price." And of that horror, says another bottler, "It's suicidal." This chap even scorns the intelligence of the price-cutter: "It doesn't take creativity to give a price allowance." This self-proclaimed "creative" bottler has this better idea of how to compete: He lends three \$10,000 talking robots, standing 5 feet 4 inches, to local supermarkets. The robots, he is confident, can be as persuasive as reduced prices.

As with beverages, so with metals, in spades. Many more can play the game of copper futures speculation than can produce copper ingot. The speculators, if there are enough of them, take the pricing game away from primary ingot producers.

Across the whole spectrum of viable futures markets, oligopoly "managed" pricing is effectively undermined. A futures market in aluminum ingot exists already in London. The Wall Street Journal tells us that this futures market is beginning to threaten the pricing prerogative of the international aluminum cartel; that nickel producers oppose the creation of a London futures contract; that "commodity hedging is a dirty word" in the rubber trade; and that producers of the anhydrous ammonia used to make half of America's fertilizer vetoed the creation of futures trading in the product in 1977, even after the Fertilizer Institute, a trade group, asked commodity exchanges to design a futures contract. On July 3, 1979, The Wall Street Journal offered the intriguing report that computer-leasing companies are accusing IBM of blocking the creation of "futures" in leasing services—preventing others from creating a market in commitments for favorable delivery dates on the newest line of computers.

Oligopoly producers resist the creation of futures markets precisely because these markets can reclaim a collective market power to establish, day by day, what the price of any subject good, article, right or service will be. Competitive pricing could not more simply be reestablished. It should be—and soon. Historic futures trading in grains, interest rates, and metals shows the way to proceed. An extension of the system to energy, now barely begun, is very much called for.

2. *Futures cope with fluctuation*

It is incredible that learned professors write giant tomes on elementary economics without even a reference to futures markets—the source of the only prices praised by those same pedants as perfectly competitive.

Some intellectual eggs are scrambled

"Asking people where prices come from gets more embarrassing answers than asking small children where babies come from," is the observation of Professor Thomas Sowell (Washington Post, September 19, 1979) of U.C.L.A. What is usually

served up in Economics I, in Sowell's words, "is the economic equivalent of believing that the stork brought you."

Competitive prices in the American economy are delivered up from the futures pits in Chicago, New York, Kansas City, and Minneapolis—and it is Ma Bell rather than the stork who delivers them.

These price markets, however, are encrusted with a heavy load of misunderstanding amid mistaken legal and economic analysis. The mere handful of professional economists who have devoted a lifetime to the understanding of this exceedingly complex institution are united in their econoclastic approach, and their warning that government regulation of the sort we have actually experienced for the last 55 years or so has seldom perceived the essence of the exercise. Empirical evidence brought a deserved respectability to futures markets. Political and regulatory attitudes have not yet been so significantly altered.

One erroneously thinks of futures regulation as something new—since the Commodity Futures Trading Commission has only been functioning since 1975. In fact, the CFTC merely continues the tradition of the Commodity Exchange Authority, existent since 1936, and the Grain Futures Administration, created in 1922. Only in long past decades was the futures regulatory agency new, vibrant, inquiring, and receptive to the empirical evidence it slowly amassed—which was instrumental in rather completely changing informed academic attitudes toward futures trading. They who can comfortably rail and thunder against the wicked grain gamblers still persecute and prosecute "speculators"; and cultivate some conspicuous myths:

1. Boards of Trade are places where grain is bought and sold;

2. Hedging is good because it provides "price insurance."

Even imperious regulators repeat the refrain; but, truly, the Emperor has no clothes. For this, courtiers bear some blame.

Myth I: The nature of price markets

Contrary to myth, one does not buy and sell produce in a futures market, and the presence or absence of "future delivery" of goods is not an accurate test for the existence of a futures contract.

Cash markets—Goods; futures markets—Prices

As Sowell suggests, the nature of markets is little understood. We have almost forgotten that true markets are hardy perennials that will reappear to perform the classic allocative function even if only a small fraction of the commodity is offered for sale at market rather than at treaty prices.

Such is the function of the Rotterdam spot (cash) oil market, where no systematic hedging is easily possible. Chicago boasts many futures markets—which are purely financial institutions—price markets. They do facilitate systematic hedging. Goods are not brought and sold there. Participants in futures markets make commitments to buy and sell goods at some later time. They make these commitments with the clear understanding that, except as a mistake, or, rarely, as a by-product of imperfectly effective futures arbitrage, no sale and delivery will ever be made, no purchase of any commodity will be effected. The hedging participants are there mainly to obtain, now, price level assurances for the near distant future.

Futures in the grain trade

The grain merchant, for example, in the process of making a foreign sale in March, to be delivered in July, may have made a commitment to a farmers' cooperative elevator in January that he will accept delivery of wheat next July. Having made, in January and March, those "cash" forward commitments for July consummation, our exporter bears the risk that the market price of wheat will fluctuate drastically between January and March. In order to conduct his business at all rationally he must find the means for entering into simulated substitute transactions having the *financial* effect of an immediate purchase (sale) timed to match his foreign sale (country purchase). The opportunity to make such simulated purchases and sales efficiently is offered only by futures markets.

The net outcome of his collective transactions, somewhat simplified, is that he obtains, for the wheat sold to the foreign buyer, the difference between the price of the July wheat *future* he "sold" in January (as he committed to purchase actual grain) and the July wheat *future* he "purchased" in March (as he committed to sell actual grain). It is fundamentally the timing of his "cash" (actual grain) forward transactions that determines his commercial success, as is but appropriate. Hedging in futures is really only a tool to implement cash market judgments and speculations. Futures transactions are only temporary surrogate transactions.

In all futures markets, every participant loses all contact with any individual "party of the second part." The organized clearing house is substituted as the

opposite party in every transaction—once the contract is formed. Any participant can then easily reverse his position after the contract has served its temporary purpose. Futures contracts, to the extent of 99 percent plus, are thus cancelled out before they mature and first then give rise to a sale of any commodity. If futures markets functioned perfectly, no sales of any commodity in connection with or in satisfaction of futures contracts would ever occur. All futures contracts would be cancelled out by other futures contracts. None would mature. No sales of any commodity would thereby take place.

Myth II: The insurance offered by hedging

Contrary to myth, hedging offers no simple "price insurance." It is a queer "insurance" in which the "insuror" seldom profits, and in which an "insured" seeks and finds positive profit, but only if he can constantly engage successfully in a complex arbitrage.

Basic speculation is not insurance

Another myth, rather more harmless, a favorite of the Bagley School at the CFTC, and too often repeated by some timid industry apologists (who for decades have hurt themselves with a want of candor), is that hedging is a form of all-purpose price insurance. The truth, as the cowardly lions of the trade have always known, but feared to tell, is that speculation is a positive virtue, a precondition of viable markets, a great public good, and an activity in which hedgers constantly engage.

"Hedging" offers "price insurance" only with respect to some general shift in the perceived value of a commodity—as if a perfectly rigid plastic relief map of prices was being moved up and down as a unit. For the commercial hedger dealing in grain or metals, however, "hedging" is an operationally complex arbitrage that deserves, instead, to be called "basis speculation"—in which a commercial hedger wrestles with an elastic rubber relief map of prices on which the manifold relations between peaks and valleys are not entirely fixed as the map is moved up and down. Any map describing shifting price relations over time, between present and future times, or between geographic locations (the varied relations called "basis") is in fact elastic in this sense.

By coordinating their dealings in "cash" grain with their dealings in futures, international grain companies do generally find it possible, with the exercise of great skill, to do business at an assured margin of profit, largely fixed in advance, regardless how much or how often the base price of wheat may gyrate. They don't intend merely to break even; they intend to anticipate accurately how the rubber relief map will stretch and compress internally, and they speculate accordingly on the timing and magnitude of basis movement, i.e., engage in arbitrage.

Public speculators, the functional "insurors", contrary to Keynes' postulate, don't get much of a premium. Their empirical "risk premium" seems to seesaw between minimal and negative. Life isn't simple for the "insureds" either. If skilled, they profit; but commercial hedgers can still experience ruinous losses, for they necessarily engage in basis speculation—which cannot be sloughed off to dentists, accountants, and art dealers beguiled into futures speculation by the prospect of easy money. Speculators should understand that they enter at their peril, for futures markets have traditionally served the grain trade rather than the speculators—but small silver speculators did win during the extraordinary summer of '79. Hope springs eternal.

Our settled national policy of promoting futures trading does not rest on the outcome of a tug-of-war between producers and consumers. "Consumer advocacy" of the usual sort is misplaced here. The welfare of consumer, producer, and processor are all advanced because hedging permits any producers, handlers, or processors (otherwise subject to an impossibly vast risk of price level fluctuation on huge inventories) to enlarge their facilities, achieve desirable economies of large-scale operation, and obtain access to bank credit at prime rates. Absent futures hedging, it is probable that not even an omnipotent government could create the facilities needed to move and process America's edible and energy-giving gold—her "amber waves of grain."

The future of futures

Contrary to myth, then, futures contract markets are not places where grains or metals are bought and sold; nor are they even remotely to be thought of as "insurance exchanges." The useful services of these financial institutions can become available to producers and users of other commodities (including money) all the better if it is understood that futures markets are price markets. The utility (and the risk) of futures hedging will be better understood by all businessmen as it

is understood that an independent skill—arbitrage—is required. So long as the active arbitrage of futures and other forward trading flourishes, they who would engage in price fixing of any thus traded commodity (including some unrepentant central banks) are simply setting themselves up for an easy, inevitable, and justified assault. Hedgers do not politely “insure,” they grasp and claw their arbitrageur’s profit with respect to present prices, future prices, and carrying prices. Price volatility disturbs and discourages only the merchant or producer who lacks the skill and imagination to profit from his knowledge as well as his product. The wonder is not that many do seek to profit by hedging—but that so few do. They who do not have been beguiled by the myth of hedging as insurance.

What the grain trade teaches

The great lesson taught by the thriving international grain trade is that a multibillion dollar worldwide business can operate very well indeed, in the face of constant shifts in price, if liquid futures markets are open, free of fear that an arbitrary and unintelligent bureaucratic order (as the trade sees it) may close down the markets at some crucial moment! The grain trade was the first to find, in futures hedging, the key to marketing’s fourth dimension—time. To the extent that specialized speculators enter the market to bear the risk of price level shift, pricing and production decisions can, in effect, be moved from the unknown future to the quantifiable present. To maintain its basic stability and continuity, the grain trade has no particular reason to care what the fluctuating price of wheat is on any given day; adequately settled hedging arrangements already exist. Only the government, thinking itself a medieval Pope or a Byzantine Emperor, seems obsessed with control to establish a “just price” calculated to curry favor with a political constituency, now agrarian producer, now urban consumer.

Help for farmers and consumers

The futures market mechanism can uniquely serve the interests of farmer and consumer simultaneously—at the expense of parasitic “cash” brokers and middlemen. Neither farmer nor consumer would relish the discriminatory political “favor” of a “fair” price offered them by the political class if they understood the miraculous utility of market pricing as Prof. Sowell does. He came to maturity in an urban ghetto that did discriminate, invidiously, on the basis of race. That pernicious political favor to the julep-sipping gentry destroyed economic value too—for all concerned—as does economic discrimination on the basis of sex in our time. The government might better concern itself with the integrity of market commitments and operations—with the avoidance of default and the punishment of deceit.

A failed test?

An incredible social and commercial importance does attach to the integrity of futures market operations. A price discovered by the interaction of market forces in Chicago rules the destiny of peasants in Pakistan and producers in Paraguay—affecting both those who eat and those who grow. The most solemn responsibility of the grain trade, acting in cooperation with the American government, is to give cause for confidence that the thus-discovered price is truly a market price—not one distorted by either private or governmental intervention or manipulations. It is tragic that the press conveys the message that some, or all, of the concerned parties have failed that test.

Brutally honest—and honestly brutal—market judgments

On September 16, 1979, Stuart Eizenstat declared (NBC, Meet The Press) that the Carter Administration does not even contemplate the possibility that wage-price controls will be imposed. Well done!—for it is both useless and impossible, if economic resource allocation is to be retained, to impose governmental price controls on those commodities that are already priced in a competitive manner in American exchanges and other financial markets. With perfect accuracy Carter blames the Nixon price freeze of 1971 for inflated meat prices that bedevil us still. Many more markets were similarly disturbed. These markets are brutally frank, and are not persuaded by mere words. On September 18, 1979, for the first time in history, the price of the near-term gold futures contract was less than \$25 short of the previously unheard of price of \$400/troy oz. Within the next ten days the \$400 barrier was breached.

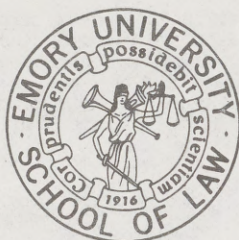
A market cure for hyperinflation

Now, sadly, the incipient psychology of hyperinflation in America likely cannot be reversed until the Administration can persuade the market—a world market not subject to guideline suasion—that it truly will not impose bureaucratic price controls; nor tax away significant incentives to production and technical innovation;

nor persist in monetization of an excessive federal debt, so largely created, in all innocence, by reflexive government extension of loan guarantees, followed by conversion of government agency guarantees to direct Treasury loans funded by floating ever more Treasury debt securities. Chrysler's hoped for guarantees, if thus converted to direct Treasury loans by the little known Federal Financing Bank, an obscure Treasury adjunct created in 1973 by Paul Volcker, would add *only* a billion to the three score, or more, billions of inflationary debt thus created, sans budget restraint, by this loan guarantee leger-demain since Nixon first used the trick to hide unbudgeted expenses. If those major battles can be won, the campaign against inflation can then be somewhat further advanced by a policy of encouraging more active and more extensive hedging with respect to more commodities—or do we prefer to be dictated to by a very “creative” 5 foot 4 inch robot, whether raised up by Coca-Cola, Massachusetts Mutual, Standard Oil of California, or Texas Instruments?

Markets have a healthy life of their own—in perpetuity. If we do utilize more, and more active, futures markets we can have competitive pricing, even if the producers are structural oligopolists; we can have commercial efficiency and enhanced productivity, even in the face of persistent price volatility. Robots, however, tend to malfunction when their limited computer programs do not comport with the organic reality ever reflected by the market. Will we have pricing by robot or pricing by market?

EMORY LAW JOURNAL



SYMPOSIUM

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GENEALOGY AND GENETICS OF "CONTRACT OF SALE OF A COMMODITY FOR FUTURE DELIVERY" IN THE COMMODITY EXCHANGE ACT

by
Glenn Willett Clark*

I. INTRODUCTION

During its short life the Commodity Futures Trading Commission (CFTC or Commission) has been vexed with fundamental definitional and conceptual difficulties generated by uncertainty as to what a "future" is. This all-important term is undefined in the Commodity Exchange Act, although the commercial phenomenon under scrutiny is referred to by that name.¹ Trade practice gives the term meaning: futures are "[t]ransactions in commodities . . . as commonly conducted on boards of trade and known as 'futures'"²

The forum for futures trading is a Commission-designated contract market where trading takes place, not in commodities, but in executory contract rights to purchase and sell commodities at a later date. Section 2(a)(1) of the Commodity Exchange Act correctly emphasizes that the commonly employed term "contract of sale" can mean "agreement to sell."³ Futures trading does not consist of sales of a commodity for later delivery. It consists, rather, of formation of contracts for later sale of a commodity.⁴ No commodity is

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¹ See Commodity Exchange Act § 3, 7 U.S.C. § 5 (1976) (originally enacted as Grain Futures Act, ch. 369, § 3, 42 Stat. 998 (1922)).

² *Id.*

³ See Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976).

⁴ This is the perception that emerges from the careful judicial description of the nature of a commodity futures market given in *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1156 (8th Cir. 1971):

A wheat futures contract on the Chicago Board of Trade is a contract made on or subject to the rules of the Board of Trade, in which one party agrees to sell and deliver and the other party agrees to buy and receive a specified quantity of wheat

sold when a futures contract is formed; futures transactions are transactions in *rights* to the commodity rather than in the commodity itself.⁵ Trade usage and conventional contract law treat the futures contract as a valid and binding contract to sell commodities upon maturity of the contract.⁶ Thus, the futures contract market may be viewed as a forum for dealing in contracts to make a contract,⁷ or contracts to make a later sale.

Futures contracts are not sold or traded, even though this process is universally referred to as futures "trading"; instead, they are formed and discharged. It is important to understand, however, that no secondary market exists or is permitted to exist. Section 4 of the Commodity Exchange Act,⁸ with other provisions of the Act, prohibits nonexchange transactions in clearinghouse futures. A futures contract position can only be redeemed, in effect, by entering into an offsetting futures contract on the floor of an exchange.⁹ In the course of their existence as executory contracts later to buy and sell commodities, virtually all futures contracts are effectively redeemed since most sellers repurchase and purchasers resell.¹⁰

This characteristic of futures contracts—that discharge is effected by offsetting with an equal and opposite futures contract rather than by actual execution—is an essential ingredient of futures. Indeed, the key prohibition of the Commodity Exchange Act turns on the idea that execution of a futures contract by performance, that

at a specified price in a designated month in the future.

⁵ See *Farroll v. Jarecki*, 231 F.2d 281 (7th Cir. 1956); *Commissioner v. Carrington*, 120 F.2d 768 (5th Cir. 1941); Rev. Rul. 78-414, 1978-47 I.R.B. at 13.

⁶ See *RESTATEMENT OF CONTRACTS* § 522(b) (1932), which provides: "An agreement is not one for wagering because of the fact that it . . . provides for the purchase or sale at a future date of securities or other commodities."

⁷ See generally S. WILLISTON, *A TREATISE ON THE LAW OF CONTRACTS* § 873 (3d ed. 1962).

⁸ Commodity Exchange Act § 4, 7 U.S.C. § 6 (1976).

⁹ This was recognized in *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), in which the court stated:

Trading in commodities futures is regulated . . . pursuant to the provisions of the Commodities [sic] Exchange Act . . . and must be conducted only on a designated contract market in accordance with the market rules. . . .

. . . .
A wheat futures contract must be satisfied or liquidated by (1) an opposite and offsetting transaction in the same future prior to the expiration of trading in that "future, or by (2) delivery of the specified quantity of wheat . . . during the specified delivery month

Id. at 1156.

¹⁰ See *id.* at 1156 n.2, 1157.

is, delivery of the commodity, is rarely if ever contemplated. Section 4 of the Act makes it unlawful to deliver or transmit "any offer to make or execute, or any confirmation of the execution of, or any quotation or report of the price of, any contract of sale of any commodity for future delivery"¹¹ Section 4 refers only to the future delivery which infrequently occurs as matured futures contracts are discharged. It categorically does not refer to the vast majority of all sales in commerce—except retail sales—which do involve sales for deferred delivery. To make this distinction section 2(a)(1) provides: "'[F]uture delivery' as used herein shall not include any sale of any cash commodity for deferred shipment or delivery."¹² The adjective "cash," in this context, simply means "nonfutures,"¹³ that is, all commodities sold on terms calling for

¹¹ Commodity Exchange Act § 4, 7 U.S.C. § 6 (1976).

¹² *Id.* § 2(a)(1), 7 U.S.C. § 2 (1976).

¹³ In the cotton trade the adjective "spot" had the same meaning—all "nonfutures." In Alston Hill Garside's standard treatise on cotton marketing, *Cotton Goes to Market*, written before cotton became a commodity within the Commodity Exchange Act, and thus before the adjective cash legally replaced spot, he states:

[B]asis is essentially the difference between two prices for cotton established in two different cotton contracts made at the same time, one of these contracts being a futures contract, that is, a contract for future delivery executed on a futures exchange, and the other being a spot contract, that is, any contract for cotton other than a contract for future delivery executed on a futures exchange.

