Part II

Marketing Orders and Agreements and Their Effects on Futures Markets
MARKETING ORDERS AND AGREEMENTS AND THEIR EFFECTS ON FUTURES MARKETS
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The general topic for this seminar deals with an aspect of marketing which is of particular concern to producers, handlers, and processors of farm products — namely, market instability. This is not to say that other businesses involve less risk; in fact, some may involve more. It does mean that farming and the businesses closely related to it are conspicuously dependent on the vicissitudes of weather and the threats of epidemics of plant and animal pests and diseases which cause wide and unpredictable variations in yield.

The particular topic assigned to me involves two quite different approaches to the reduction or elimination of risk from price changes in the production, handling, and processing of farm products. Hedging by trading in futures markets is a procedure by which those who, in the normal course of their business must "take positions" in commodities, may shift to others much of the risk of loss from such price changes. On the other hand, an important objective of many marketing orders is to set up programs which are designed to reduce the price swings which constitute the risks.

Farmers' Struggle With Uncertainty

In order to give you an idea of the nature and persistence of the drive back of the moves to make market orders work, I should like to sketch briefly the road by which farmers arrived at the point where they would consent to such controls as these plans involve.
FUTURES TRADING SEMINAR

For over a century American farmers have been under economic pressures they have not understood, many of which arose from rapid expansion of production on new land, augmented by improved transportation and the oncoming rush of mechanization and new technologies. Always they faced the double instability of price and yield. Many went to a town or city where industry and trade called; many, following Horace Greeley’s advice, moved “out West” — to Ohio, Illinois, Iowa, and on to the far West. Here, especially in the mountainous areas west of the Rockies, they found numerous valleys with fine soils easily accessible to abundant water for irrigation. Often such areas had climatic conditions uniquely favorable to certain crops — cantaloupes, winter lettuce, early cherries, Tokay grapes — with opportunity far beyond what Greeley had dreamed. But always the same problem soon arose — surplus and chaotic markets as seasonal peaks in shipments glutted the distant markets which were often the only outlets.

Horace Greeley, writing about nearby markets in 1870, gave a vivid description of the kind of situation which, over half a century later and several thousand miles out into his West, gave rise to the “social invention” we call “market orders.” He wrote:

“I write in the fullness of a peach-harvest of extraordinary abundance. Peaches were never before at once so plentiful and so good. . . . Yet, while the growers have been constrained by their abundance to sell peaches at a low figure, and often at prices which left them nothing after defraying the cost of transportation and marketing, the consumer have paid for them an average of not less than two dollars per bushel.”

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INFLUENCE OF ENVIRONMENTAL FACTORS

How a surplus such as Greeley described might affect a producer of one of these specialty crops far from market may be illustrated by a hypothetical example. Take a fruit for which eastern consumers were paying the equivalent of $4.00 for a package which would gross the Pacific Coast producer $1.00 on tree or vine. With most of the intervening costs fixed for the season, a 10 percent drop in retail prices, if passed on to producers, would reduce gross receipts by 40 percent, and profits often to beyond the vanishing point. Such occurrences were not unusual; in fact, for some products, they were almost yearly occurrences at seasonal shipping peaks which usually found many cars consigned to eastern receivers 8 to 10 days away.

To correct such situations was the central idea of the Orange Growers Protective Union and the California Fruit Union in the middle 1880's, the Southern California Fruit Exchange in 1895, and a host of others to follow.

Experience quickly showed that no drive by farmers to establish their own organization could enlist all farmers, and that the nonparticipants not only shared any gains in price and bore none of the costs but that their actions often wrecked a program. Said one speaker in a pessimistic vein:

"You can get one-third of the growers together in an organization; these can get another third to join; but no power outside the Almighty can draw the other one-third in."18

14 On the likelihood of such passing on of a drop at retail levels, see Karl A. Fox, Policies to Combat Depression, Bureau of Economic Research (New Jersey: Princeton University Press, 1956), p. 301.
Although there was wide recognition of the fact that not all farmers would join or adhere after they joined, many persons hoped that in periods of industry stress it might be possible to get coordinated action between the diverse groups within an industry by means of yet another device, the industry "clearing house" for the dissemination of market information, and at times to carry on action programs. A long series of such ventures "soon fell apart because of their inability to bring any measure of compulsion to bear on their members."  

It took a particular experience, in the gloom of the depression period, to drive home in a dramatic way the basic difficulty of using such voluntary organizations to reconcile the conflict between the motives of the group and those of the individuals that composed it. The basic conflict is simply this: In economic terms, the demand facing a group of farmers at the farm level is almost always inelastic within the ordinary range of experience — a little less would bring a little more — but for the individual farmer of moderate volume (as he sees it after he gets home from the meeting) the demand is one of unit elasticity — increasing his output to his limit will not affect the price but will affect his income. The greater the success of the group in raising prices by curtailing supplies the greater the temptation to the individual to expand his own. This is not news to you; and do not think it is to a farmer.