A. GARSIDE, *COTTON GOES TO MARKET* 251-52 (1935). The usage was consistent in Garside's work and in the trade:

[S]uch expressions as "future delivery," "a future," "a December future," or "future contract" are used by the cotton trade only with reference to trading in the futures markets; that is to say, on the New York Exchange or other future delivery exchanges. They are not used with reference to trading in the spot markets. A large portion of the cotton that is sold by merchants in the spot markets is sold for deferred delivery, but merchants do not refer to such sales as sales "for future delivery." In speaking of such spot business, they use the word "forward" in place of "future," and so they speak of such sales as being for "forward delivery."

Id. at 137. Spot market transactions were even subdivided according to the degree to which delivery was deferred:

The trading in the spot markets is partly in cotton for immediate delivery or prompt shipment and partly in cotton for forward shipment. Practically all of the selling in country markets of the South is for immediate delivery. On the other hand, shippers sell some cotton to spinners for prompt or nearby shipment, some for shipment up to a year or more ahead. There have been numerous cases of shippers having booked orders from spinners calling for shipments extending over several years.

The time factor obviously calls for differences between prices for various future deliveries on the Exchange and between prices for various deliveries or shipments of spot cotton in spot markets. In considering the time factor, it is necessary for us to think of four different prices, namely, the price for a nearby future delivery on

present or future delivery, other than sales in discharge of a matured futures contract.

The Commodity Exchange Act thus differentiates between the process of formation and discharge of executory futures contracts and the *sale* of commodities for delivery in the future, known as cash forward contracts. Although the distinction is important for the CFTC—because the agency has exclusive jurisdiction over futures but is excluded from regulating most species of cash forward contracts¹⁴—considerable confusion is associated with the conceptual line of demarcation between the two.

A competent economist, experienced in the intricacies of the grain trade, will have little difficulty drawing this distinction.¹⁵ An equally competent lawyer, however, upon examination of the controlling statute—the Commodity Exchange Act—will have extreme difficulties in doing so.¹⁶ Some, it will be argued here, have misperceived both the appropriate economic and legal distinctions. The Commission, for its part, must learn from the one discipline no less than from the other. The rationale for the existence of an independent and presumably expert agency is that its members understand

the Exchange, the price for a distant future delivery on the Exchange, the price for an immediate delivery of spot cotton in a spot market, and the price for a distant forward shipment in a spot market.

Id. at 255-56. That this is the trade usage and meaning of cash is also verified by Holbrook Working, the dean of futures economists, in his classic article *Futures Trading and Hedging*, 63 AM. ECON. REV. 314 (1953), reprinted in *THE ECONOMICS OF FUTURES TRADING* 68, 70 (B. Goss & B. Yamey eds. 1976). Taylor, *Futures Trading in Commodities—A New Standard of Legality?*, 43 YALE L.J. 63 (1933) had the same understanding respecting the Grain Futures Act: "'Cash' transactions, sales of actual grain for deferred delivery . . . , are outside of its scope." *Id.* at 96.

¹⁴ See Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976).

¹⁵ Holbrook Working explained the problem and its resolution:

Mistaken impressions of the difference between futures trading and other trading have been furthered by a language difficulty that arises in connection with the frequent need to speak collectively of all-other-sorts of trading, as against futures trading. There is no good and convenient word for the purpose—and perhaps there cannot be . . . 'Nonfutures' would be an accurate and transparent term for the purpose, but an awkward one. In this situation, convenience has been served most commonly by using the word 'cash' to mean 'nonfutures'.

Working, *supra* note 13, at 70.

¹⁶ See, e.g., Memorandum from the Office of General Counsel, CFTC, to the Commission, Determination Pursuant to Section 217 of the Commodity Futures Trading Commission Act of 1974 Whether Any Leverage Transactions Are Contracts for Future Delivery Within the Meaning of the Commodity Exchange Act (Sept. 20, 1978), reprinted in [1978] SEC. REG. & L. REP. (BNA) No. 470, at E-1.

the economics and dynamics of the trade and administer the governing statute accordingly.

Three important questions facing the CFTC depend significantly on a proper understanding of the difference between futures and cash forward contracts:

(1) Are leverage contracts more appropriately cognizable as cash forward contracts than as futures?

(2) Is it a fundamental premise of the Commodity Exchange Act that commodity options generally are cognizable as futures, warranting regulation similar to that imposed on futures exchange trading between 1936 and 1975?

(3) Are contracts for the later sale and delivery of rights, interests, or services—commodities that are not traditional goods—cognizable as futures if settlement does not require delivery of a good, article, or instrument?

This article will answer the first two questions in the affirmative, based on an examination of the relevant jurisdictional and definitional provisions of the Act, traced from their historical origins. This may be seen as a genealogy of futures. The article will then explore the characteristics of nontraditional futures that may be eligible for sponsorship and protection under the Act. This is not unlike deciphering a genetic code: to what may the Commodity Exchange Act give birth? What novel sorts of futures can we anticipate that the trade and trade organizations may seek to sponsor and create? The question is whether contract market status may be conferred upon a futures contract that calls for delivery of a calculated per-unit general equity value. The article will suggest that futures contracts based on fluctuations in, for example, a consumer price index, stock market indexes, or almost any imaginable right, interest, or service are cognizable as futures fitting easily and consistently into the conceptual legal pattern established in federal law over sixty years ago and applicable today.

II. GENEALOGY

A. *Cash Forwards v. Futures*

1. *Early Distinctions*

In the early decades of the twentieth century, two kinds of cash

grain transactions took place on the floor of the Chicago Board of Trade: spot and forward. Two species of futures were also traded during this period: conventional offset futures and short-term options called privileges. Even under the then-prevailing strict demarcation between interstate and intrastate commerce, enough cash grain transactions crossed the Illinois state line that such trades were acknowledged to be interstate in character. Futures trading, on the other hand, was generally considered to fall in the category of intrastate commerce.¹⁷ Generally speaking, cash had to do with the movement of goods, and futures with the pricing of goods. Cash transactions were not then, and are not now, synonymous with spot transactions because cash transactions encompass both spot and forward sales. Furthermore, the term "cash grain," or its modern equivalent "cash commodity," cannot properly be equated with a commodity sold "cash and carry."

Within the category of cash grain transactions, cash forward contracts were further subdivided into "to arrive" and "time" contracts. "To arrive" contracts in grain and cotton were usually sales of goods which occurred at the time the contract was made. Such contracts called for immediate delivery, and financial settlement at the presently prevailing price was based on the specific goods scheduled shortly "to arrive" at the terminal market after being shipped from an interior or overseas collection point. British futures markets appear to have evolved from dealings in such "to arrive" contracts.¹⁸

¹⁷ This is reflected in the observation made by the Senate Agriculture Committee in its report on H.R. 11843, 67th Cong., 2d Sess. (1922), which became The Grain Futures Act, ch. 369, 42 Stat. 998 (1922). The Report states:

The bill is based upon the Commerce power of the Constitution and is intended to take the place of that portion of the future trading act of Aug. 21, 1921 (42 Stat. 187), which was declared unconstitutional by the Supreme Court of the United States. . . . That Act was based solely upon the taxing power of the Constitution and as to its regulatory features was held by the court to be an unauthorized exercise of that power because it was plainly designed as a regulatory and not a revenue law. Although transactions in futures generally are intrastate in character, and therefore ordinarily subject to State regulation only, nevertheless it is well established . . . that when . . . transactions of an intrastate character are . . . conducted under such circumstances as to become an obstruction and burden upon [interstate] commerce they come within the power of Congress to regulate interstate commerce. Transactions in grain futures are shown to be within this power by the finding and declaration in Section 3 of the bill . . . that they are conducted under circumstances and conditions which result in substantial interference with the free movement of grain in interstate commerce.

S. REP. NO. 871, 67th Cong., 2d Sess. 3 (1922).

¹⁸ G. REES, *BRITAIN'S COMMODITY MARKETS* 416 (1972).

"Time" contracts were also sales of goods effected at the time the contract was made. These contracts, however, contemplated that the selling interior merchant would hold and store the commodity for an extended period of time. In the meantime, both the farmer and the interior merchant, who were sellers of goods in turn, were financially secure with respect to the transactions. The farmer, at least, would already have been paid, leaving the terminal merchant bearing the risk of price fluctuation unless he were able to sell or assign his contract rights.

As the subject of time contracts became future rather than present goods, and as financial settlement was deferred to the time of delivery, traffic in assignments of rights in time contracts developed into organized futures trading in Chicago.¹⁹ Time forward contracts involved sales of a cash commodity. They contemplated literal physical delivery, and involved an extension of credit to the extent that financial settlement was deferred to the time scheduled for delivery.

Delivery in connection with futures contracts is a vestige of the historical evolution of the time forward contract into the modern futures contract, but much has changed. The futures contract does not involve the present sale of a commodity or an extension of credit, nor is it made only for product marketing or securing raw material for milling and processing operations. Delivery is no longer essential to the purpose of the contract. Instead, it serves the purpose of correlating the price of futures market offset transactions to contemporaneous delivery-market transactions upon maturity of the futures contract.

Two species of generic futures contracts were also dealt in on the floor of the Chicago Board of Trade during this period. One type, which may be labeled clearinghouse futures, was the orthodox offset futures contract. These were the futures of the economics textbooks and were readily identified, described, and classified. Clearinghouse futures, however, were not the only type of "contracts of sale of a commodity for future delivery." The other species of exchange-traded futures were the short-term options known as privileges. A significant thesis of this article is that, consistent with the never-

¹⁹ See T. HIERONYMOUS, *ECONOMICS OF FUTURES TRADING* 71-74 (1971); Working, *Economic Functions of Futures Markets*, in *FUTURES TRADING IN LIVESTOCK* 8-9 (H. Bakken ed. 1970).

altered basic structure of the Commodity Exchange Act and its lineal ancestors, and within its historic provisions, trading in commodity options is appropriate only on organized boards of trade, and might best be regulated in the same manner that trading in clearinghouse futures contracts is regulated.

Thus, spot, cash forward, futures, and options transactions all took place at one time or another on the floor of the Chicago Board of Trade.²⁰ Nowadays, spot transactions in grain probably never

²⁰ In *Board of Trade v. United States*, 246 U.S. 231 (1918), the Supreme Court, in an opinion by Justice Brandeis, described the three "standard forms of trading" in grain conducted on the Chicago Board of Trade in 1918. The first form was called spot sales, which Justice Brandeis accurately characterized as dealing in grain "already in Chicago" and as being a "sale . . . for immediate delivery." *Id.* at 236. The second, future sales, was characterized as involving "agreements for delivery later in the current or in some future month." *Id.* The name is more accurate than the Court's description. When the contract was made, the sale had not occurred and would not occur on the floor of the Board of Trade; it would take place in the future. Delivery might follow upon the future sale, but it was a mere incident thereof and did not often occur in connection with dealings in clearinghouse futures contracts. The third form of trading Justice Brandeis noted was in "sales 'to arrive.'" His characterization of "sales 'to arrive'" was only subtly different from his characterization of "future sales," yet the two served entirely different purposes. Sales "to arrive" were, in trade usage, sales of cash commodities, cash forward contracts, which were popularly referred to as "calls."

Unlike futures, calls were not price-discovery and hedging transactions. It would have been unthinkable for a futures price determined in a call session at the close of futures trading to prevail throughout that afternoon and evening as the call price did. Futures market pricing was discontinuous and prices were volatile, fluctuating from minute to minute. Pricing began anew each morning and closed early each afternoon. Cash market pricing, on the other hand, was continuous and usually stable over a half-day period. Cash market transactions did not cease when the Board of Trade closed; call prices were in effect after the closing of the exchange. Indeed, they applied exclusively to that time period. Call transactions were a part of cash market activity. They contemplated future delivery, and speculators figured largely in the transactions. Standardized nonfutures contracts contemplating future delivery were thus sold to the public. Call transactions generally effected immediate transfer of title to cash grain and set in motion the interstate shipment of specific goods.

The Chicago exchange's "call rule" was challenged as an antitrust violation in *Board of Trade v. United States*. The rule prohibited board members from executing "to arrive" contracts after exchange hours at a price other than that set at the close of the call session. The Supreme Court gave nine justifications for upholding the rule, most of which centered on the perception that a cash forward auction market actually increased competition by opening dealing in cash grain to more traders than the few Chicago merchants who had previously dominated the trade.

Almost hidden in the Court's opinion is an observation that is crucial to the attempt rationally to categorize cash forward contracts as cash grain transactions rather than as futures. Justice Brandeis noted that the auction call market "enabled country dealers to sell some grain to arrive which they would otherwise have been obliged either to ship to Chicago commission merchants or to sell for 'future delivery.'" *Id.* at 241 (emphasis added). His

occur on exchanges that are also futures contract markets, but they do occur under the sponsorship of "boards of trade" that would never, uncounseled, recognize themselves as such. In the course of historical development, cash forward contracting has assumed other forms and taken place at other sites, and today it most commonly occurs by telecommunication between sites. On-exchange cash forward dealings in grain are largely restricted to Kansas City and Minneapolis. Options dealings in grain have been illegal since 1936.²¹

One could once satisfactorily define a grain exchange as a place where people came together to buy and sell grain. Around the turn of the century, grain and livestock were bought and sold extensively at central auction markets in terminal cities. Today the function of commodities exchanges is practically limited to trading in clearing-house futures contracts. Sales of actuals no longer occur in central markets. As a result, the importance of the price-discovery function of futures markets is heightened. Today cash grain is priced continuously by reference to the near "future," regardless where it may be traded.

2. *Initial Legislation*

The present text of the Commodity Exchange Act has its beginnings in the Cotton Futures Act of 1917.²² Alone among the statutes in the evolutionary chain culminating in the current version of the Commodity Exchange Act, the Cotton Futures Act placed both futures and cash forward contracts in the same legal category. It imposed a tax "upon each contract of sale of any cotton for future delivery made at, on, or in any exchange, board of trade, or similar

understanding, and consequent categorization, was that sales "to arrive" were to be included in some category other than futures. This understanding was correct and was consistent with the usage and practice of the trade.

²¹ See Commodity Exchange Act, ch. 545, § 4c(B), 49 Stat. 1491 (1936) (current version at 7 U.S.C. § 6c(B) (1976)). This prohibition has been perpetuated in slightly altered form in the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 4c(a)(B), 88 Stat. 1389.

²² United States cotton futures Act, ch. 313, 39 Stat. 476 (1916), was a portion of the act making appropriations for the Department of Agriculture for fiscal 1917. It repealed the United States cotton futures Act, ch. 255, 38 Stat. 693 (1914). Though effectively superseded in large measure by subsequent acts, the Cotton Futures Act of 1917 appears never to have been repealed.

institution or place of business"²³ Couched in the language of the Uniform Sales Act, which was in effect at the time, the Cotton Futures Act taxed both (1) unconditional²⁴ contracts to sell specific²⁵ cotton in a deliverable state,²⁶ title to which was transferred by the

²³ United States cotton futures Act, ch. 313, § 3, 39 Stat. 476 (1916). The tax applied to transactions in which actual or constructive delivery took place on the major exchanges—conspicuously Memphis, Dallas, Houston, Savannah, and New Orleans—where terminal market dealers assembled and traded their wares. The amount of the tax was high, two cents per pound, or \$10 per standard 500-pound bale. *Id.* § 3; *see id.* § 4. It was thus a prohibitive tax which encouraged terminal market dealers to conform both their futures and cash forward dealings in cotton on the major exchanges to one of the three statutory exemptions:

(1) Section 5 contracts were exempt. These were orthodox futures contracts differing from grain futures contracts only in that the Cotton Futures Act mandated settlement on the basis of "actual commercial differences" rather than exchange-dictated "fixed differences." *Id.* § 5. "Setoff" or "ring" settlement of § 5 contracts was permitted. *See id.* § 10.

(2) Section 10 contracts—the purest form of cash forward contracts—were exempted. These contracts were adaptable by the parties to their precise marketing, manufacturing, and processing needs, and they could be used as a source of supply. Section 10 permitted the parties to specify the grade, type, sample, or description of the cotton "contracted to be bought or sold, the date of the purchase of sale, and the time when shipment or delivery of such cotton was to be made." Unlike § 5, § 10 prohibited setoff or ring settlements; actual transfer of the specified cotton was required. *Id.*

(3) Section 6A contracts, calling for later physical delivery of cotton at the exchange, were also exempted. Under this hybrid contract, the seller had no option to deliver a lower grade upon payment of commercial differences or to receive a premium payment upon delivery of a higher grade. At the time of tender of the cotton, however, the seller and buyer could agree to a delivery of nonbasis-grade cotton at a mutually acceptable price. Setoff or ring settlement was also permitted. *See id.* § 6A. Section 6A contracts were hybrids because, upon demand of the buyer, the contract would operate as a cash forward contract for basis-grade cotton; at the same time, however, the seller could have escaped from continuing contractual obligation by previous ringing-out or offset. The seller had to pay, or receive payment, to ring-out, and if nonbasis-grade cotton were tendered at the contract's maturity, it could only be sold "spot" at then-current prices, in which case the seller would lose all advantages of the futures contract because he lacked the inventory of basis-grade cotton. These few on-exchange spot sales were controlled by federal law, but otherwise all spot sales—of which there were many more in cotton than in grain—were outside the scope of the Act.

Dealer-to-dealer cash forward transactions, which were effectively required to take the form of either a § 10 or a § 6A transaction, were subject to taxation under the Cotton Futures Act of 1917 to the extent that eventual delivery took place "at, on, or in an exchange." The Act applied to every contract of sale of cotton for future delivery, in the broadest sense of that phrase. An adequate exemption for farmer-to-farmer and farmer-to-merchant cash forward contracts was provided by excluding futures contracts and cash forward contracts not involving "delivery made at, on, or in any exchange, board of trade, or similar institution or place of business." *Id.* § 3. These off-exchange transactions involved the initial assemblage of cotton and contemplated delivery at the furnishing merchant's place of business or the local gin.

²⁴ Uniform Sales Act § 1(3) (1906 version).

²⁵ *Id.* § 18(1).

²⁶ *Id.* § 19 (Rule 1).

making of the contract,²⁷ even if payment and delivery were long deferred²⁸—cash forward contracts; and (2) contracts later to sell²⁹ cotton, perhaps not yet grown,³⁰ of a given description—futures contracts.

Unlike the later Future Trading Act of 1921, which broadly excluded cash forward grain contracts from taxation whether they called for exchange-regulated delivery or not,³¹ the Cotton Futures Act exclusion was keyed to delivery location.³² Both futures and cash forward cotton contracts contemplating delivery to be made, if at all, “at, on, or in any exchange, board of trade, or similar place of business”³³ were taxed. The Act thus left untaxed, with respect to cotton, all off-exchange futures, privileges, options, calls, indemnities, and advance or decline guarantees. These omissions apparently caused no problems, however, probably because such trade in cotton did not then exist.

In 1921 Congress passed the Future Trading Act,³⁴ which undertook to tax grain futures in a format similar to the Cotton Futures Act, but with a crucial difference: futures and cash forward contracts were clearly differentiated. Section 4 of the 1921 Act imposed a tax³⁵ on “each contract of sale of grain for future delivery,”³⁶ but section 2 provided that “[t]he term ‘future delivery,’ as used herein, shall not include any sale of cash grain for deferred shipment or delivery.”³⁷ The deceptively simple language of section 2 makes a fundamental distinction that has been maintained to the present day.³⁸

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.* § 1(2).

³⁰ *Id.* § 19 (Rule 4(1), Rule 5).

³¹ See notes 34-51 *infra* and accompanying text.

³² A delivery location exclusion, as distinct from an exclusion based on location of contract formation, resulted from the desire of parties forming cash forward contracts for secrecy. They acquired information on the floor of a cash exchange, but went back to their offices to form contracts—utilizing runners, telegraphs, telephones, and personal off-exchange meetings. A. GARSIDE, *COTTON GOES TO MARKET* 107-08 (1935).

³³ United States cotton futures Act, ch. 313, § 3, 39 Stat. 476 (1916).

³⁴ The Future Trading Act, ch. 86, 42 Stat. 187 (1921).

³⁵ The tax was “20 cents a bushel on every bushel involved” in a transaction. The Future Trading Act, ch. 86, § 4, 42 Stat. 187 (1921).

³⁶ *Id.*

³⁷ *Id.* § 2.

³⁸ See Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976) (“The term ‘future

The Future Trading Act originated in the House as H.R. 5676.³⁹ That bill retained the Cotton Futures Act's definition of contract of sale, which included not only cash transactions, both spot and forward, but also, under Uniform Sales Act concepts, all futures contracts.⁴⁰ The House further copied the Cotton Futures Act by taxing futures and cash forward contracts in grain that would be fulfilled "at, on, or in an exchange, board of trade, or similar institution or place of business."⁴¹ In contrast to the Cotton Futures Act,⁴² however, both H.R. 5676 and ultimately the Future Trading Act gave

delivery' as used herein, shall not include any sale of a cash commodity for deferred shipment or delivery.").

³⁹ H.R. 5676, 67th Cong., 1st Sess. § 2 (1921), reprinted in *Hearings on H.R. 5676 Before the House Comm. on Agriculture*, 67th Cong., 1st Sess. 355 (1921).

⁴⁰ Section 2 of the Cotton Futures Act is the source of the continuing definitional and jurisdictional statement that "the term 'contract of sale' shall be held to include sales, agreements of sale, and agreements to sell." Section 1 of the Uniform Sales Act differentiated between "contract to sell" and "sale," and considered the universe fully occupied by those two categories. The most likely explanation for the contemporary meaning of "agreements of sale" in § 2 of the 1917 Act is that the phrase parallels or derives from the conception of § 1(2) of the Uniform Sales Act that "a sale . . . is an agreement whereby the seller transfers the property [title] . . . for a consideration called the 'price'." The conception persists in § 2-106(1) of the Uniform Commercial Code: "A 'present sale' means a sale which is accomplished by making of the contract."

So viewed "agreement of sale" is technically descriptive of a sale, while "sale" describes the same transaction in both lay and Sales Act terms. Cash forward contracts are technically "contracts to sell" in Uniform Sales Act terms, but they normally effect transfer of title to the subject goods upon the making of the contract if "there is an unconditional contract to sell specific goods, in a deliverable state." Uniform Sales Act §§ 18, 19 (Rule 1). Cash forward contracts thus share the major characteristic of a Sales Act "sale" with spot transactions: when title is transferred, a sale operationally takes place in Sales Act terms, even though both payment and delivery are deferred. Futures contracts are not cognizable as a Sales Act "sale," nor do they have the same direct effect as a Sales Act "sale" in terms of transfer of title and shift of risk of loss. A futures contract is, rather, comprehended within the meaning of the phrase "agreements to sell" in the Commodity Exchange Act and all its predecessor statutes, and within the meaning of "contract to sell goods" in § 1(1) of the Uniform Sales Act. Thus, subsumed within "contract of sale" in § 2 of the Cotton Futures Act are Sales Act "sales" of cash cotton, both spot and forward, and Sales Act "contracts to sell" made by forming clearinghouse futures contracts or options to sell either clearinghouse futures or actual cotton. Sales Act "contracts to sell," which may be either absolute or conditional, are comprehended within the phrase "agreements to sell" in § 2 of the Cotton Futures Act.

⁴¹ United States cotton futures Act, ch. 313, § 3, 39 Stat. 476 (1916).

⁴² See note 23 *supra* and accompanying text. In the Cotton Futures Act "board of trade" had been undefined, but the language "exchange, board of trade, or similar institution or place of business," presumably referred only to institutions such as those in Memphis and New Orleans where the terminal market functions of sale on consignment, warehousing, and auction sales were carried out.

an expansive definition to "board of trade."⁴³ The term encompassed not only the major grain exchanges in Chicago, Kansas City, Minneapolis, and elsewhere, but also all farmers' organizations.

Under the House version, then, all grain transactions—whether futures or cash forward contracts—at virtually any location were subject to taxation unless otherwise excepted. To counter the possibility that cash forward or futures transactions entered into by farmers or farmers' associations might be taxed, section 4 of the House bill provided two exceptions from taxation. First, contracts were exempted

[w]here the seller is at the time of the making of such contract the owner of the actual physical property covered thereby, or is the grower thereof, or in case either party to the contract is the owner or renter of land on which the same is to be grown, or is an association of such owners, or growers of grain, or of such owners or renters of land⁴⁴

The second exemption allowed farmers, dealers, or their associations to form and discharge orthodox clearinghouse futures without taxation if the contracts were "made by or through a member of a board of trade which has been designated by the Secretary of Agriculture as a 'contract market.'"⁴⁵

⁴³ The Future Trading Act, ch. 86, § 2, 42 Stat. 187 (1921) defined "board of trade," as it is still defined, as "any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling grain or receiving the same for sale on consignment." This definition is in no way restricted to terminal market functions as was the undefined phrase "exchange, board of trade, or similar institution or place of business" in the Cotton Futures Act of 1917. Note again the broad language: "board of trade shall . . . include any . . . association . . . of persons . . . engaged in the business of . . . selling grain." *Id.*

⁴⁴ H.R. 5676, 67th Cong., 1st Sess. § 4(a) (1921), reprinted in *Hearings on H.R. 5676 Before the House Comm. on Agriculture*, 67th Cong., 1st Sess. 355 (1921). Under this convoluted exception, an individual grain farmer, owner, or tenant was free only to take short hedge positions by selling either futures or cash forward contracts, while a farmers' association could take either long or short positions, regardless whether they were cognizable as hedges, if the members of an association, in appropriate measure or quality, were growers, owners, or renters. An individual grain dealer was also free thereby to take only short hedge positions, while an association of grain dealers, incongruously, could take long or short positions, not necessarily cognizable as hedges, if the members of the grain dealers' association were, in appropriate measure, owners of grain inventories. The scope of the exception was quite inadequate as respects normal commercial hedging by dealers.

⁴⁵ *Id.* § 4(b). There were, of course, two other exclusions from taxation incorporated into the introductory clause of the House version of § 4. One was for pure spot transactions, effected by language specifying that the tax was limited to "contracts of sale of grain for

The House version of section 4, by taxing contracts calling for on-exchange delivery, had the pernicious and surely unintended effect of allowing the formation of option and privilege contracts entitling their holders to buy and sell, at a previously fixed striking price, forward or futures contracts calling for performance *other than* delivery of grain, "at, on, or in an exchange." Thus, operations of free exchanges and open boards of trade were not taxed.⁴⁶ The proposed

future delivery." *Id.* § 4. The other was for forward and futures transactions *not* calling for ultimate delivery "at, on, or in" an exchange. Thus, despite the other exemptions from taxation, the § 4(a) exception for owners and growers of the physical commodity was still needed to accomplish the following results:

(1) Provide that farmers' associations would not be cognizable as boards of trade in relation to the Act's operative provisions.

(2) Exempt from tax actual grain sales effected in fulfillment of futures contracts by the several parties enumerated in section 4(a), under the circumstances described therein, including grain sales and deliveries pursuant to futures contracts made with farmers, co-op elevators, and grain dealers.

(3) Exempt from prohibitive excise formation of cash forward contracts calling for performance of delivery "at, on, or in an exchange or board of trade" by the parties and under the circumstances enumerated in section 4(a), including, among others, the formation of Chicago Board of Trade "calls" by farmers, co-op elevators, and grain dealers.

⁴⁶ During this period there flourished in many large American cities a confidence game in which bunko artists, over a period of weeks or months, engaged in "bucketing" by simulating the operations of a legitimate stock or commodity brokerage office or exchange or a working bookmaker's office. Contemporary references to "private exchanges" comprehend, and may largely be restricted to, this phenomenon. In organizational form, the orthodox exchanges in Chicago, Kansas City, Minneapolis, and elsewhere were no less private. The distinction, rather, is that on contract markets all parties forming futures contracts become obligated to the clearinghouse, not to any individual market participant. Purported private-issue futures not backed by a properly functioning clearinghouse are scarcely distinguishable from "bucketed" transactions. See note 64 *infra*. Traditional bucketing is easily described. The name is derived from the broker's disposition of a customer's order to have a futures contract formed for him. The customer presumptively intends to have the order forwarded to a contract market where a futures contract will be formed by his broker, for the customer's account, acting as agent for an undisclosed principal. In monetary terms, however, a speculator may be quite indifferent about whether his broker causes the contract thus to be formed, or whether the broker himself, rather than a market participant, takes the opposite position.

Unless the futures contract is made in the pit and passed to the clearinghouse, the very impressive and highly successful customer protection services of the clearinghouse are not available to the customer. If the broker, with or without the customer's knowledge or consent, does not cause the contract to be formed on the exchange, but simply puts the order in his own bucket or waste basket while pretending—often in collusion with the customer—that a futures contract has been formed, he is bucketing.

In so doing the bucketing broker wagers against his customer, and the broker can win only if his customer loses. The customer does, however, obtain the monetary benefit of the bargain he meant to make. The bucketing broker's gain is not derived from the customer's loss. The evil is not necessarily fraud, but, far more broadly, breach of fiduciary obligation—failure of the agent to place himself in the position of single-mindedly advancing the interests of his principal.

section 4(a) exception, moreover, failed to exempt from taxation dealers' cash forward contracts contemplating on-exchange delivery when such contracts were not validated by dealer ownership of grain "at the time of the making of such contract."⁴⁷ Thus, the coverage of the proposed exception was woefully inadequate in that it would have prohibitively taxed a large legitimate traffic in cash forwards on the one hand, while failing to outlaw bucketing on the other.

Senator Capper and the Senate Agriculture Committee recognized the defects in the House bill. Since the purpose of the "at, on, or in an exchange" language of the bill was to permit growers and dealers to consummate cash forward transactions,⁴⁸ Senator Capper added an exclusion from taxation in section 2 which segregated all cash forward contracts from futures. The exclusion, which appears in the present Commodity Exchange Act, simply provided that contracts of sale of a commodity for future delivery would not be construed to include "any sale of cash grain for deferred shipment."⁴⁹ As finally enacted, the words "or delivery" were added.⁵⁰ As the committee explained, "[t]his addition was made in order that transactions in cash grain when made for deferred shipment or delivery would not fall within the provisions for taxing imposed in section 4 of the bill."⁵¹

3. *Cash Forward Contracts: A Tentative Conclusion*

The most persuasive economic analysis of the subject tends to the conclusion that both the trade and the commentators understand "cash" to be an adjective having no relation to the timing of deliv-

In its more sophisticated form, a bucketing broker would, in executing his customer's instructions, take a given position in the pit as agent for his customer, but additionally take for himself, in connection with execution of the customer's order, a position contrary in full or in part to his customer's position. The broker thus would place himself in a classic conflict-of-interest situation of profiting on his own futures positions if and when the customer loses on his positions. State bucket-shop laws are slowly falling into desuetude, or being repealed. In any event they are probably preempted by the Commodity Exchange Act.

⁴⁷ H.R. 5676, 67th Cong., 1st Sess. § 4(a) (1921).

⁴⁸ See S. REP. No. 212, 67th Cong., 1st Sess. 1 (1921).

⁴⁹ *Id.* Senator Capper and the Senate Agriculture Committee appeared to understand that the "at, on, or in an exchange" language, if carried forward from the 1917 Act, would indeed permit untaxed operation of "private exchanges or bucket shops." See *id.* This was a problem for grain, as it had not been for cotton, because self-styled free exchanges and open boards of trade had grown up in northern cities, particularly Chicago.

⁵⁰ The Future Trading Act, ch. 86, § 2, 42 Stat. 187 (1921).

⁵¹ S. REP. No. 212, 67th Cong., 1st Sess. 1 (1921).

ery, sale, payment, shipment, or transfer of title. Cash transactions comprise the universe of commercial transactions in commodities after the very narrow category of highly stylized transactions called "futures" is either excluded or excepted.⁵²

To either economists or trade participants, this point is fundamental: the universe of commodity transactions divides into subsets of cash and futures. The treatment accorded cash forward contracts under the Cotton Futures Act was aberrant and exceptional; only with respect to cotton was the attempt ever made to impose a federal regimen on cash forward contracting. With respect to grains, and later other commodities, the draftsmen knew that federal regulation or taxation of cash forward contracts was inappropriate and unintended.

⁵² Some evidence that this was the conception of the draftsmen of the original legislation, the Future Trading Act of 1921, can be seen in § 5 of that Act, which set out the few requirements a board of trade had to meet in order to qualify for designation as a contract market. Section 5(b) prescribed the original reporting requirement. The contract market, or more accurately, the board of trade seeking to become a designated contract market, must have been ready and able constantly to tell the governmental authorities the details and terms of all transactions entered into by the board and the members of the board of trade. The Future Trading Act, ch. 86, § 2, 42 Stat. 187 (1921). These transactions fell into two categories, which were mutually exclusive and which together exhausted the field. Reports were to be made of all transactions "either in cash transactions consummated at, on, or in a board of trade, or transactions for future delivery." *Id.* Board members engaged in off-exchange cash transactions also, but a board of trade was obligated to report only cash transactions taking place at that board of trade.

Looking back at § 4(a) of the Future Trading Act, it is clear that the draftsmen understood that futures and forward contracts were made, not sold. The Act refers to the required holding of grain by the putative seller "at the time of the making of such contract." *Id.* § 4. Reports were required by § 5(b) of "cash transactions consummated at, on, or in a board of trade," not of "cash sales"—a meaningless phrase studiously avoided in the Act. Although "sales of cash grain" do exist, "cash sales of grain" means nothing in the commodities context. The statutory phrase in § 2(a)(1) is "cash commodity," not "cash sale." Perhaps a few cash *spot* transactions were consummated at, on, or in a board of trade seeking designation as a contract market. At local farmers' cooperative elevators, readily cognizable as boards of trade under the Act, cash spot transactions indeed took place, but the federal authorities regulating grain futures neither wanted, needed, nor required reports of such transactions.

The cash transactions "consummated at, on, or in a board of trade" seeking designation as a contract market were "to arrive," "time," or "call" transactions. These were all cash *forward* transactions. The authorities were interested in acquiring reports of these cash transactions as the contracts were formed. The cash transactions to which reporting applied were overwhelmingly, if not exclusively, cash *forward* transactions awaiting future delivery; yet they fell into a different category entirely than did "transactions for future delivery."

B. *Leverage Contracts—A Special Case*

Federal regulation of cash forward contracting was indeed unintended until the enactment of the Commodity Futures Trading Commission Act of 1974 (CFTC Act).⁵³ Section 217 of that Act gave the CFTC exclusive jurisdiction over leverage contracts—jurisdiction that its predecessor agency had not possessed. The executory contract rights created by leverage transactions were correctly dealt with and categorized in the CFTC Act not by falsely extending the definition of futures, but simply by creating a new area of CFTC jurisdiction.⁵⁴

All that section 217 empowered the CFTC to do was to treat leverage transactions—generic cash forward contracts—*legally* the same as futures for regulatory purposes *if* the Commission found that leverage contracts were in fact being formed and discharged for classic hedging or price-discovery purposes on boards of trade that had neglected or refused to obtain designation as a contract market.⁵⁵ Only if the foregoing were true might section 217 override the

⁵³ Pub. L. No. 93-463, 88 Stat. 1389.

⁵⁴ The Commission's authority over leverage contracts does not flow from a strained classification of leverage contracts as "contracts of sale of a commodity for future delivery"—as modified by the exclusion of "sales of cash commodity" from the term "future delivery." Rather, it flows directly from the newly-bestowed jurisdiction over "any transaction for the delivery of silver bullion, gold bullion, or bulk silver coins or bulk gold coins, pursuant to a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract." Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 217(b), 88 Stat. 1389; see Commodity Exchange Act § 19(b) (to be codified at 7 U.S.C. § 23).

A reasonable caveat was entered in § 217 which some are now misinterpreting. Section 217 provided: "If the Commission determines that any such transaction is a contract for future delivery within the meaning of the Commodity Exchange Act, as amended, such transaction shall be regulated in accordance with the provisions of such Act." Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 217, 88 Stat. 1389. The drafting is inartful; the objective imprecise. What is a "contract for future delivery"—a drayage contract? In the definitional and jurisdictional sections of the Commodity Exchange Act that infelicitous phrase does not appear. The only full and correct reference to the futures contracts formed and discharged in transactions taking place on Commission-designated contract markets is "contract of sale [agreement to sell later] of any commodity for future delivery on or subject to the rules of any board of trade in the United States . . . which has been designated by the Commission as a 'contract market.'" Commodity Exchange Act § 4, 7 U.S.C. § 6 (1976). This is longhand for what economists and the trade understand to be simply the futures alluded to and best described in § 3 of the Commodity Exchange Act.

⁵⁵ This may have been happening in the past, but it was impossible to know what was transpiring under the mantle of organizations which used such names as "American Board of Trade," "Pacific Coast Coin Exchange," and "International Precious Metals Exchange."

section 2(a)(1) exclusion of sales of cash commodities. The last sentence of section 217 authorized the possible override and also had another effect: it gave the CFTC the option to treat this kind of board-of-trade-formed hedging contract—if it were such—in a manner different from other futures. Otherwise the provisions of the Act simply apply. Section 217 gave the CFTC an option to determine that a leverage contract will be legally *treated* as a classic future, but only *if it is in fact a future* within the jurisdictional construct of the historic Act, which requires the involvement of a board of trade and a hedging or price-discovery purpose.

C. Options as Futures

Commodity options are conditional contracts to acquire either a particular commodity or a futures contract for that commodity.⁵⁶ Options can be comprehended within the meaning of "contract of sale of a commodity for future delivery" and thus are within the scope of coverage of the Commodity Exchange Act provisions that regulate or prohibit commodity futures.⁵⁷

Commodity options, however, have been treated separately in the statutes since 1921. Section 4 of the Future Trading Act taxed grain futures contracts while section 3 imposed a like tax on options.⁵⁸ In 1922 the Supreme Court in *Hill v. Wallace*⁵⁹ declared the section 4 futures tax unconstitutional. When the Grain Futures Act of 1922 was drafted to achieve—by direct prohibition in reliance on the

Was there hidden in these organizations a board of trade? The answer is probably no, if installment-sale merchandising, coupled with secured financing, was the focus of their operations, but the point is nonetheless debatable.

⁵⁶ See generally Lower, *The Regulation of Commodity Options*, 1978 DUKE L.J. 1095.

⁵⁷ To the extent that commodity futures contracts create essentially an executory contract right, and to the extent that actual execution of the contract is not contemplated, orthodox privileges or commodity options are entirely of the same character as futures. Both are generally used in commerce as an executory contract right only. Option contracts can be used to assure a source of supply, particularly for supplies that may not be required, just as delivery on a futures contract may be demanded and the commodity thus acquired used in manufacturing operations. But neither is efficient in terms of price nor satisfactory in terms of quality. Futures markets are not good sources of supply; delivery is always a mistake or the result of a mistake. Delivery is to arbitrage as war is to diplomacy—the result of a failure of the ideal process of adjustment.