The particular experience to which I referred took place in the restricted Tokay grape area around Lodi, California, in the summer of 1932. When it became evident that another bumper crop was on the way, growers and shippers recalled

Kraemer and Erdman, op. cit., pp. 90-120
INFLUENCE OF ENVIRONMENTAL FACTORS

that in 1930 a crop of 7,670 cars had grossed them "on the vine" an estimated $750,000; that in 1931 a short crop of 4,109 carlots had brought about $2,000,000.\textsuperscript{20}

With this background in mind and overlooking lessons learned in the past, growers and shippers again organized a clearing house including 85 percent of the Tokay tonnage, and proceeded to prorate shipments. The plan worked well for a few weeks but was given up at the end of the fourth week when it developed that the noncooperating shippers, holding but 15 percent of the tonnage, had actually shipped 50 percent of the week's quota.\textsuperscript{21}

Action minded groups in the California Farm Bureau Federation and the California State Chamber of Commerce shortly asked for a study of the desirability and feasibility of compulsory programs as procedures for these producers of special crops. The result was the drafting of the California Agricultural Prorate Act and its enactment early in 1933.\textsuperscript{22}

In the meantime, the U. S. Congress had included in its Agricultural Adjustment Act, enacted in May, 1933, two sections which

"Empowered the Secretary of Agriculture to enter into such agreements with 'processors, associations of producers, and others' as would in his judgment 'effectuate the declared policy' of the act, and to put these 'processors, associations of producers, and others' under license. . . ."\textsuperscript{23}

These had been inserted in the adjustment bill late in its development by persons interested in "basic" crops. Per-

\textsuperscript{20} E. A. Stokdyk, Marketing Tokay Grapes, California Agricultural Experiment Station Bulletin 558 (Berkeley, 1933), pp. 50-56.

\textsuperscript{21} Ibid., p. 52, Table 16.

\textsuperscript{22} Introduced January 26, 1933, and signed by thhe Governor June 5, 1933. See E. A. Stokdyk, Economic and Legal Aspects of Compulsory Proration in Agricultural Marketing, California Agricultural Experiment Station Bulletin 565 (Berkeley, 133), pp. 3-44.

\textsuperscript{23} Nourse, op. cit., pp. 15-16 and 423-438. Note that the license feature was replaced by "Orders" by Public Law 300, August, 1935. Ibid., p. 424.
sons interested in special crops, the California groups in particular, seized upon these sections as promising devices and urged their passage.²¹

Finally, the California legislature in the same spring passed the California Adjustment Act of 1933 to parallel the federal act on intrastate matters.

**The New Plans Evolve**

Various groups of producers and handlers at once set out to try the new "inventions" — like boys and dads on Christmas morning. In 1956 it was reported that to that date a total of 70 marketing programs had been promulgated under California law (exclusive of milk) and that at that time 28 were in active operation.²³.

Of course, not all of the schemes had worked. Many were poorly set up, others were badly administered, and farmers resented inequities which developed. In any case, numerous activities were soon being challenged in the courts. As certain procedures were cast in doubt or struck out by court action, the procedures were changed or the laws amended, or both, to permit the sorts of action needed to attain the desired objectives. Legislative evolution thus leaves California farmers with the California Marketing Act of 1937 (though repeatedly amended) as the law under which most current state programs are operating, and with the major provisions of the original Prorate Act now embodied in the Agricultural Producers Law which specifically authorizes regulations applicable only to producers.²⁶

²¹ Nourse, *op. cit.*, pp. 3-9, 15 and 16.
²³ I have omitted milk with which experience has been perhaps less applicable to commodities traded on futures markets, but see *Report to the Secretary of Agriculture by the Federal Milk Order Study Committee* (Washington, 1962), 95 p.
INFLUENCE OF ENVIRONMENTAL FACTORS

As of August 15, 1961, 30 programs were in operation under the California Marketing Act, with 3 others in effect but inactive. And in November, 1961, 43 federal marketing agreement and order programs were in effect for fruits, vegetables, and tree nuts produced in 21 states. 

I have given an overly long background story, even though I have had in the back of my mind the remark of the school girl who, asked by her teacher to review a book on penguins, said: "Well, the book tells a lot more about penguins than I care to know."

My purpose is to emphasize the nature and persistence of the drive that has impelled so many farm groups to organize with market stabilization as a main objective. I suspect that much of this drive has now been transferred to experimentation with this new institution. For those products for which it proves to be feasible and politically acceptable, it may reduce price swings to the point at which futures trading will not develop or will wither away. But let us look more closely at the thing itself and how it works.