⁵⁸ The Future Trading Act, ch. 86, § 3, 42 Stat. 187 (1921).

⁵⁹ 259 U.S. 44 (1922). When the question of the constitutionality of the § 3 prohibitive tax on options came before the United States Supreme Court four years later, it also was declared unconstitutional. *Trusler v. Crooks*, 269 U.S. 475 (1926).

commerce clause—the result unobtainable by taxation, the House version of what is now section 3 of the Commodity Exchange Act provided that “[t]ransactions in grain involving the sale thereof for future delivery as commonly conducted on boards of trade and known as ‘options’ or ‘futures’ are affected with a national public interest.”⁶⁰ The Senate version of the bill struck out the words “options or.”⁶¹ Senator Capper’s committee explained:

The word “options,” as used in the grain trade, has a technical meaning and refers to such transactions as “puts and calls,” “ups and downs,” “indemnities,” etc., which, while *they are also “futures”* within the broad meaning of that term, need not be included in this bill because they are subject to the tax of 20 cents per bushel laid by the future trading act of August 24, 1921.⁶²

⁶⁰ H.R. 11843, 67th Cong., 2d Sess. (1922).

⁶¹ S. REP. NO. 871, 67th Cong., 2d Sess. 1 (1922).

⁶² *Id.* (emphasis added). The view that options are also futures was not unique. In continental Europe—where traffic in options was and is widespread—options, there called “premiums,” are considered ordinary futures contracts with a special stipulation that, in consideration of a cash payment, one of the parties has a right to withdraw from the contract within a specified time. U.S. DEP’T OF AGRICULTURE, CIRCULAR NO. 323, TRADING IN PRIVILEGES ON THE CHICAGO BOARD OF TRADE 2-3 (1934). Functionally, an American clearinghouse future provides the same right of withdrawal if the party rings out. The crucial difference is the timing of the payment made, if any, by the party seeking to shift risk to the party presumably receiving a risk premium. The option writer receives an “up-front” earned premium. The risk-assuming party to a futures contract may or may not receive equivalent compensation—a risk premium—as part of a return on his round-turn futures transaction. See generally Gray, *The Search for a Risk Premium*, 69 J. POL. & ECON. 250 (1961), reprinted in Goss & Yamey, *supra* note 13, at 141; Rockwell, *Normal Backwardation, Forecasting, and the Returns to Commodity Futures Traders*, in 7 FOOD RESEARCH INSTITUTE STUDIES 107 (Supp. 1967), reprinted in Goss & Yamey, *supra* note 13, at 153. In a recent decision, *CFTC v. United States Metals Depository Co.*, 79 Civ. 1201 (S.D.N.Y. Apr. 5, 1979), Judge Weinfeld’s opinion is conceptually confused—lumping together “deferred delivery” and futures contracts; equating “margin sales” and futures contracts; and characterizing an option premium as a “contango fee”—and factually inaccurate—stating that there is a “down-payment” on a futures contract that is “applied against the ultimate sale price.” The opinion strongly suggests that up-front payment of a premium is crucially distinctive, perhaps even outcome-determinative. The morally persuasive result is more accurately and simply sustainable on the strength of the single crucial finding, if accurate, that the customer did not form a “deferred delivery” contract but, rather, purchased an option because “the customer would pay a fee for the right to buy a certain amount of bullion for delivery 30, 90 or 180 days from the purchase date.” But the opinion lacks a reasoned finding that the purported “contango fee” was, instead, an option premium paid on the date of purchase of the option contract right—and paid expressly for that contract right. A true leverage fee or carrying charge appropriately related to contango expenses—equivalent to the price spread between nearby futures prices and inevitably higher distant precious metals futures prices—can be an appropriate charge associated with covered maintenance of an ongoing leverage contract. See R. Gray & D. Rutledge, *The Commodity Leverage Contract: An Economic Analysis* 11-12 (1978) (unpublished study

Thus the controlling assumption in 1922 and later was that options were generic futures which the Grain Futures Act did not need to regulate because the Future Trading Act prohibition by taxation was still in effect. In 1936 the Commodity Exchange Act⁶³ again evidenced the assumption that commodity options were generic futures and that on that basis the Commodity Exchange Act could make unlawful the formation of any such contract.⁶⁴

submitted by International Precious Metals Corporation as an exhibit to its comments to the CFTC's request for comments on its proposed Moratorium on the Offer and Sale of Leverage Contracts. 43 Fed. Reg. 23,729 (1978)). Labeling a fraudulent fee a "contango fee" does not make it such, of course. One must respect the real differences that exist in legitimate commercial practice between four different instruments: futures, leverage contracts, options, and cash forward contracts for deferred delivery. But the defendants in *United States Metals Depository* adduced no convincing evidence that their product was other than an ill-disguised option.

⁶³ Commodity Exchange Act, ch. 545, 49 Stat. 1491 (1936).

⁶⁴ The most directly relevant prohibitive language is found in original § 4, derived from the Grain Futures Act, and §§ 4a-4i, added by 1936 legislation. The 1921 Act, after Senator Capper changed the pattern of the exceptions, contained language in the introductory portion of § 4 that encompassed all futures and forward contracts. Gone was the old limitation of taxation to future sales involving delivery made, if at all, "at, on, or in any exchange" A very different exclusion for all cash forward contracts was placed in § 2: "any sale of cash grain for deferred shipment or delivery" was excluded from the Act's coverage. An exclusion for future sales involving delivery made, if at all, "on or subject to the rules of any board of trade in the United States" became part of § 4 of the Grain Futures Act in 1922. The Grain Futures Act, ch. 369, § 4, 42 Stat. 998 (1922). The difference from the old "at, on, or in" exclusion was presumably a recognition that delivery in fulfillment of grain futures contracts, as opposed to cotton, did not involve technical delivery to the terminal exchange's own designated warehouse, or of warehouse receipts to the exchange floor, but, rather, to any of several grain elevators within the Chicago rail-switching district. Thus, the subtle change to "delivery on, or subject to the rules of any board of trade."

Under the 1921 statute, the only exclusion that kept a prohibitive tax from being imposed upon cash forward contracts was that inserted in § 2. The Future Trading Act, ch. 86, § 2, 42 Stat. 187 (1921). Under the 1922 statute, the § 2 exclusion was retained, but the "at, on, or in" limitation on the scope of the Act's operative provisions contained in § 3 of the Cotton Futures Act, having been dropped in the 1921 Act, was reinserted, in variant form, in § 4 of the Grain Futures Act. The Grain Futures Act, ch. 369, § 4, 42 Stat. 998 (1922). As a result, cash forward contracts contemplating off-exchange delivery, and not subject to the rules of any board of trade, were saved by both the language of § 2 and the language of § 4 of the Grain Futures Act of 1922. Cash forward contracts contemplating delivery on, or subject to the rules of, any board of trade were, under the Grain Futures Act, saved only by the continuing effect of the exclusionary language encompassing all cash forward contracts contained in § 2. The foregoing is as an introduction to what may be seen as a scheme of concentric circles delineating the scope of various reporting and regulatory requirements. Commodity Exchange Act, ch. 545, §§ 4-4i, 49 Stat. 1492 (1936). The outer circle is represented by § 4 of the 1921 Act, which used language inclusive of future delivery made anywhere. The first smaller included circle is § 4 of the 1922 Act, which describes delivery made on or in the vicinity of any board of trade.

Section 4c⁶⁵ presents the strongest internal evidence that the Commodity Exchange Act treats commodity options as generic futures, with the implication that their regulation, to the extent they are not otherwise prohibited outright, should proceed along lines parallel to those deemed appropriate for futures regulation.⁶⁶ The

Sections 4a through 4i, as is appropriate for their various prohibitions and regulatory provisions, represent smaller included concentric circles, some of which limit application to delivery made on or subject to the rules of any contract market and some of which apply to delivery on or subject to the rules of any board of trade.

"Board of trade" and "contract market," of course, are not synonymous. Every Commission-designated contract market must be a board of trade of some size and significance. Many boards of trade, foreign and domestic, are not Commission-designated contract markets. To the probable discomfiture of organized agriculture in the United States, it appears undeniable that farmers' cooperative associations are boards of trade under § 2 and subject to at least certain provisions of the Act as a result of the repeal in 1936 of § 4(a) of the Grain Futures Act by the Commodity Exchange Act. The House Agriculture Committee, it should be noted, believed § 4(a) to be superfluous, *see* H.R. REP. NO. 421, 74th Cong., 1st Sess. 5 (1935), but this is not fully accurate since the definition of "board of trade" remained unchanged.

Sections 4h and 4c, instead of resting within the smallest included concentric circle, limited to clearinghouse futures, or going to the larger included concentric circle, which encompasses, *inter alia*, foreign-issue futures, jump back out to the all-inclusive delivery anywhere, which expands further to encompass purported private-issue ("bucketed") futures. Section 4h is convoluted, but an accurate and understandable paraphrase is as follows: in the United States no person may solicit orders for domestic clearinghouse, foreign-issue, or private-issue futures contracts; nor may any person make a private-issue futures contract since lawful domestic futures contracts can only be made on a contract market; nor may any person conduct any other "dealings in commodities for future delivery"—including options for physicals and options for futures contracts but not including cash forward contracts, which are excluded under the language of § 2(a)(1)—unless these orders for clearinghouse, foreign-issue, or private-issue futures contracts, or those futures contracts themselves, or any other "dealings in commodities for future delivery [anywhere]" involve the intermediation of a member of a designated contract market. All of these prohibitions apply, however, only to orders, contracts, or dealings that serve one of the following purposes: (1) hedging; (2) price discovery; (3) delivery of actuals in fulfillment of an orthodox or bucketed futures contract or other like dealings.

Section 4h operates within the full outer concentric circle. *Its limitation is that it applies only to transactions that serve hedging or price-discovery functions.* This limitation repeats a frequently recurring linguistic formula of the Commodity Exchange Act, which has its origin in § 3 of the Grain Future Act, that transactions known as futures serve for *basis* price determination and are utilized as a means of hedging.

⁶⁵ Commodity Exchange Act, ch. 545, § 4c, 49 Stat. 1492 (1936) (current version at Commodity Exchange Act § 4c(a), 7 U.S.C. § 6c(a) (1976)).

⁶⁶ As noted above, *see* note 64 *supra*, a fair interpretation of § 4h is that dealings in commodity options that serve either a hedging or price discovery function should occur only through a member of a contract market, and that intermediary dealings in commodity options by persons other than members of a contract market are unlawful. Section 4c, in the years between 1936 and 1975, made interpretation of § 4h almost purely academic, however, because it proceeded to make unlawful the historic forms of commodity options on certain

very prohibition contained in section 4c(B) of the 1936 Act presupposes that privileges, indemnities, bids, offers, puts, calls, advances, guarantees, and decline guarantees are transactions having the character and certain of the uses of clearinghouse futures contracts, because section 4c(B) presupposed that these historic forms of option contracts were usable either for hedging or for price discovery.⁶⁷

A question is posed by the omission of the word "option" from section 4c(B) of the 1936 Act. It was included in the revised section 4c(a)(B) of the Commodity Exchange Act, as amended by the Commodity Futures Trading Commission Act of 1974.⁶⁸ Did the Commodity Exchange Act in 1936 prohibit only those options best equated with pure bucketing—namely, advance guarantees and decline guarantees, in which no pretense of purchase or acquisition of right to purchase a clearinghouse futures contract was present—and privilege style options, arguably corresponding to the sometime exchange-traded cash forward contracts known as "calls"?⁶⁹ Did the Commodity Exchange Act, in other words, permit—or at least not clearly prohibit—traffic in options to purchase clearinghouse futures contracts themselves if those options had a duration comparable to the related clearinghouse futures contract,

domestic agricultural commodities. During these years the offer and sale of commodity options on world commodities could take place in the United States, so far as the Commodity Exchange Act is relevant, only because those commodities were not commodities within the meaning of the Act.

⁶⁷ See *id.*

⁶⁸ Commodity Exchange Act § 4c(a)(B), 7 U.S.C. § 6c(a)(B) (1976).

⁶⁹ One judicial opinion, *Lane v. Logan Grain Co.*, 105 Mo. App. 215, 79 S.W. 722 (1915), stated that historic privileges would always be unlawful gaming contracts under Missouri statutory law, and that futures would only be unlawful gaming contracts if the requisite intent to deliver was absent. The holding, however, was based on the specious reasoning that the existence of the "put" in the hands of the purchaser necessarily negates the existence of delivery intent. This fails to consider that, as respects the existence of an executory right to compel another party later to purchase, pay for, and take delivery of a carload of grain, the "put" option does not differ from the "short" futures contract. The holder of a "put" may intend to deliver. He profits from his transaction, unless he is able to assign the contract right to another for an appropriate price, only if he compels purchase and effects delivery. The court's reasoning is not convincing, and the factual result carries no moral compulsion: a nonexchange-traded "put" on Kansas City May wheat, originally created by a bucket-shop operator named Nathan, potentially victimizing one Purcell, passed from hand to hand before it became the subject of litigation occasioned when a subsequent purchaser, the Logan Grain Co., recognized the worthlessness of the instrument and stopped payment on its check. Logan Grain Co. won; Purcell escaped immediate loss; Nathan and the option writer he assisted await retribution; and the probable innocent, Lane, footed the bill.

and, in compliance with section 4h, were conducted through a contract market member?

Where the contract market member might have conducted such dealings is another question. Prior to 1968, section 4b's antifraud provision related only to the conduct of *contract market members* with respect to either (1) interstate, that is, cash commodity commercial dealings, or (2) futures contracts calling for delivery under the rules of a government-designated contract market.⁷⁰ Before 1968 section 4b might well have been interpreted as requiring that options to purchase or sell clearinghouse futures contracts be dealt in only on contract markets.⁷¹

In 1968 section 4b was revised.⁷² The revision made any person, not just contract market members, subject to the Act's general antifraud provision and simultaneously made the Act's far-reaching general antifraud provision *inapplicable* to a contract market member's *nonexchange* cash commodity commercial dealings. A contract market member's dealings in options to purchase or sell clearinghouse futures, to the extent such options related to Commodity Exchange Act commodities and were not prohibited outright, still would have been subject to the requirements of section 4b *if* such options were themselves cognizable as agreements to sell later any commodity—creating valuable executory contract rights—even though the agreement to sell was conditional.

⁷⁰ See Commodity Exchange Act, ch. 545, § 5, 49 Stat. 1492 (1936).

⁷¹ Such options would not have included options on so-called world commodities, which were those commodities not encompassed by the list in § 3 of the 1936 Commodity Exchange Act. See also Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976).

⁷² In 1968, the initial clause of § 4b was modified as follows:

It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of, [1] any contract of sale of any commodity in interstate commerce, *made, or to be made on or subject to the rules of any contract market, for or on behalf of any other person*, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any *other* person if such contract for future delivery is or may be used for (a) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (b) determining the price basis of any transaction in interstate commerce in such commodity, or (c) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

Pub. L. No. 90-258, § 5(a), 82 Stat. 26 (1968) (amending Commodity Exchange Act, ch. 545, § 5, 49 Stat. 1491 (1936)) (additions italicized, deletions bracketed).

If, however, options to purchase or sell clearinghouse futures contracts were not cognizable as agreements to sell later any commodity, the general antifraud provision of the Commodity Exchange Act would not apply to options to purchase or sell the very futures contracts whose domestic creation was meant to be so carefully superintended by federal authorities. On this interpretation, certain speculation in identical fluctuations in value would have been left uncontrolled by section 4b.

Why the CFTC searched so long, and so largely in vain, for a new regulatory structure for commodity options between 1975 and 1978 is not easily comprehensible. As outlined above, it has always been arguable that the sanctions of section 4b applied to commodity options, and that traffic therein by parties other than contract market members was unlawful. The incentive and resources to police commodity options dealings were present at and available to the organized contract markets under this construct. They seem not to have been available to the CFTC.

III. GENETICS

Let us now pose an important question relating to the future of "futures." What form may delivery take under the Commodity Exchange Act, or indeed, must delivery be required at all in connection with the possible future creation of index value futures generally, and a proposed general industrial equity value futures contract specifically?

Before 1974, only certain enumerated domestic agricultural products were commodities within the meaning of the Commodity Exchange Act.⁷³ With respect to all of these commodities, futures markets had developed over the course of the preceding century that

⁷³ These commodities were: "wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice" Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976); see Act of July 23, 1968, Pub. L. No. 90-418, 82 Stat. 413; Act of Feb. 19, 1968, Pub. L. No. 90-258, § 1(a), 82 Stat. 26; Act of July 26, 1955, ch. 382, § 1, 69 Stat. 375; Act of Aug. 28, 1954, ch. 1041, § 701(a), 68 Stat. 913; Act of Oct. 9, 1940, ch. 786, § 1, 54 Stat. 1059; Act of April 7, 1938, ch. 108, 52 Stat. 205; Commodity Exchange Act, ch. 545, §§ 2, 3, 49 Stat. 1491 (1936); S. REP. NO. 850, 95th Cong., 2d Sess. 10, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 3817, 3828.

provided for delivery, which was rarely carried out, as a means of forcing convergence of spot and futures prices upon expiration of the futures contract. This technique of assuring that futures and spot prices came together was historically necessary, and continues to be necessary for any commodity that does not yet have a completely trustworthy and accepted spot price quotation.

Recently, however, controversy has arisen over proposals by certain contract markets to create futures contracts based on stock market indexes. The proposals sparked a jurisdictional debate between the CFTC and the SEC during the congressional reauthorization of the CFTC⁷⁴ and have generated discussion throughout the industry and the investing public.⁷⁵ While actual delivery of a commodity pursuant to a futures contract almost never occurs, it is said that "stock index futures would be unique: the underlying 'commodity' is an intangible statistic."⁷⁶ Thus, a critical question is whether the potential for delivery is an essential element of a future.⁷⁷

⁷⁴ See Young, *A Test of Federal Sunset: Congressional Reauthorization of the Commodity Futures Trading Commission*, 27 EMORY L.J. 853 (1978).

⁷⁵ See, e.g., Morner, *There May Be a Future in Stock-Index Futures*, FORTUNE Mar. 26, 1979, at 107, 110, where the author summarizes the major recent developments in this area:

To date, just one exchange has set forth a specific and detailed proposal for a stock-index future. Last year, the Kansas City Board of Trade sought permission from the CFTC to trade a contract in the Dow Jones industrial average, but it dropped the idea after Dow Jones balked at having its name attached to such an instrument. Now the K.C.B.T. has come up with a revised contract, pegged to Standard & Poor's 500 composite stock index. Each contract would be valued, in dollars, at 500 times the S.&P. index—roughly \$49,000 at the current level. Contracts would be available for six different future dates, as far out as eighteen months. Like other futures, they could be bought on very low margin—as little as \$2,000 per contract. . . .

Two other exchanges are also drawing up proposals for stock-index futures. The Chicago Mercantile Exchange is working on a contract that will be similar to the K.C.B.T.'s, and the Chicago Board of Trade is pushing ahead with a plan to offer eleven new futures contracts. Ten of these would be indexes of stocks in a particular industry—the eleventh, a composite of those ten. Even the New York Stock Exchange and the Amex (an affiliate of the American Stock Exchange) are exploring the idea of stock-index futures.

Id. at 107.

⁷⁶ *Id.*

⁷⁷ The framers of the Commodity Exchange Act understood, as commentators and government agencies too often have not, that contract markets are neither produce markets nor commodities markets, but are financial or price markets. Executory contracts—pure financial rights, still inchoate—are the things dealt with and priced. This characterization of executory contracts is implicit in the prohibition of § 4 of the Act, 7 U.S.C. § 6 (1976), which identifies

A. *Delivery of Non-goods*

Prior to 1974 the Commodity Exchange Act's definition of commodity emphasized the tangible nature of commodities with respect to which futures contracts were traded.⁷⁸ Commodities were "goods

the subject price quotation as a report of the price of the futures contract. Telford Taylor, writing 45 years ago, made this acute observation in his classic article *Futures Trading in Commodities—A New Standard of Legality*, 43 YALE L.J. 63, 66 (1933). The article was a devastating criticism of the factually erroneous decision of the United States Supreme Court in *Dickson v. Uhlmann Grain Co.*, 288 U.S. 188 (1933) which, in dictum, appeared to perpetuate an unworkable and confusing common law "intent to deliver" test with respect to exchange-traded futures, but which should more accurately be read, on the facts taken to be true, as condemning only off-exchange bucketing.

The American clearinghouse futures contract is not conceived of as creating either an indebtedness or an account receivable: credit is not advanced; interest is not paid. The same is true of any usual form of option to purchase or sell a futures contract. Although Professor Long can be understood to have advocated a contrary view, see Long, *Commodity Options Revisited*, 25 DRAKE L. REV. 75, 88-91 (1975), his argument proves too much. His logic and authorities would suggest also that any unliquidated futures position, however temporary or shifting, that moves into a *potential* profit-taking position, is then and there transmuted into an "indebtedness." The market could not long function on widespread application of any such premise. He correctly understands, however, that a conditional executory obligation to pay scarcely differs analytically from an absolute executory obligation. His argument is persuasive that options and futures are essentially of like character. No American futures contracts are "interest-bearing"—which usage strongly emphasizes that they are uniformly thought to create only inchoate executory rights.

Certain foreign-issue futures were historically conceived of otherwise. Americans would find the treatment accorded cotton futures contracts formed on the Le Havre, Liverpool, and Bremen exchanges before World War II, for example, appropriate for cash forward contracts, but not for futures—for they were interest-bearing. An obligation to deliver cotton, and make payment therefor *first* on the maturity date of the contract, was given literal effect. If a "short" rang out prior to the contract's maturity date on a drop in the futures prices below the price at which formed, he could, in American terminology, discharge his pre-existing "short" contract by forming a "long" contract, and would receive a sum representing his profit on the "round turn." In the European usage, however, such a "short" was viewed as receiving an advance of credit from the "longs" in the system who had or would have losses, in equal measure, on their offset transactions. The "short's" obligation was not discharged simply by forming a reversing transaction. The "longs" who accommodated our hypothetical "short" were entitled to the going price of money for the remaining term of the contract. If the "short's" round turn transaction produced a net loss rather than a gain, he was viewed as advancing credit to the profit-taking "longs." In that circumstance it was the "long" who paid interest on the advance of credit for the remaining term of the contract. Garside describes the operation of the foreign-issue cotton futures contract as follows:

[Interest bearing] means that if a person who has entered into a futures contract liquidates it by an offsetting transaction before the maturity date, he pays interest on any profit realized and is credited with interest on any loss incurred on the contract, such interest being computed for the period from the date when he liquidates the contract to the maturity date of it

A. GARSIDE, *COTTON GOES TO MARKET* 157 (1935).

⁷⁸ See note 73 *supra*.

and articles." In 1974, however, the definition of commodity was expanded to include "all other services, rights, and interests" with respect to which futures contracts might exist or come to be implemented.⁷⁹ Such implementation can occur only with the approval of the Commission. When the Commodity Futures Trading Commission Act of 1974 was enacted, futures contracts relating to financial rights and interests were in the process of being created.⁸⁰ Indeed, it was contemplated that futures contracts on ocean freight rates for transportation might be developed.⁸¹

Delivery of financial instruments on maturity of a futures contract relating thereto is readily possible. One simply trades a formerly executory contract right for another intangible, the financial instrument; acquisition of the instrument is that which seemingly is sought. More fundamentally, acquisition of the instrument could be dispensed with if the transfer of claims and rights could be otherwise more effectively indicated and memorialized. For example, delivery of the *services* of an ocean freighter upon maturity of a futures contract would be impractical and unnecessary; the hedging function meant to be served would be better satisfied by cash payments in lieu of delivery if offset had not earlier taken place. If, however, delivery were to be made, it would simply be a prespecified performance, that is, a service—even if reified as "hull space."

Since 1974 the language of the Act has contemplated, in the broadest terms, that a service can be a commodity;⁸² the later carrying-out of a specified performance, including, for example, the paying of a once-inchoate but eventually determinable monetary value, can constitute future delivery. With respect to any new intangible "service, right, and interest," commodity futures contracts could conceptually be created that would most rationally be handled by calling for performance of service or delivery of value in literal satisfaction of the delivery requirement of the contract.

⁷⁹ See Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 201(b), 89 Stat. 1389 (codified at Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976)).

⁸⁰ See H.R. REP. No. 975, 93d Cong., 2d Sess. 41 (1974), *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5891.

⁸¹ See S. REP. No. 1131, 93d Cong., 2d Sess. 19 (1974). More recently organized call auctions in forward barge rates from St. Louis to Gulf of Mexico ports have developed in St. Louis. The Senate was aware that fluctuation in currency values and shipping rates were major uncertainties in international trade, against which futures trading institutions might provide some insurance. See *id.* at 27.

⁸² See Commodity Exchange Act § 2(a)(1), 7 U.S.C. § 2 (1976).

B. *Delivery of an Indexed Value*

With reference specifically to possible securities price-index futures, Congress surely understood that an index is nothing that has or can easily be given corporeal existence. In 1978 Congress understood that an index related to, but was different from, an aggregate of securities, and that the theorized futures contract relating to calculated equity values might be a "futures contract concerning . . . an index."⁸³ Congress, however, rejected strenuous assertions that such a contract merited only disapproval.⁸⁴

⁸³ H.R. REP. No. 1181, 95th Cong., 2d Sess. 14 (1978). An index is purely a statistical concept, a moving measure of an averaged price level. It is a specified *statistical* aggregation of securities, keyed to a particular historical price level, which is typically assigned the index value 100. A hedger utilizing an index futures contract cannot plausibly be interested in making or taking delivery of the purely conceptual aggregation which merely forms the statistical basis of the index calculation. In order to be reliable as an index, the statistical aggregation which forms the basis of the average price must be large and diverse. The aggregation, if viewed literally, is then probably too large to form the basis for commercial-delivery dealings in securities by any other than financial institutions and mutual funds.

⁸⁴ See *id.*; S. REP. No. 850, 95th Cong., 2d Sess. 22 (1978), *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 3817, 3831. The Senate Agriculture Committee's deliberations concerning the Futures Trading Act of 1978 indicate that financial interests and services, as distinct from financial instruments, could become commodities that would be the subject of potential futures trading. The Senate Report, reciting the concerns and representations of the Securities and Exchange Commission and the Treasury Department, stated that those agencies were legitimately concerned with certain potential commodities that were, or were related to, instruments recognized to be securities. The concern was that of the "SEC with equity securities and indexes thereof, and the Treasury with potential expansion of Government security futures contracts." *Id.* (emphasis added). "Indexes thereof" are indeed something other than equity securities, and they were separately dealt with in the SEC's proposals to the Senate Agriculture Committee. See, e.g., Letter from Harold M. Williams, SEC Chairman, to Senator Talmadge (Apr. 18, 1978).

With enactment of the Futures Trading Act of 1978, the SEC was particularly concerned that the proposed denial of jurisdiction to the CFTC over futures on equity securities would not reach proposed stock-index futures. The SEC repeatedly suggested that commodity be defined more narrowly so as not to encompass any equity security, any pool interest in equity securities, or index of value of equity securities. See S. REP. No. 850, 95th Cong., 2d Sess. 20, 21 (1978), *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 3817, 3839, 3840. After the problem of stock-index futures was fully aired, Congress rejected the SEC's plea for a narrower definition of commodity. The House Report stated:

The Committee does not believe that the same considerations [militating against approval of a purely hypothetical futures contract on a *single* exchange-traded equity security, for example] necessarily would apply to any proposal for trading in a futures contract based upon an aggregate or pool of a number of different securities or an index involving such an aggregate. It appears at least theoretically possible that futures contracts may be developed concerning an aggregate of securities or an index thereon that may reasonably be expected to serve a valid economic function.

A futures market in general industrial equity values could be the purest form of futures market functioning as a price market. The simple, expected, and desirable technique of forcing convergence of cash and futures prices in this setting is not accomplished by delivery of any article or instrument or collection of articles, instruments, or share certificates, but rather by a delivery of *value* as such. Delivery of value is the performance of service called for by an index futures contract, which was specifically created and designed to hedge against fluctuations in general industrial equity value generated by fears of price inflation or deflation in the economy. The 1978 Senate Report speaks specifically of possible nontraditional futures contracts as potentially useful "to hedge against inflation and market uncertainty."⁸⁵

1. *Hedging*

The economic concept of hedging an indexed value is quite legitimate. Literal future delivery of the required service is easily possible by the performance of paying an originally inchoate but now determinable value. Similarly, the delivery of the "right or interest" commodity actually conserved by hedging—an interest in general equity value—is possible. Delivery of a collection of share certificates of equivalent value would only be undertaken in lieu of literal delivery of the service or transfer of the interest which the buyer might have been seeking to receive or acquire later.

The commodity underlying a stock-index future would be a future

H.R. REP. No. 1181, 95th Cong., 2d Sess. 14 (1978) (emphasis added); see S. REP. No. 850, 95th Cong., 2d Sess. 22 (1978), *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 3817, 3831 ("No convincing case has been presented to the committee to treat these futures contracts differently from any other futures contracts.").

Congress further understood and contemplated that futures contracts might emerge that served no price-discovery function because an existing cash market already served that function. The function which such financial interest futures contracts would serve was seen as almost exclusively a hedging function. The Senate Report, in its discussion of proposed stock-index futures, admonished:

Further, the fact that a futures contract does not fit into the traditional mold where there are *both* hedging and price-discovery functions should not be the determining factor in whether the contract is to be regulated by the CFTC. So long as the futures contract serves a legitimate function, Congress has vested the Commodity Futures Trading Commission with jurisdiction.

Id.

⁸⁵ S. REP. No. 850, 95th Cong., 2d Sess. 22 (1978), *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 3817, 3831.

interest in a monetary value as such—analogous to a classic future interest in realty, chattels, or securities—or the performance of the unique service of paying an actually-to-be-realized monetary value with which the hedger deals commercially, against receipt of a probability-based present evaluation of the future worth of that monetary value.⁸⁶ This futures contract, as seen by the seller, is not a contract later to sell and deliver any particular exchange-listed equity instrument, such as a stock certificate, nor is it properly viewed as a contract later to sell and deliver any collection of stock certificates. Instead, it is a contract later to sell and deliver, at a *presently-discovered price*, an actually-to-be-realized *future per-unit value* of industrial equities generally. This value is exclusively a function of the market's general movement; it excludes the specific price movements attached to any particular equity issue or portfolio of issues.

The purely calculated actually-to-be-realized value involved in an equity value futures contract, though it has no embodiment in a financial instrument, and need never acquire one, is a separate financial interest. This interest is not best viewed as an equity security, nor could a classic future interest, except with contortion, be viewed as a security. It is not the embodiment of an owner's residual interest in any firm or venture, nor is it necessarily the embodiment of a right to acquire any such owner's residual interest. The interest to be subjected to futures trading would be an interest best described as an inchoate probability-derived value of an executory contract, later to be evaluated monetarily.

Viewed from a slightly different perspective, the commodity underlying the futures contract is the organized market's promised service to pay realized monetary value. This monetary value, func-

⁸⁶ Equity value futures contracts bear some similarity to gratuitous or contractual dealings in classic future interests, which are well known to estate-planning practitioners and managers of college endowments. Remainders, executory interests, and powers of appointment could more often be bought and sold if a true exchange market therein existed and could, to some extent, theoretically be based on events other than death. That which is given or sold is not land, chattels, or securities as such; it has always been rightly named a future interest. A contract is made between an annuitant and a college endowment fund, for example; the contract is real and enforceable, with a commitment later to deliver, on the occurrence of a specified event, at a presently-discovered price, a future value or power of disposition that will actually be realized. The subject of the contract is a future interest in lands, chattels, or financial instruments.

tionally akin to insurance proceeds, is paid against a market-derived probability-based present evaluation of the future worth of that same monetary value, which is functionally akin to insurance premiums.⁸⁷

2. *Hedging is Basis Speculation*

The classic hedging activity, basis speculation, would be uniquely facilitated with respect to any equity value by the existence of general equity value futures contracts. Commodity futures hedging does not eliminate risk of price fluctuations; it shifts an important element of price fluctuation risk from hedgers, who are presumably risk-averse, to speculators, who are presumably risk-prone.⁸⁸ Unlike gambling, both insurance and futures hedging grew out of common origins as a means of coping with preexistent risk not deliberately and extraneously created by gaming partners.⁸⁹ The preexistent risk that futures hedging can effectively shift to others is the risk that the general price level of the subject commodity will fluctuate over time. A risk that futures hedging cannot shift is the risk that, over the course of time, the futures price, which is the predicted general price level of the subject commodity, and the several quality- and location-dependent cash prices will not experience a precisely parallel movement. The varied specific operations of commercial hedgers at different operational locations and concerning a commodity of differing quality are profoundly affected by the individual hedger's merchandising skills and sense of timing applied in cash markets.

Commercial hedgers are averse only to the risks they believe

⁸⁷ Although proposed equity value futures contracts are analogous to insurance, there are differences. Insurance socializes risk by spreading it, on the basis of actuarial calculations, so completely among a large number of policyholders that the risk can be regarded as eliminated. Premium payments, however, must cover both losses and the insurer's overhead and profits.

⁸⁸ To understand *why* hedgers hedge by buying and selling futures contracts, however, it is necessary to understand that a hedger is seeking to make a profit through this activity. As Hieronymus put it: "[T]o hedge is to insulate one's business activities from *price level speculation* while retaining the opportunity to *speculate in basis variation*. The definition takes hedging out of the academic context of risk shifting and puts it in the business context of trying to make a profit." T. HIERONYMUS, *supra* note 19, at 149 (emphasis added).

⁸⁹ See 6A A. CORBIN, CORBIN ON CONTRACTS §§ 1490, 1494 (1962) (suggesting, by way of explicit analogy to the payment of insurance premiums and receipt of insurance proceeds, that futures trading, involving the shifting of a preexistent risk, is not wagering or gambling under any generally understood or properly applied definition of gambling or wagering).

themselves unable to control or predict. They happily retain the risks associated with their particular operation, even as they shift to others the risk of general future price movement. The fluctuating difference between the futures price, which is the market measure of general anticipated price movement, and the cash price applicable to the hedger's particular commercial activity at his particular location, is the hedger's basis. Hedgers speculate in basis fluctuations. Hedging is basis speculation, but it is speculation unique to values somewhat subject to the hedger's particular control and specific predictive capability in cash markets. These are risks which even a cautious hedger wants to bear; to bear them is the essence of his commercial activity. The hedger can enhance his commercial profits to the degree that he shifts to others the risks he cannot control or predict and skillfully manages those he can.⁹⁰

It does not appear to be true, as once believed, that growth and prosperity of a futures market is a function of its appeal to speculative instincts. Indeed, the accumulated historical and empirical evidence has now led to general acceptance of the proposition that the success of a futures market rests on its appeal to, and commercial

⁹⁰ See T. HIERONYMOUS, *supra* note 19, at 147-50, 173-74. It is important to understand that the resultant risk-shifting is not literally effected by a direct transfer of risk to others paying premiums in exchange for a promise of indemnification. It is effected by taking on an additional speculation, tending generally to be of an opposite quality. As Hieronymus explains:

[T]he hedger should realize that he does not actually shift risk; he offsets the risk of price level change. He does not cease to speculate; he takes on an additional speculation. Because the additional speculation is opposite . . . profits and losses, because of changes in *price level*, cancel and leave only profits and losses that result from changes in *price relationships*. The hedger should be under no illusion that he has no market position; he has two where previously he had only one.

Id. at 173 (emphasis in original). Corbin recognized this possible distinction between a futures contract and a contract of indemnification as utilized in insurance arrangements, but concluded:

There would certainly be no wager if the miller should pay a stated premium to one who promises to indemnify him against the depreciation of wheat in the market. In the hedging agreement . . . the miller does not pay a definite premium for his protection against depreciation. Instead, he makes a promise that is aleatory in character, just like the promise of the one to whom the risk of depreciation is transferred. He promises to pay a difference that is variable and uncertain in amount. . . . The ordinary insurer always gets something in the way of a premium; but the corresponding party in this sort of hedging agreement will get nothing as a premium in those cases in which he is required to make good a loss. This difference should probably be regarded as immaterial.

A. CORBIN, *supra* note 89, § 1494, at 866-67.

use by, hedgers.⁹¹ To some degree a short hedger's shifted risk is effectively cancelled out by a long hedger's shifted risk. While it is theoretically conceivable that a sort of futures market could exist without speculator participation, Professor Working emphasizes that hedgers cannot realize the economic benefits of futures trading unless the markets attract significant speculative interest.⁹²

The essence of the proposed general industrial equity value futures contract is that it would uniquely facilitate effective basis speculation in price movements of any particular equity security. Such speculation would be subject to the preexistent risks inherent in holding, or consummating forward transactions with respect to, the particular equity security.

Hedging in this context would operationally focus, by way of basis speculation, not on cash transactions in all the statistician's securities, but rather on cash transactions in a single discrete portfolio of securities having an infinitely variable composition. This would pose risks of specific price fluctuation—basis variation—that the hedger wishes to bear. The correct perception is that the commodity which is the subject of hedging is not any particular share certificate or collection of share certificates, but is, rather, the value of industrial equities generally, or of a single broad category of industrial equities. In this context, a hedger would not, under any normally foreseeable circumstance, desire to take delivery of a statistician's conceptual aggregation of securities which forms the basis of the index calculation. Some commercial reason for literally holding or acquiring a portfolio of industrial equity securities consisting of all of the components of, for example, the Standard and Poor's Index, would not easily become compelling; probably only an index mutual fund would be in such a position. Cash market commercial-delivery dealings in stock certificates belong, of course, on historic securities markets. But systematic discovery of the general future value of industrial equities does not now occur on securities markets, and never has.⁹³

⁹¹ See Working, *supra* note 19, at 14-18.

⁹² *Id.* at 24.

⁹³ The Philadelphia Stock Exchange, however, has a proposal pending before the SEC to trade, in a true secondary market, call options to purchase interests in a physical aggregation of share certificates, the average value of which is reckoned by reference to the New York Stock Exchange index. See *Hearings on the Proposed Stock-Index Future of the Kansas City Board of Trade Before the Commodity Futures Trading Commission* (Oct. 25, 1978) (statement of the Philadelphia Stock Exchange, Inc.).

The opportunity for the hedging activity of basis speculation afforded by the existence of general equity value futures contracts would permit the affected investor or businessman to abstract, from the bundle of preexistent risks that he necessarily otherwise bears, those risks relating to general price-level fluctuation, and to pass them on to others through the mechanism of futures hedging. At the same time, the investor would retain the more controllable or predictable risks specific to the particular securities portfolio with which he deals. As to dealings in a particular securities portfolio in the cash securities markets, the investor is properly subject to the rules and conventions of the cash securities markets.