Nature of the Setup Under Market Orders

The terms "marketing agreements" and marketing orders" are often used confusingly. The federal law of 1933 provided for marketing agreements between producers and/or handlers of an industry and the Secretary of Agriculture. Since these bound only the signers, the Act made use of an old device to compel a nonsigning minority to comply; namely, to require all handlers to be licensed. Operation without license drew a heavy fine, violation of the provisions of the license was cause for revocation of the license. In 1935 the amended Act replaced the licenses with market orders.

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The marketing order is the significant document under both federal and California state law. The marketing agreement is basically used only to indicate to the officer — the U. S. Secretary or the State Director of Agriculture — that a major section of the industry wants the program and agrees to comply with its rules.

All but one of the 33 California marketing programs operating under the California Agricultural Marketing Act of 1937 are joint-order and agreement programs. Two others operate under the Producers Marketing Law. All of the 15 federal programs operating in this state are joint producer-handler programs with agreements applying only to the handlers who signed but with orders applying to all, producers and handlers alike.

In general, much the same procedure is followed for the inauguration of a program whether under federal or state law. Usually, there is discussion by interested persons among themselves and with appropriate officials about possible programs; draft of a tentative program, perhaps after industry group discussions — often long and contentious; public hearings on the contemplated program; evaluation by officials of evidence presented; revision of the program to make it at once acceptable to the several segments of the industry, operationally feasible, and compatible with the enabling legislation as to procedures and public welfare; and submission to a referendum to get producers' and/or handlers' reactions. If the industry approves by the required margin — in both cases very substantial — and the Secretary or Director approves, the order is issued.

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28 I shall restrict my discussion to California experience mainly because it has been so extensive and also because facts are readily available.

[72]
INFLUENCE OF ENVIRONMENTAL FACTORS

The list of commodities for which there are market orders seems to be expanding. The commodities to which market orders may or may not apply are named in the enabling legislation, specifically or by groups, or may be excluded. Inclusion or exclusion has been the subject of numerous legislative battles at both the state and federal levels. Interested industry groups managed to have the turkey industry made eligible for control via marketing orders by a special proviso inserted in the Agricultural Act of 1961, and a bill in Congress at this writing would authorize federal egg marketing orders.

The purposes of these orders are, simply stated, to improve returns to agricultural producers. To get the desired results, the following major lines of activity are authorized by the various enabling laws:

1. Volume control.
2. Quality control, sometimes including pack or container specifications.
3. Industry promotion — sometimes the main item — not permitted under federal law.
4. Research.
5. Elimination of unfair trade practices.

Only the first two are of direct concern in our discussion today. It may be pertinent to note, however, that producers' and handlers' interest seems to be shifting to the third item — industry promotion and advertising. Although volume con-

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control — "orderly marketing" or "surplus control" — was at first the main purpose, only 11 of the 33 programs California had in effect in 1960 provided for volume control, but 25 provided for sales promotion and advertising. Of some $9 million collected for operating these programs in 1959-60, 69 percent was expended on "promotion." "Inspection," 8 percent, doubtless included mostly quality control, while a part of "administration," 18 percent, would have been for volume control aspects. Apparently, California producers have more faith in sales promotion than in volume restriction.

The program under each order is carried out by a manager and staff employed by an "Advisory Board," a body appointed by the Secretary or the Director (in California) from nominees recommended by the participating producers and, if they are included, the handlers. Such an advisory board has less authority than is ordinarily assumed, since it may not act on important matters on its own initiative but may only recommend to the Director. The latter, if he approves, issues the specific order for action, let us say, establishing the operating levy or a quota for the season.

The various "self-help" programs are supported by assessments levied against the persons regulated on some equitable basis. They are ordinarily collected by the first handler. In California money collected pursuant to a marketing program is deposited in a bank under an account established by the state and credited to that program. The enabling act establishes maximum rates.

A New Institution Develops

Here, then, is a new procedure developed in the past three

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INFLUENCE OF ENVIRONMENTAL FACTORS

decades by which producers of given agricultural products in a specified area may virtually take things into their own hands when the marketing system seems to function badly. What we have is a new "social invention," the marketing order, to use the term which Professor Black in the 1959 seminar applied to futures trading. Before speaking more on the likely impact of the new on the old, let us take a better look at the new, which is, in a sense, a supergovernment, imposable on but not interfering with existing government, to provide special regulatory facilities desired by given industry groups within it to regulate certain activities of its own members.

We have long had various kinds of special "districts" — drainage, fire protection, mosquito abatement, etc. These have been superimposable on areas outlined by boundaries other than those establishing the older township and county system. When so imposed by a prescribed majority of the voters of the area, any regulations and tax levies involved in its purposes are applicable equally to those who favored the plan and to the dissident minority.