C. *A Justification for a Futures Market*

Securities markets basically seek to assess the present discounted value of future returns on shares of particular firms. This value is uniquely shaped by the plans and personalities of corporate management, and by the proprietary success of those managers in dealing with the personnel and assets they control. The disclosure called for in relation to markets where securities are publicly distributed and traded is a full disclosure of personalities, projections, plans, and other relevant information that would largely be proprietary information if the issuer had not gone public. The trading regulation is a stern policing of the abuse of insider information in secondary securities markets with reference to plans and proprietary prospects.

The information relevant to formation of futures contracts, however, is not at all like proprietary insider information: it is diffuse and ordinarily available to all interested parties on a timely basis.⁹⁴ No market directly determines the present spot value of industrial equities generally; a calculation of the present average value of selected industrial equities, however, is made by certain private services that calculate and disseminate stock price indexes.⁹⁵ Through this ongoing calculation the spot price of general industrial securities, as a commodity, is determined. No presently existing market, however, determines the futures price—the present evaluation of the future worth—of this commodity.

What is needed is a futures contract that will give an immediate,

⁹⁴ See T. HEIRONYMOUS, *supra* note 19, at 7, 99-102.

continuous, and direct measure of the market's evaluation of the future worth of industrial equities generally. This should take place in an open, public, supervised, and competitive auction market closely approximating the economist's ideal of perfect competition.⁹⁵ The commodity which, when thus traded, would give this measure, and afford the opportunity for hedging against price fluctuations—that is, for shifting the risk of the market's general fluctuation to those who, in search of a profit, choose to bear such risks—is an interest reflective of *general equity value*.

1. *Must a Good Be Delivered?*

Section 5 of the Commodity Exchange Act provides that the CFTC is authorized and directed to designate a board of trade as a contract market when the board of trade complies with and carries out specified conditions and requirements.⁹⁶ One of the conditions which section 5(a) might superficially seem to require before a contract market can be designated is a provision for delivery. The precise requirement of section 5(a), however, is that the proposed contract market be located where a cash market exists for the relevant commodity on which commerce occurs in sufficient volume and under such conditions as fairly to reflect the general value of the commodity and relevant grade price differentials.⁹⁷ This requirement is qualified by the proviso that the Commission may approve the establishment of a contract market in some location not meeting those cash market locational requirements if the board of trade seeking designation as a contract market “provides for the delivery of commodities on such contracts at a delivery point or points and upon terms and conditions approved by the Commission.”⁹⁸

The Commission's discretion extends to hypothetical approval of a contract market that promulgates appropriate provisions for any sort of economically relevant delivery or for any functional equivalent of literal physical delivery. The overriding and controlling statutory requirement is simply that the contract market's practices, rules, and conventions be such as to assure that accurate cash mar-

⁹⁵ See *id.* at 97-99; Working, *supra* note 19, at 12.

⁹⁶ Commodity Exchange Act § 5, 7 U.S.C. § 7 (1976).

⁹⁷ *Id.* § 5(a), 7 U.S.C. § 7(a) (1976).

⁹⁸ *Id.*, 7 U.S.C. § 7(a) (1976); see Taylor, *supra* note 13, at 100 (concluding that this statutory requirement was “obviously for the purpose of promoting correlation between cash and future prices”).

ket prices become the point of reference for futures market offset transactions or settlements upon contract maturity. This is especially true when no good or article is being priced by the contract market. Since non-goods are now commodities, the search for articles to deliver is fatuous.

2. *Methods of Delivery*

If the Commission feels constrained to require literal delivery in connection with futures trading in general equity values, or industry-category equity values, or cost-of-living index values, delivery could be structured in any one of several ways. There could be a delivery of:

- (1) a collection of industrial equity share certificates equivalent in value to the subject indexed equity value; or
- (2) United States dollars, in lieu of delivery of share certificates and as the only direct measure of cost-of-living in the domestic economy; or
- (3) the subject indexed equity value per unit in any chosen foreign currency; or
- (4) the subject indexed equity value per unit in the money in which the measuring index is reckoned.

Among these alternatives the last would seem to be preferable. Delivery of the subject indexed equity value in the currency in which the measuring index is calculated is simple, direct, timely, and devoid of extraneous perils of a squeeze on assembly or possible unavailability of share certificates on a timely basis. Increasingly, in cash securities markets, shares are not physically delivered; book-entry transfer suffices and has become commonplace.⁹⁹ Eventually share certificates may never even be issued. The SEC has been given a statutory mandate by the Securities Act Amendments of 1975 to promote certificateless delivery in connection with securities trading.¹⁰⁰

The first alternative—delivering industrial equity share certifi-

⁹⁹ See Clark, *The Fate of the Negotiable Stock Certificate—UCC Immobilization or SEC Elimination*, 5 U.C.C. L.J. 83, 83-94 (1972).

¹⁰⁰ Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (current version at 15 U.S.C. § 78q-1(e)).

cates—seems reflective of the cash market, but it is not. The price fluctuation against which one would hedge by using a general equity value futures contract is not a shift in value of any individual industrial equity or particularized portfolio of individual industrial equities. The price fluctuation against which the hedger seeks protection is, rather, the fluctuation in the value of industrial equities generally. One or another of the existing stock average indexes is utilized merely as the best available working approximation to a measure of that ongoing fluctuation in value.

The second alternative is easily possible; its drawback is that it leaves open the possibility that a buyer might, in a particular instance, force a seller to go through the unnecessarily cumbersome, expensive, and time-consuming chore of assembling a package of stock certificates to make delivery. It would be ironic if the CFTC opted to require delivery of share certificates just as certificateless delivery was becoming the norm in securities exchange markets. The third alternative is also objectionable. It would attempt to combine in a single futures contract the proper function of two very different futures contracts: an equity value futures contract and a particular foreign exchange futures contract.

The future delivery logically called for is a delivery of value in the same denomination as that generally used to measure value in the economy whose level of general industrial equity value is the subject of hedging activity. Although a futures contract to facilitate hedging in deutsche mark or yen equity values is as readily foreseeable as is a dollar-denominated equity value futures contract, it is somewhat more remote from present commercial concerns in relation to the United States economy. The immediate need is for the creation of a vehicle that could facilitate hedging in United States dollar-denominated general equity values in order to obtain protection against general United States inflation and market uncertainty. The necessity for such a vehicle is evidenced by the increasing and persistent volatility in dollar-denominated equity values generally. Proper use of such a futures contract for hedging could shift the risk burden and the potential profit from risk assumption away from those who do not wish to be subject to the risk of fluctuations of equity values generally, but who do wish to implement their respective judgments concerning the likely future course of value of a particular equity issue, whether or not that particular equity security is traded on any exchange or over-the-counter.

Prior to the Commodity Futures Trading Commission Act of 1974, the Commodity Exchange Act incorporated a narrow definition of hedging. In economic terms, this definition improperly focused on a supposed equal and opposite positioning in cash and futures markets as indicative of "hedging." Under section 4a(3) of the Act,¹⁰¹ as amended by the Commodity Futures Trading Act of 1974, the Commission was authorized to employ its economic expertise to redefine hedging in a more meaningful way. It has now done so in Rule 1.3(z),¹⁰² emphasizing the economically correct conception that a futures contract "represents a substitute for transactions to be made or positions to be taken at a later time" in cash markets, and which arise in part from "potential change in the value of services which a person provides, purchases or anticipates providing or purchasing."¹⁰³

This definition recognizes that futures transactions, in the ordinary course, will be reversed prior to maturity by operating hedgers. Hedgers, even more than speculators, are not expected to deliver. Delivery is not practicable or desired, and it will not ordinarily occur. The price at which the reversing transaction will take place is one which will ordinarily be determined in the futures pit except upon contract maturity, when the cash market will dictate the price.

D. *Integrity of Price Discovery—The Ultimate Rationale*

Delivery in the Commodity Exchange Act is not seen as an operational necessity; it merely sets boundaries to various prohibitions and requirements. In sections 4 through 4i, for example, the various delivery formulas simply serve to describe, *inter alia*, the scope of reporting. Futures formed on foreign exchanges must be accounted for. Requiring delivery is not at all the ultimate rationale of the Act—requiring integrity in contract formation is.

The ultimate corrective for a particular flawed price discovery is, of course, the potential link to physical marketing channels by delivery. This link is significant, however, only as a gauge of controlling spot price. If a cash market exists that either directly or by statistical calculation gives a trustworthy and acceptable spot price,

¹⁰¹ Commodity Exchange Act § 4a(3), 7 U.S.C. § 6a(3) (1976).

¹⁰² 17 C.F.R. § 1.3(z) (1978).

¹⁰³ *Id.*

the entire function of ultimately bringing futures into convergence with spot prices upon maturity can be performed by simply compelling acceptance of the price determined in the cash market and using it to settle, with cash payments, any stray futures transactions that might remain unreversed.

The academic literature has recognized, as the trade probably intuitively understood earlier, that futures markets are bad places to take delivery. Delivery does not easily or routinely occur on futures markets. The coin of delivery, in the first instance, is just another piece of paper—an inspection certificate, warehouse receipt, or shipping certificate.¹⁰⁴ Soybeans are not dumped on the speculator's doorstep. The physical stocks ultimately obtainable, and which must be accepted if the time for setoff is past, are often quite unsatisfactory for commercial and industrial purposes.¹⁰⁵

Present delays in rail transportation and shortages of boxcars make it sheer folly to rely on futures delivery for stocks needed to keep a mill operating, or realistically to contemplate delivering on a futures contract as an alternative to cash marketing. To some degree, however, delivery has been contemplated. Two perceptive English observers of futures markets have succinctly explained that, in order to fulfill their function as pure price markets, futures contracts generally must permit the delivery of many different grades of the subject commodity.¹⁰⁶

Even though the original Commodity Exchange Act dealt only with futures contracts relating to tangible agricultural commodities,

¹⁰⁴ See T. HIERONYMOUS, *supra* note 19, at 43.

¹⁰⁵ For a humorous if tragic example, see the testimony of John A. Dussult, who tried to stock a cattle ranch by taking delivery on futures contracts, in *Commodity Futures Trading Commission Act: Hearings Before the Senate Comm. on Agriculture and Forestry*, 93d Cong., 2d Sess., pt. 3, at 783-93 (1974). Cf. *Schwartz v. Bache & Co.*, 340 F. Supp. 995 (S.D. Iowa 1970) (electrolytic nickel of a grade acceptable for delivery on forward contracts was unsatisfactory for a contemplated industrial use).

¹⁰⁶ See G. REES, *supra* note 18, at 438, in which it was stated:

Usually, the contracts evolved for use on futures markets are not very suitable media for transactions in the physical commodity. On actuals markets the primary concern of the market authorities must be to define standards of the commodity so that sales can be made by description of their contacts. Buyers, especially if they process the commodity with machinery which proves troublesome, or even impossible, to use when the quality is not suitable, will, therefore, often be extremely fastidious in their purchases. On the futures market, by contrast, other criteria determine the description of the grade on the contract. In order to reduce opportunities to corner physical supplies, the grade established for futures trading must be one for which actual supplies are adequate. For these reasons it is normal for

the drafting of the Act reveals a vague understanding that physical delivery, as such, was conceptually unimportant. What was important was a completely trustworthy means of determining an accurate spot price.

Section 5(a) of the Act, specifying the circumstances under which the Commission is authorized to designate a board of trade as a contract market, properly imposed the broad, general, and controlling requirement that a futures market not be brought into existence unless, at that location, an adequately liquid and accurate cash market for the commodity exists or is price-controlling.¹⁰⁷ All that is conceptually required is a means both for discerning the controlling spot price of the commodity with accuracy and commercial acceptability and for bringing the fluctuating futures price into convergence with the then spot price upon expiration of the futures contract.

This same necessity is reemphasized in section 8a(9)¹⁰⁸ of the Act relating to the emergency powers of the Commission. Under this

terminal markets to permit the delivery of a whole range of grades against futures contracts and, because of this, such contracts are often referred to as basis contracts. It frequently happens, therefore, that grades which may be delivered under the terms of a futures contract will not be suitable for the manufacturer. Normally, the existence of two separate markets—one for purchasing the physical commodity and the other for hedging—ensures that the manufacturer need not run the risk of having to use a contract for shipments which could turn out to be unsuitable, should the seller decide to deliver a grade permitted within the terms of the basis contract. Attempts to combine delivery with hedging and speculation on one market are always subject to this very real difficulty, as the history of the London Metal Exchange makes abundantly clear.

In *THE ECONOMICS OF FUTURES TRADING* (B. Goss & B. Yamey eds. 1976) the editors explain: Since the buyer is subject to the risk that he may be delivered an unwanted grade of the commodity at an inconvenient time or place, a futures contract is ordinarily not suitable as an instrument for the acquisition of desired supplies of the commodity, and is not used for that purpose. Rather, it is used primarily by operators known as hedgers and speculators who are not interested in making or taking delivery in settlement of their commitments on futures contracts. Typically, obligations on one contract are discharged by means of a subsequent off-setting contract (a purchase being followed by sale), price differences being dealt with by an appropriate monetary settlement. The availability and low cost of this latter alternative method of settlement, itself made possible by the standardisation of contracts and facilitated by the operation of clearing houses, attract hedgers and speculators interested in the futures market for enabling them to trade in price changes and for not enabling them to dispose of or to acquire supplies of the physical commodity.

Id. at 7-8.

¹⁰⁷ Commodity Exchange Act § 5(a), 7 U.S.C. § 7(a) (1976).

¹⁰⁸ *Id.* § 8a(9), 7 U.S.C. § 12a(9) (1976).

section, the Commission may take drastic and unusual action if there exists a condition of disturbance "which prevents the market from accurately reflecting the forces of supply and demand for such commodity."¹⁰⁹ All that is conceptually required is that both the cash and futures markets accurately reflect the price-determining forces at play—the one for spot, the other for future values. The most crucial requirement is that the cash market price be accurate, for the classic function of delivery is to force the futures price into convergence with the controlling cash price which must accurately reflect the forces of supply and demand.¹¹⁰ If a cash market exists whose price quotations are commercially accepted as giving that measure, no physical delivery of goods, articles, or instruments is needed to bring about the required convergence.

E. *Acceptable Alternatives to Delivery*

The Act's concept of a future has never required physical delivery of goods, articles, or instruments. Cash settlement payments have long been the approved means of settling cash-futures differences at the margin.

Among the currently traded agricultural commodities, delivery on a matured future is most difficult for meats and live animals. Nevertheless, delivery persists largely because participants in the trade cannot refer to any constantly-quoted and accepted measure of spot prices, causing the potential for arbitrage to persist through the end of trading in the futures contract.¹¹¹ Delivery is necessary to force convergence of cash and futures prices upon expiration of the fu-

¹⁰⁹ *Id.*

¹¹⁰ The trade understands that it can, under certain circumstances, dispense with physical delivery altogether. Goss & Yamey describe the creation of a pure non-delivery futures contract:

The Paris white (refined) sugar market ceased operations in December 1974. There was an unsatisfied need for hedging facilities, and the London exchange decided to meet it by means of an ingenious innovation. A new contract, known as the white sugar conversion, has been traded since the middle of July 1975. It relates to the conversion of raw sugar into refined sugar, and therefore by itself does not correspond to anything which can be delivered in an actuals market. Delivery of the appropriate refined sugar can be effected only where the seller has sold an equal amount of raw contracts and conversions.

B. Goss & B. Yamey, *supra* note 13, at 52-53.

¹¹¹ See Bakken, *Adaptation of Futures Trading to Live Cattle*, in *FUTURES TRADING IN LIVESTOCK* 67 (H. Bakken ed. 1970) (Those who use livestock futures in hedging are those who "may, under certain conditions, permit contracts to terminate in physical deliveries.").

tures contract. But even with respect to one meat contract, the Chicago Board of Trade's iced broiler contract, the CFTC-approved technique of delivery is delivery of the dollar value of unsettled contracts. Payment of money in full is made in lieu of delivery of iced broilers.

Many other CFTC-approved futures contracts already provide for cash payment settlement of cash-futures price differences at the margin to effect the required settlement that physical delivery alone does not always give. It is not at all unusual to provide for partial settlement of various futures contracts, nominally requiring physical delivery, by means of cash payment in lieu of delivery. All deliveries of nonbasis-grade grain in fulfillment of a futures contract are accompanied by a cash payment settlement of the grade price difference. For grains the cash payment settlement involves payment of "fixed differences"; for cotton the settlement is made on the basis of "commercial differences,"¹¹² as required by the Cotton Futures Act.

The precedent is clearly established. If cash payment settlement of grade differences can be approved, so can cash payment settlement of the *total* cash-futures difference value. Partial cash payment settlement of cotton futures is not in principle different from total cash payment settlement. Both are payments at the margin determined by reference to a trusted cash price quotation prevailing on the futures maturity date.

With respect to financial instrument futures, physical delivery of instruments is made, but is not necessary in order to provide an acceptable measure of cash prices. To the contrary, the cash prices obtained or derived from the activities of dealers in government securities are accepted and generally regarded as definitive. Cash settlement in lieu of delivery could easily be instituted.

With respect to agricultural commodities, of course, the situation is historically different. In the grain trade, prevailing spot prices at any given time during the life of a futures contract are derived from and quoted on the basis of the controlling near future. On maturity of the future, of course, the spot price controls. For grains and oil seeds, a futures market is the forum in which spot prices are effectively discovered. For financial instrument futures, as well as for

¹¹² See G. REES, *supra* note 18, at 438; B. Goss & B. Yamey, *supra* note 13, at 6.

equity value futures, futures trading plays no discernible role in spot price discovery. For discovering spot prices these futures contracts have no significance; but financial instrument and financial interest futures contracts do play a uniquely important role in providing a trustworthy measure of the market's opinion as to likely future developments.

In connection with the enactment of the Futures Trading Act of 1978 this was known and understood. Congress refused to block summarily the potential creation of a Dow Jones stock-index futures contract as to which the function of discovery of spot price was not present.¹¹³ The possible hedging function associated with the hypothetical existence of such a contract was sufficient grounds for giving the CFTC discretion to permit such futures to exist upon a more detailed expert inquiry into their economic purpose. An equally important function would be the market evaluation of future developments.

F. *Requiring Delivery is Discretionary with the Commission*

Under the Commodity Exchange Act, discretion is given the Commission to provide for the terms of delivery applicable to any particular futures contract. Section 5a of the Act sets forth in great detail the operational requirements to which a designated contract market must conform.¹¹⁴ The Commission is not constrained with respect to the delivery provisions and positions that it may approve. Under section 5a(4), the requirement that contract markets provide for a post-maturity delivery period is discretionary.¹¹⁵ The discretion of the Commission under this section permits a deliberate decision to provide for the functional equivalent of physical delivery rather than for literal physical delivery; *a fortiori* the Commission may approve futures contracts in which the subject commodity—to be literally delivered—is simply a service or a species of value akin to a future interest.

Under section 5a(6) the Commission has discretion to impose grading standards.¹¹⁶ Should a futures contract be such that grading

¹¹³ See H.R. REP. NO. 1181, 95th Cong., 2d Sess. 14 (1978); S. REP. NO. 850, 95th Cong., 2d Sess. 22-23 (1978).

¹¹⁴ Commodity Exchange Act § 5a, 7 U.S.C. § 7a (1976).

¹¹⁵ *Id.* § 5a(4), 7 U.S.C. § 7a(4) (1976) (Contract markets must provide for a delivery period "when so directed by order of the Commission.").

¹¹⁶ *Id.* § 5a(6), 7 U.S.C. § 7a(6) (1976).

is meaningless, as it is with financial instrument futures, and as it would be with indexed value futures, the Commission can deliberately omit to promulgate grading standards. Where imposition of a literal delivery requirement would not serve the price-discovery or hedging function, the Commission may also omit to prescribe physical delivery, and may prescribe a functional equivalent in lieu thereof.

G. *The Uses of Futures*

The Commodity Exchange Act's conception of a future is functional. Of all contracts calling for deferred or future delivery, only those contracts are assigned to the category futures that facilitate either hedging or market-price discovery.

Most futures contracts never end in delivery. Contracts that do, paradoxically, are not cognizable as futures. Section 3 of the Act accurately describes what is involved. It declares the national public interest to be affected by transactions commonly conducted on boards of trade and known as futures, and it correctly depicts these transactions as "carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and the by-products thereof."¹¹⁷ Futures transactions are characterized by the *uses* to which they are put. Section 3 identifies those uses:

[T]he prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof . . . ; such transactions are utilized by shippers, dealers, millers, and others engaged in handling commodities and the products and byproducts thereof . . . as a means of hedging themselves against possible loss through fluctuations in price¹¹⁸

These are the unique and important functions of futures trading—hedging and price discovery. If either of these purposes is served by a proposed futures contract, the Commission may, in its discretion, permit the contract to come into being.

¹¹⁷ *Id.* § 3, 7 U.S.C. § 5 (1976).

¹¹⁸ *Id.*, 7 U.S.C. § 5 (1976).

The key substantive prohibition of the Commodity Exchange Act, contained in section 4, is a declaration that it is unlawful for any person to deliver through the mail or in interstate commerce any offer to make futures contracts, or any confirmation of the execution of any futures contract, or any quotation of the *price of any futures contract*, unless the futures contract in question has been made by or through a member of a commodities exchange that has been designated by the Commission as a contract market. The limiting language describes and characterizes a futures contract as that

which is or may be used for (a) hedging any transaction in interstate commerce in any commodity or the products or by-products thereof, or (b) determining the price basis of any such transaction in interstate commerce, or (c) delivering any commodity sold, shipped, or received in interstate commerce *for the fulfillment thereof*¹¹⁹

Almost identical language is repeated in the statutory prohibitions contained in sections 4b, 4c(a), and 4h. The emerging pattern is this: the Act describes the existence of the futures contract, made subject to the statutory prohibitions and requirements, in terms of its functions—the specifically enumerated functions of hedging or determination of *basis price*. The price thus discovered is the price of an executory contract right, a pure financial right. The significant statutory prohibitions are articulated in terms of contracts contemplating delivery under exchange rules, if delivery is to be made at all. Delivery is understood to be merely occasional, relating only to the rare fulfillment of a futures contract by means other than setoff. To the extent that delivery occurs in any significant measure, the market is not functioning, as designed, as a pure market in prices.¹²⁰

¹¹⁹ *Id.* § 4, 7 U.S.C. § 6 (1976) (emphasis added).

¹²⁰ As Professor Working explains:

Some authorities on futures trading have held that it is not necessary for a futures market to be usable for merchandising — that deliveries on futures contracts might be eliminated entirely. That is probably true, once “hedging” use of the market has become well established. But “hedgers” must know precisely what kind and quality of the commodity, in what location, is covered by the futures contract; and they must be assured that contracts will be fulfilled in accordance with the contract terms, either by delivery or by an equivalent financial settlement.

Experience has amply demonstrated that it is necessary at times to require holders of futures contracts to accept financial settlement, instead of allowing them to insist that delivery be made.

Working, *supra* note 19, at 20-21.

The statutory emphasis in section 3 on large volume and low margin trading in transactions that, as to the hedging parties, temporarily substitute for later contemplated dealings in cash markets, is consistent with the best academic definitions of futures. These definitions also emphasize the characteristic of trading in purely executory contracts in large volume by both commercial hedgers and speculating investors in connection with which delivery should never be made, and in which delivery or absence of delivery plays no definitional role.

In his effort to describe the essence of a futures contract, Professor Thomas Hieronymous emphasized some of the same points:

A futures contract is an agreement to later buy and sell a commodity. . . . Trading is in contracts for later consummation. Trades are exercises in futurity. They are not purchases and sales of actual or cash commodities. Title does not change hands; money does not change hands. Very few—only one or two percent—of the contracts made ever mature and are consummated. Trading in futures contracts is for purposes other than the exchange of title.¹²¹

Professor Henry Bakken, in a 1959 commodities futures seminar, pointed out that trading in futures contracts was entirely an exercise in trading in rights with respect to goods and articles, not trading in articles themselves. Ideally, Professor Bakken contended, delivery would never be made, futures contracts relating to fluctuating general price levels would be designed, and futures markets in which delivery was neither expected nor required could easily be imagined. This would represent a further desirable development in the process which early separated these markets in prices and rights from the markets in which physical commodities flow from producer to processor to consumer.¹²²

Professor Holbrook Working has made the most forthright statement of this insight:

Futures trading in commodities may be defined as trading conducted under special regulations and conventions, more restrictive than those applied to any other class of commodity

¹²¹ T. HIERONYMOUS, *supra* note 19, at 28.

¹²² Bakken, *Paper and transcribed commentary*, in 1 FUTURES TRADING SEMINAR, HISTORY AND DEVELOPMENT 25-27, 50 (1960).

transactions, which serve primarily to facilitate hedging and speculation by promoting exceptional convenience and economy of transactions. This may seem to some an inadequate definition. It does not say that futures trading is buying and selling for deferred delivery; it draws only a slender line of distinction between futures transactions and cash transactions (dealings in the actual commodity); and it makes the distinction between futures trading and other sorts of trading turn primarily on *purpose* rather than on more easily and objectively recognizable criteria. All of these characteristics are in fact merits of the definition.¹²³

IV. CONCLUSION

Lawyers cringe when required to evaluate purpose, rather than render judgment on the basis of more objective criteria, but it cannot be otherwise in this area. Only rarely, in the early decades of this century, were judges at all sympathetic to the recently developed clearinghouse futures institutions and practices. For the most part, there was a simple failure to recognize that the moral and legal misgivings relating to purported private-issue futures or options were not applicable to exchange-traded futures. Too often the judicial, legislative, and administrative impulse was to duck the problem by prohibition, thus thwarting the sensible evolution of market institutions that could adapt to newly-important uncertainties. The general inutility of attempted past prohibitions should be remembered when considering the creation of new, inventive, and potentially useful futures contracts. The market can best judge the utility of new proposals—and will do so quickly.

As new institutions arise that seek to cope with, and profit from, inevitable uncertainty, the traditional distinctions between insurance, securities, and futures may seem to blur, but some focus may be found in a return to fundamentals. The economic and social institution of the joint stock company, and its modern descendants in the forms of corporations, limited liability business associations, and limited partnerships, serves society chiefly as a device for sharing ownership broadly at a point in time, and for divorcing management responsibility from ownership rights. Futures do not divide ownership rights at a point in time, but rather over a span of time.¹²⁴

¹²³ Working, *supra* note 19, at 69.

¹²⁴ See Paul, *A Forward Look at Futures Trading in Livestock*, in *FUTURES TRADING IN LIVESTOCK* 99 (H. Bakken ed. 1970).

Where temporal risk-allocation is the essence of the exercise, as it is with futures and futures-related interests, the tendency of the SEC to arrogate all risk-distributing institutions to itself should be resisted. As the Supreme Court has found, the risk associated with ownership of residential housing—whatever the organizational form—is not the business of the SEC;¹²⁵ neither is the risk associated with the standardized non-contributory pension plan within the SEC's domain.¹²⁶ Though literally within the coverage of the Securities Act of 1933,¹²⁷ insurance contracts also are sensibly left to other regulators—or are left unregulated.

Hybrid institutions do emerge. A planned New York Insurance Exchange—its sponsors may hope—will be “regulator-free.”¹²⁸ But the time may come when, caught in the crossfire of disparate state and federal regulation, this putative New York simulation of Lloyds of London may wish it had the benefit of the sensibly straightforward and conflict-avoiding exclusive jurisdiction vested in a single governmental agency and the benefit of a clear statement that commodity pool interests are not subject to SEC registration requirements.

Such a result would easily be possible under the Commodity Exchange Act as it now stands. Insurance underwriting contracts are now formed in a cash market. With the proposed advent of formation of insurance underwriting contracts on an exchange in the United States, however, the lore and logic of futures contract formation may become applicable—as might literal application of the definitional and jurisdictional provisions of the Commodity Exchange Act. Experience, rather than logic, may caution the CFTC not to engage in a jurisdictional struggle over insurance, but both the law and the logic compelling CFTC oversight of exchange formation of insurance underwriting contracts may lie before us. An ambitious overlord of the futures markets who had a penchant for activist insurance regulation might well take up the challenge.

Justice Holmes, who wrote the Magna Charta for United States clearinghouse futures in the 1905 decision of *Board of Trade v.*

¹²⁵ See *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

¹²⁶ *International Bhd. of Teamsters v. Daniel*, 99 S. Ct. 790 (1979).

¹²⁷ Securities Act of 1933, § 3(a)(8), 15 U.S.C. § 77c(a)(8) (1976).

¹²⁸ See *Groundwork Being Laid for Planned Fall Opening of Insurance Exchange*, Wall St. J., Mar. 2, 1979, at 16, col. 1.

Christie Grain & Stock Co.,¹²⁹ stated:

People will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy . . . as a simple prohibition and laws to stop its being are harmful and vain.¹³⁰

The insights of law and economics merge, and finally promote the same ends: market integrity, competitive pricing, commercial freedom, and governmental restraint. When the markets can also provide higher prices for producers, lower prices for consumers, and an opportunity for game-players to get rich, their appeal should be irresistible. The made-in-America futures markets provide all this. They deserve appreciation, but, more than appreciation, they need overlords who understand.

¹²⁹ 198 U.S. 236 (1905).

¹³⁰ *Id.* at 247-48.

STATEMENT OF CHARLES L. FRAZIER, DIRECTOR, WASHINGTON OFFICE, NATIONAL FARMERS ORGANIZATION

The National Farmers Organization urges favorable action on S. 770, a bill that would terminate futures trading in potatoes. Our position was set forth in a letter to Senator Frank Church on April 17, 1979, and in earlier testimony before congressional committees when similar legislation was proposed. A copy is enclosed for the record.

Our position is based firmly on established facts disclosing that—

(1) the futures contracts bear unjustifiably on cash market prices for the product, and

(2) the New York Mercantile Exchange has demonstrated that it is incapable of protecting small traders when large operators ignore or deliberately violate the market rules.

In 1976 NFO members in Maine sold potatoes to two firms who had undertaken to hedge their cash contracts on the Mercantile Exchange. These firms had good records of settlement in prior dealings so the contracts were not insured. The purchasing firms could not secure timely settlement on their futures contracts and were unable to pay for cash deliveries even though the product was delivered and traded overseas.

Even after certain legal maneuvers were finished and some money was made available in partial settlement by the defaulting traders, those funds were tied up by a member firm serving as clearing agent on the contracts, based on a fear of additional litigation.

As a result of the shabby business practices disclosed by this series of events our own organization found it necessary to compensate producers for their producers for their products, from reserve funds, in an amount exceeding \$400,000. Equally important to us was the lasting injury to our organization in its standing with Maine potato growers. We do not wish to discuss the matter in further detail because

certain aspects are still involved in litigation. We cite the transaction, though, as a concrete demonstration of producer vulnerability under current procedures.

It should also be noted that the grading of such a perishable commodity as potatoes is often subject to questionable pressures and demands. Transportation problems being what they are today, and the influence of severe weather on potato equality being rather hazardous in the winter, it is not unlikely that grades may be determined fairly at one shipping point and still be entirely unacceptable at point of delivery.

Let's encourage producers to make forward cash contracts to deliver the product to honest user-buyers. Let the speculators go elsewhere and trade on commodities that are more widely produced. Only those commodities grown on a widespread basis should be traded through futures contracts and the exchanges handling those transactions must be able and willing to enforce settlements in a timely manner.

NATIONAL FARMERS ORGANIZATION,
Washington, D.C., April 17, 1979.

Hon. FRANK CHURCH,
U.S. Senate,
Washington, D.C.

DEAR SENATOR CHURCH: After a careful check with President Devon Woodland and other leaders in the National Farmers Organization who have a particular interest in prices received by potato producers in the three main production areas, we believe it appropriate to commend you on the introduction of S. 770 on March 27, 1979. This bill would terminate trading in futures contracts of potatoes.

We supported similar legislation in March of 1972, when testifying before the house Committee on Agriculture. At that time our producers were especially concerned with the effect of futures trading on cash prices, believing that futures trading in a thin supply situation following some low production seasons unduly influenced our cash prices. More recently, a number of our knowledgeable potato producers have observed the actions of a few very large processors with respect to their contract obligations and the effect of their failure to settle in timely fashion with other trade members who were cash purchasers of the crop.

Although we do not necessarily attribute ulterior motives to all who use the mercantile boards to hedge or speculate, we are firmly of the opinion that trading in potato futures is detrimental to producers and the consuming public. The potato crop is highly concentrated geographically. Cash prices paid to producers are too easily influenced by a few large investors because of the influence of weather and restricted transportation facilities. An ever-increasing proportion of the crop goes to processing use each year. Control of cash markets is concentrated in fewer hands.

As you know, prices for the 1978 crop are disastrously low in all the major production areas. We believe producers would clearly be better off if we had no futures contract trading and those processors or traders who were sincerely interested in assuring themselves of adequate supplies were encouraged to make forward cash contacts for delivery with producers or their organizations. Since this course would contribute to a stable market and better production planning on the part of producers, the consuming public would also be assured of adequate supplies at reasonable prices.

You are urged to push for passage of S. 770. We will follow closely the course of any hearings and consequent legislative action.

Sincerely,

CHARLES L. FRAZIER,
Director, Washington Office.

STATEMENT OF CHARLES L. FRAZIER, NATIONAL FARMERS ORGANIZATION BEFORE
THE HOUSE COMMITTEE ON AGRICULTURE—MARCH 16, 1972

FUTURES TRADING ON IRISH POTATOES, H.R. 7287

Mr. Chairman, and members of the committee, I appreciate this opportunity to appear for the National Farmers Organization in support of H.R. 7287. As you know, the membership of the National Farmers Organization is made up entirely of farm owners and operators. Our attitude toward this legislation is in keeping with our efforts to bargain for better prices on behalf of our members with the processors and other purchasers of the major farm commodities.

It should be noted at the outset that the members of the Aroostook County NFO have considered carefully the proposed legislation and recommend its adoption. These growers have substantial financial commitments in the production of potatoes and as all of us are aware, they have been selling potatoes at less than the cost of

production. These producers provide an excellent example of the economic consequences of improved efficiency in farming. It is a highly specialized type of production and costs have risen for equipment, labor and handling of the crop. In their efforts to help themselves in obtaining better prices, these producers are of the opinion that futures trading in potatoes is more of a hindrance than an aid.

In addition to the difficulty resulting from rising costs of production and low prices, the potato grower also faces the disadvantage of undertaking to market a crop at prices that are occasionally influenced by speculative activity.

The results of a market survey conducted by the Commodities Exchange Administration of the USDA develop a number of facts on the trading of potatoes on the New York Mercantile Exchange. Many numbers will not be repeated here in the interest of conserving the committee's time. I want to emphasize, however, a viewpoint briefly developed by other witnesses and reinforced by this study. Almost four out of every five people dealing in potato futures appear to be speculators and the number of producers using the exchange to hedge the sale of their crop has declined substantially.

We recognize that there may be some value or advantage in hedging for those who have a legitimate operation to protect as handlers or users of potatoes. We think those who desire a continuation of futures trading on potatoes must acknowledge, however, that is a relatively small crop in comparison with some of the other major commodities on which future contracting is customary. It is a perishable commodity with time limitations on the handling and sale of each crop. As a consequence, the cash prices of potatoes are more susceptible to unusual influences by speculative activity.

Briefly stated, it is highly probable that the grower viewpoint is correct—cash prices are unduly influenced by speculative activity—the value of futures contracts to those with a legitimate interest in potatoes is overshadowed by the speculative activity—and the harm done to producer prices is just one more unnecessary burden for the growers who are trying to pay their bills and keep farming.

We do not condemn all futures trading. It is recognized that this is properly a part of the marketing pattern in the grain trade, for example. And we do not necessarily attribute ulterior motives to all who have defended the exchange activities on potatoes. We believe, however, that the case is strong for termination of exchange trading on potatoes.

There is a danger that a very large proportion of potato growers will be driven out of production of this crop if prices continue at their current low levels. If elimination of potato trading on the Mercantile Exchange will contribute to price stability for growers and users, this valuable food source for many people will be protected. It is urged that favorable action be taken on H.R. 7287.

STATEMENT OF G. C. RANDALL, EXECUTIVE DIRECTOR, IDAHO POTATO COMMISSION

Mr. Chairman and members of the Senate Subcommittee, on behalf of the Idaho Potato Commission we appreciate the opportunity to express our views on potato futures trading.

The Idaho Potato Commission is comprised of nine members, five grower members, two shipper members and five processor members. The Commission was created by Idaho law and its responsibility is to promote and advertise the Idaho® potato and to engage in research that will maintain it as the best and most famous potato. I, the undersigned, am the Commission's executive director.

The Idaho Potato Commission is unanimously opposed to potato futures trading and specifically the Russet Burbank contract as it is apparent to the Commission that trading in these futures benefits no one, particularly the growers. Hardly any segment of the Idaho potato industry uses futures contracts in the conduct of their business.

The present Russet Burbanks contract lumps all Russet Burbanks into one category and can over a period of time erode the image of the Idaho® potato. An image and awareness by the consumer that Idaho potato people have spent millions over the years to promote.

From a practical standpoint the Commission wonders why a futures contract is allowed to exist when no one is using it. Trading on the Chicago Mercantile Exchange for the Russet Burbank contract has been so slim that it is not even reported in any of the financial publications.

In short why allow futures trading in a perishable commodity when none of those in the industry, growers, shippers, and processors want it.

Continued trading will only result in occasional unwarranted influence on the cash market not related to normal supply and demand.

Efforts to provide better supervision over this futures market will only result in increased expenditures of taxpayers' dollars.

The Idaho Potato Commission wishes to strongly record its support of S. 770.

STATEMENT OF MELDON B. ANDERSON, EXECUTIVE VICE PRESIDENT, IDAHO
GROWERS SHIPPERS ASSOCIATION, INC.

IDENTITY OF PARTY

The Idaho Grower Shippers Association, Inc., is a voluntary non-profit trade association with a membership comprised of producers, fresh packers, and processors of IDAHO potatoes. Members grow approximately 100,000 acres of potatoes annually and market in excess of 95 percent of the fresh potatoes shipped from Idaho into the channels of interstate commerce. Executive offices are located at 465 W. 17th Street in Idaho Falls, Idaho 83401.

I am Meldon B. Anderson, Executive Vice President of the Association and this testimony is submitted on behalf of its members. We appreciate the opportunity to present our written views for the hearing record on S. 770, a bill "to prohibit the trading of potato futures on commodity exchanges."

POSITION OF PARTY

The Idaho Grower Shippers Association favors the banning of futures trading in Russet Burbank Potatoes and, therefore, supports this legislation (S. 770), "to prohibit trading of potato futures on commodity exchanges." Further, we do not support modification and/or tightening of trading rules to keep the current potatoes futures contract trading on the Chicago Mercantile Exchange as proposed by the economics staff of the U.S. Department of Agriculture.

Our position is based on the premise that potato futures trading has not been, is not presently, and will not be in the future a viable marketing tool for the grower of Idaho potatoes. The main reason is that the contract delivery potential is extremely limited in Idaho which prevents a grower from taking a true hedge position in the futures market. The text book concept of a hedge that is promoted by the commodity broker is that very few hedgers actually deliver so actual ability to do so isn't necessary. However, when this concept breaks down in the daily trading of futures contracts and the grower is faced with a loss on his position or delivery, the hedger must be able to margin through delivery to achieve his price objective in the market. Actual delivery potential of the hedgers involved is what keeps the cash and futures prices in line during the life of the contract and brings them together in the closing month.

Professional traders and those who operate the commodity exchanges are well aware of the delivery potential of the "hedgers" in Idaho. This general knowledge eventually turns the grower's hedge into a speculative position if he can't deliver as the contract month approaches. Unfavorable price fluctuations against his position have him trapped with no way to see his price position through.

Other reasons for banning the Russet Burbank potato futures trading are as follows:

(1) The current futures contract, if actively traded, would afford outside influences the opportunity to manipulate the forces of supply and demand in the cash potato market and to disrupt the orderly marketing of fresh IDAHO potatoes. This would be especially true in the market for our cartons since the par delivery is 80,000 lbs. packed in new 50 lb. cartons with no substitutions. We store our potatoes in anticipation of a strong late spring market which the current contract could seriously impact with delivery of straight cars of cartons.

(2) The current contract on the CME accommodates the continuing effort by competitive growing areas to eliminate the identity of IDAHO potatoes in the market place. Our growers and handlers have contributed too many of their resources in advertising tax dollars to stand by and let this happen through a futures contract where delivery allowances are unrealistic.

(3) Finally, an actively traded contract in May could complicate an already serious equipment problem for transportation that develops in late spring when California fresh fruits and vegetables begin competing heavily for truck and rail equipment in the West. Energy restraints dictate that a wise use be made of transportation equipment that is necessary to move our potatoes to our regular customers in the East, Southeast and Midwest. Any equipment tied up in futures deliveries, as has been the case in the past with the IDAHO contract, would be unwise and critical to our transportation needs.

Since the demise of the Idaho potato futures contract on the CME, the IGSA has presented testimony in opposition to potato futures trading on two occasions before the Commodity Futures Trading Commission. At both hearings in Idaho, we predicted that the revised contracts would have very little industry support as has been the case to date. Attempts to further modify and/or tighten the rules of trading for the contract will do nothing to change this situation because it still won't offer the Idaho grower or handler anything positive for the marketing of their potatoes.

THE BOARD OF TRADE OF
KANSAS CITY, MISSOURI, INC.,
Kansas City, Mo., November 26, 1979.

Subject: Comments in opposition to S. 770, a bill to ban futures trading in potatoes.
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
U.S. Senate, Washington, D.C.

GENTLEMEN:

I. INTRODUCTION—KANSAS CITY BOARD OF TRADE

The Board of Trade of Kansas City, Missouri, Inc. (KCBOT), has been a grain exchange since 1856. Grain futures trading began in 1876, the KCBOT was "licensed" under the first Act to regulate commodity futures in 1922, and it continues today as the only designated futures market exclusively for hard winter wheat. Over the years various other futures contracts have traded at the KCBOT—corn, soybeans, milo (now called grain sorghum, and earlier, kafir corn), live cattle, and a Gulf wheat contract. In 1979 futures trading volume will exceed four billion bushels of wheat traded—a record year.

Currently the KCBOT has 215 members representing 110 firms, primarily in the grain industry. They range in size from sole proprietorships to the largest cooperatives, exporters, millers, and wire houses. Thus the KCBOT is an "old line" grain exchange—the second oldest in America—and is generally classified as a commercial or hedger's market, with 90 percent of our open interest being hedges.

II. POTATO FUTURES CONTRACT

We respectfully address some of the policy issues raised by S. 770. First, we are firmly opposed to the bill. However, we will not discuss the economic justification for a particular potato futures contract of a particular market, as we have not made an in-depth study of the terms and conditions thereof.¹

Our belief is that the Congress of the United States is not the proper forum for the consideration and resolution of issues such as the economic justification (or lack thereof) of a particular futures contract. The CFTC has been charged by law with the responsibility of making such determinations, and equipped with a professional staff. The Senate and the House, having just reauthorized the CFTC, should permit it to carry out its responsibilities in an orderly manner.

This bill is somewhat like legislation to prohibit the sale of General Motors stock on the New York Stock Exchange. That is a decision that Congress has invested in the Securities and Exchange Commission, which is staffed by various experts who are both professionally trained and who devote long hours to reviewing the various policy issues involved in such types of decisions. There are now approximately 50 futures contracts traded on the nation's 10 commodity exchanges with others in the works. We do not believe it is appropriate or even possible for the Congress of the United States to debate the merits or demerits of a particular futures contract each time a question regarding one is raised in public.

III. GENERAL ISSUES

We wish to also speak to the issue of the social utility of futures contracts generally and the public and producer's perception thereof. A recent publication by Dr. Joseph M. Burns, put out by the American Enterprise Institute for Public Policy, on the Economics of Markets, makes most of the public policy arguments for

¹ In all likelihood there is a need for a Maine potato futures contract since: (a) potato merchants must own title to potatoes as part of the marketing process and thus are subject to price risk; (b) prices on Maine potatoes fluctuate; (c) potatoes are a fairly fungible product; and (d) potato farmers, whether they realize it or not, can obtain certain benefits through forward contracting, price discovery, and even direct hedging on an efficient basis that would not be available if the market was eliminated. Whether the existing contract is well designed is beyond our knowledge.

futures trading. We would suggest that this book be referred to for both general and specified analysis of futures trading.² In fact, Burns quotes authorities as far back as John Stuart Mill to support the role of speculators for efficient risk shifting and moderation of wild price swings.

Some of the basic functions and purposes of a futures market include:

- (1) Price or value discovery; (a) for current time; (b) at various times in the future;
- (2) Risk shifting (hedging) at an economic cost;
- (3) Permits forward contracting;
- (4) Facilitates borrowing on inventories;
- (5) Reduces the spread or margin (difference) between producer and consumer;
- (6) As a corollary of (5), permits the middleman (elevator, processors, merchandiser) to operate on a thin margin per unit;
- (7) Substitute for the real commodity;
- (8) Due to speculators, tends to reduce or ameliorate wide price swings of the commodity; and
- (9) Occasionally is an alternative source of supply.

Such benefits are typical in an active, well organized and well regulated futures market which disseminates its prices and which has wide user and public confidence. Regretfully, however, suspicion, misunderstanding, and criticism seem to be constant companions of commodity trading. Consumers, of course, and legislators from urban areas, complain when prices rise; by contrast, farmers and legislators from farming areas complain when prices fall. Both blame the market as if it were the cause. The function of the market, however, is value discovery—simply finding out the price at which people will buy and will sell, based on supply and demand at that moment. However, many blame the market for setting the price, as if there were a conspiracy involved. Blaming markets is comparable to blaming a thermometer for the fever of an ill patient or the messenger who brings bad news.

IV. INDUSTRY

The "futures industry" is in some ways a misnomer, since it is made up of many industries, being the 50 (approximately) different commodities which now have futures trading, plus the wire houses or FCM's and floor brokers and traders who service them. This total group is constantly trying to inform and educate the various publics affected by futures trading. The CFTC, which by law is supposed to be engaged in an educational effort, could do much more. We hope they can be encouraged to do more to help reach the general public as well as specialized groups such as consumers, producers, the press, and even some in Congress.

V. SUMMARY

In summary, we feel the CFTC is the Government entity that should make the determination on a potato futures contract. It must be kept in mind that no futures contract can endure if it has no economic utility. Conversely, a contract is consistently traded *only* if it fulfills an economic purpose. Neither the CFTC, nor the Congress for that matter, can by edict or law change that fact. No government can create an economic purpose for a futures market or contract if one is lacking. Likewise, while the government may have the power to shut down a contract, it cannot eliminate the economic factors which create a need for the market.

Thus we respectfully urge this committee to leave economic analysis to the agency set up for that purpose, the CFTC, and leave market decisions to the market.³

Very truly yours,

W. N. VERNON III,

Executive Vice President and Secretary.

STATEMENT OF THE CHICAGO BOARD OF TRADE

The Chicago Board of Trade welcomes this opportunity to submit comments on S. 770 which proposes to ban futures trading in Irish potatoes on any exchange in the United States.

² There are numerous other books and scholarly articles too numerous to list, which support this view. A bibliography can be supplied on request.

³ One positive suggestion would be prompt approval of Senator McGovern's Resolution No. 225 to encourage various agencies (USDA, CFTC) to better educate producers in the use and benefits of futures trading—a subject too long for discussion at this time.

Although potato futures are not traded on the Chicago Board of Trade, the Exchange is deeply concerned that any bill to ban any futures contract should even be proposed.

Futures trading exists because it provides positive economic benefits—particularly to the market for the commodity which is traded, but also to the economy at large. Two economic benefits in particular stand out: (1) Futures markets provide a vehicle which can be used for hedging unwanted price risks created by inherently volatile supply and demand factors of a commodity such as potatoes; (2) Futures markets provide a highly efficient mechanism for incorporating economic information into competitively determined prices and broadly disseminating that price information to the farmer, processor, end-user, and general public.

As a price risk hedging vehicle, futures provide a tool for producers, end-users, and merchandisers to protect or insure themselves against volatile prices. Producers who constantly run the risk of declining prices can hedge their risk of loss by using futures as a temporary substitute for the commodity in order to lock in a firm sale price. Likewise, purchasers or end-users who constantly face the risk of rising prices can hedge their risk of loss by using futures as a temporary substitute for the commodity in order to lock in a firm purchase price. In either case, the producer or end-user has an extra tool to use in marketing or acquiring his commodity.

The economic benefit of futures markets as an efficient mechanism for broadly disseminating competitive price information is probably even more important. The open auction style of trading provided by futures markets is totally open to the public view as are the prices it produces. Futures markets permit the closest approximation to perfect competition of any style of market. No force does a better job of equalizing the role of all market participants than competition in a free marketplace.

In summary, these are the basic economic benefits provided by futures trading. These benefits are clearly in the interest of the public.

To ban futures trading in any commodity is to eliminate the possibility of providing these economic benefits of futures trading. A ban on the possibility of futures trading in any commodity would seem also to be contrary to the public interest.

No one is forced to participate in a futures market. It is an option that the producer, merchandiser, or end-user of a commodity uses only by choice. To ban futures contracts in a commodity is to arbitrarily eliminate that choice for everyone. A ban is contrary to the basic principle of free enterprise. If no one chooses to use a futures market, it will die quickly enough. The test of market use is a rigorous test for the survival of any product.

On the other hand, if a futures market is being abused, misused, or isn't functioning properly, there are significant and tested ways of dealing with these problems.

As early as 1922 with the enactment of the Grain Futures Act, Congress recognized the desirability of self-regulation by futures exchanges. More recently, this concept was incorporated in the 1974 and 1978 amendments to the Commodities Exchange Act. The rationale for recognizing this self-regulation on the part of exchanges is basic. They possess unique expertise in the day-to-day operation of these markets and are in a singular position to act effectively to remedy activity detrimental to market functions or to implement needed contract revisions.

The outright ban on the use of a futures contract for a commodity negates this legislative self-regulatory framework by taking the self-regulatory responsibility away from the exchanges and indeed, even negates the oversight review by the CFTC. Such an action is, in the opinion of the Chicago Board of Trade, contrary to the legislative framework established by Congress, and sets a dangerous precedent.

In addition to self-regulation by exchanges, there are several legal mechanisms which counterbalance the activities of exchanges. If, as in the present case, there is concern about deliverable supplies of a commodity, which in turn carries with it a concern for manipulation or cornering, the 1974 and 1978 amendments to the CE Act give the Commission authority to take preventive measures, in addition to the self-regulatory actions of the exchanges. Moreover, an aggrieved party has the ability to make use of the court system to seek redress for any damage arising as the result of any illegal activity. Redress can take the form of awarding damages for unfair trade practices, tort, contract violations, and the like.

In substance, then, because of external legal devices and the self-regulatory role of the exchanges, we feel the decision to trade or not trade a futures contract should be left to fundamental economic principles, for the final determination.

WASHBURN, MAINE, October 29, 1979.

Ms. DENISE ALEXANDER,
Hearing Clerk, Senate Subcommittee on Agricultural Research and General Legisla-
tion, Washington, D.C.

DEAR MS. ALEXANDER: I am enclosing my recent letter to Mr. Robert Humphrey of Senator William Cohen's staff relative to my opinions on potato futures trading. My intention is to offer this letter as my testimony in opposition to Senate Bill S. 770.

I would call the committee's attention in particular to the paragraph on page three of my letter beginning, "So in finalizing, * * *"

Thank you and the committee for your kind attention to this matter.

Very truly yours,

DONALD C. UMPHREY.

Enclosure.

DONALD C. UMPHREY,
Washburn, Maine, October 26, 1979.

Mr. ROBERT UMPHREY,
Senate Office Building,
Washington, D.C.

DEAR BOB: Understand you are making some sort of a survey on the New York Mercantile bill being promoted by Senator Muskie and Church. I am not familiar with the bill except basically it is to outlaw the trading of potatoes on any commodity exchange.

I was one of the original members of the exchange when they introduced Maine potatoes as a trading commodity back in 1939, I believe. My experience with the exchange is extremely favorable as I have seen it used most successfully by some growers as a hedging tool.

Many people say they don't understand it and don't dare use it. Actually it is very very simple. . . . just a bookkeeping organization to oversee a business transaction between two people . . . a buyer and a seller. If a grower has a car of U.S. #1 Maine potatoes and hedges them at a firm price on the exchange, there is no risk whatsoever, provided he has the car of potatoes and can deliver it to New York City as the contract reads. Your money is available as soon as good delivery is made with no questions.

For example, take the last three disastrous years for Maine potatoes and look back over the life of the March, April, and May options. There has been the opportunity to sell some portion of your crop for figures of ten dollars a barrel and up. Growers will just not take advantage of these opportunities and seem to wait until prices have fallen to low levels due to one reason only, and that is oversupply. You don't have to worry about prices when the supplies are barely adequate. The owners of the raw material have control and the buyers are at their mercy. Naturally the reverse is true when we are in oversupply which has been the case over the past three years. The real answer is the whole potato problem is very simple—oversupply. The reason of the oversupply is simply that too many inefficient potato growers are finding finance through government agencies to keep on producing which in turn is making it really tough on those few growers that are still keeping their heads above water even at these disastrous prices. These growers are willing to make a profitable sale whenever one presents itself which in most cases of my experience is Mercantile Exchange related.

Now comes the experience of last March when all trading was halted by the Exchange officials. My own personal sincere feeling is that they acted wisely as in my mind there was the very likely possibility of a real "squeeze" by those on the long side as in their opinion we did not have legitimate quality left in Maine to make the deliveries. I think we in Maine were too stubborn to admit that the quality of our crop was extremely poor and ungradeable. The inspection service in New York proved this, however, it was very suspicious as to the amount of turn-downs in that market with all other markets seemingly having a minimum of trouble. But, I cannot say that malicious actions were taking place there, as I do not have any concrete facts and only hope that there are government agencies that would investigate this end of it and make honest reports of their findings. I have always had a great respect in general of the inspection service, and am hopeful that this coming delivery month of November will prove that when you have the quality, then there will be no above normal trouble in making a good delivery in New York City.

I would like to be in a position of quoting specific cases of growers using the Exchange in their marketing program, thus finding a profitable way to insure their total expenses for a crop, in many instances even before the crop was planted. Some

of these cases are not "direct" board hedges but were available to them only because there was a "board" on which the actual buyer (broker), fertilizer company, machinery dealer, etc., could use to protect his potato purchase. These opportunities would not be available without the Exchange.

In the old days, the only financing available generally was a sale usually below the cost of production to a Boston, New York, or other dealer. Actual future sales of tablestock and seed futures to the trade were just fine if the market was higher than the contract price at time of delivery, but if the market was lower, it was very difficult to make a delivery that was acceptable. There always seemed to be a way for the buyer to break the contract if the market was against him. This method just was never satisfactory.

So in finalizing, I am personally most hopeful that the potato contract on the New York Mercantile Exchange can continue and improve in areas where improvements are needed and possible. I am also hopeful that some government representatives will make the sincere effort to get real facts on potato trading and not be swayed by hysterical emotions of troubled groups who naturally also are voters. Maybe, no elected official has this option?

I wanted to mention earlier that I am no longer a member of the exchange due only to the fact that I have semi-retired and had no need of a seat on the exchange especially when they are saleable in the thirty thousand dollar range.

Meanwhile I trust you are enjoying your work in Senator Cohen's office and my very sincere regards to you.

Sincerely,

DON UMPHREY.

STATEMENT OF MEREDITH BRAGDON, PRESIDENT, MAINE POTATO COUNCIL

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, my name is Meredith Bragdon. I raise 200 acres of potatoes in Perham, Maine, and I am presently serving my second term as president of the Maine Potato Council, an organization representing all potato growers of five acres or more.

For over twenty-years the Maine Potato Council has attempted to eliminate potato futures trading on Maine potatoes. Seven referendums have been conducted during this time. The most recent referendum was taken in April 1978 and the results showed a 62 percent ballot return with 81 percent voting in favor and 19 percent voting against elimination.

In 1970 the referendum showed a 74 percent return with 81 percent in favor and 19 percent voting against elimination.

In 1970, Maine had 1,708 growers and today we have only 1,300. We don't blame this decrease on the potato futures market but it has helped.

The suspension of April and May trading, resulted in substantial financial losses to growers as well as dealers. In southern Aroostook a few people lost \$650,000 and one of my neighbors had to pay \$110,000. These people aren't too interested in hedging any more.

It is my understanding that a commodity that is traded should have sufficient volume to reflect the general value of the commodity. Maine no longer produces the potatoes for an April and May contract since the original contract called for Katahdin variety and only 23 percent of our 116,000 acres were planted to this variety.

The difference between cash and future prices do not converge as they should in a good futures contract, therefore, liquidation of hedging positions are impossible. Thus one of the reasons for less hedging. Also banks in the area will not finance hedging unless the hedger has the collateral to more than cover the hedge—needless to say, Maine family farmers do not have this collateral.

The governing board of the mercantile has truly demonstrated that they lack the ability to prevent price and market manipulations. The perishability and lack of available supplies indicate that the potato is not a commodity for a futures contract.

Therefore I urge you to give this legislation S. 770 a favorable vote out of committee.

96TH CONGRESS
1ST SESSION

S. 770

To prohibit trading in potato futures on commodity exchanges.

IN THE SENATE OF THE UNITED STATES

MARCH 27 (legislative day, FEBRUARY 22), 1979

Mr. CHURCH (for himself and Mr. MUSKIE) introduced the following bill; which was read twice and referred to the Committee on Agriculture, Nutrition, and Forestry

A BILL

To prohibit trading in potato futures on commodity exchanges.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That the third sentence of section 2(a)(1) of the Commodity
4 Exchange Act (7 U.S.C. 2) is amended by striking out "So-
5 lanum tuberosum (Irish potatoes),".

6 SEC. 2. The Commodity Exchange Act is further
7 amended by adding at the end thereof a new section as fol-
8 lows:

9 "SEC. 19. Notwithstanding any other provision of this
10 Act—

II—E

1 “(1) no contract for the sale of potatoes (*Solanum*
2 *tuberosum*) for future delivery shall be made on or sub-
3 ject to the rules of any board of trade in the United
4 States, and

5 “(2) any person who violates the provisions of this
6 section shall be guilty of a misdemeanor and upon con-
7 viction thereof be fined not more than \$5,000.”.

8 SEC. 3. The amendments made by this Act shall become
9 effective thirty days after the date of enactment.