In the new institution which we are discussing, the voting is restricted to those who are to be regulated. Thus, during the recent referendum on the defeated national turkey order, the voting was restricted to those growers who had each produced at least 3,600 pounds of turkeys during the base period. Left out were growers of less than about 200 turkeys each, who were not to be regulated.

These groups are operated by advisory boards, as you will recall, which are appointed by the Secretary or Director from lists of nominees selected by the growers and/or handlers from their own numbers. It is these boards which must make the recommendation to the responsible officer that he im-

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pose the specific controls they believe to be needed to bring about the adjustments in supplies required to raise prices. Even in these days when the educational level is high, such boards will not grade high on their knowledge of demand and supply — the very heart of these programs to raise incomes. Of course, the most unlettered fruit peddler knows something about supply and demand: scarcity makes for high prices; how high? That’s easy; just ask too much, then lower your price if you have to.

The ground rules laid down in the enabling legislation for the guidance of these newly appointed advisory boards and the responsible administrative officer at state and federal levels are stated in flowery language which sets up goals such as “orderly marketing,” “expanding markets,” “improving returns to producers,” and, in federal legislation, the usual references to “parity.” Yet, these bodies must make recommendations to the responsible officers for specific action, on, let us say, an order to impose a 12 percent “green drop” of cling peaches.

What do they need to know? They probably do not need to know about the demand schedule in detail but they do need to know about the total value schedule derived from it. Fortunately, there is usually available to the administrative officers the trained personnel which, with personnel at the state agricultural college, can make available modern statistical analysis in understandable terms. Fortunately, also, an order program which worked badly would quickly be terminated, usually after another referendum, but the Director’s judgment is one which gives him sobering power to say no even without a referendum.

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INFLUENCE OF ENVIRONMENTAL FACTORS

An example of the way growers can take over occurred in California during recent months. The Cling Peach Advisory Board, faced with a new record crop, was deadlocked on a vote to recommend a "green drop." The board is made up of 11 grower members and 11 canner members. Grower members favored the "green drop" but the canner group reportedly voted 6 to 5 against it. When it became evident that nothing would be done, a grower group, realizing that doing nothing would mean a chaotic market and maybe bankruptcies among both growers and canners, proceeded to formulate a grower control plan to accomplish the surplus removal if the established board did not act. The Director sent out the proposed order for grower approval. The vote was a decisive "yes." Shortly afterward the old board changed its vote and recommended the 12 percent "green drop."37

This latest episode is the sort of thing I had in mind in saying that this is what growers of these volatile special crops have wanted. The plan is still "evolving." Some persons have suggested granting production control power. So far this has not been done.38

Evaluation of Programs

Evaluation of the effectiveness of marketing programs is not simple. The main difficulties are lack of information on operations, repeated changes in procedures, and changes in the economy itself.

The gaps in information about experiences with given programs are perhaps the first things that strike one. Such annual reports as are made by managers or secretaries are seldom

adequate for analytical purpose, and only a few are readily available. Even when statistics of movement, prices, and product utilization are given, there is inadequate information on “market context” to permit drawing valid conclusions from the data supplied.

Although some groups have been experimenting with industry controls for some three decades, an attempt on my part to list for each of several groups the successive control devices or procedures that had been tried led me nowhere except to the realization that a vast trial and error process has been going on. The numerous changes ran the gamut from minor amendments in the wording of regulations to shifts from state to federal enabling law, or the reverse. Again, there is little information available on the reasons for such changes or on-the-ground evaluation of results as to effectiveness.

Finally, evidence on the effectiveness of programs is obscured by the fact that numerous important changes in the industry or elsewhere were taking place simultaneously so that the results of marketing order programs became diffused and intertwined with the results of other influences than their own. Much of the popular discussion of marketing programs has been in a status quo atmosphere with the naive, tacit assumption that when a correction is made in a marketing process other things remain as they were. Such problems simply do not remain “solved.”

Among the important changes has been the burgeoning population influx which has converted thousands of acres of orchards to housing tracts. In numerous cases this has led to significant shifts in acreage. Lemon production has moved into the coast counties below Santa Barbara, and walnut acre-

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INFLUENCE OF ENVIRONMENTAL FACTORS

age has moved north to the more suitable areas in central and northern California where yields are higher.

The products have changed; over half the 1961-62 lemon crop will be utilized in lemon juice or frozen concentrate lemonade. Orange utilization has likewise changed. In 1946-47, the first postwar season, 72.4 percent of the United States orange crop was sold fresh and 27.6 percent processed; by 1960-61 the proportions had been reversed — 65.6 percent was processed and only 34.4 percent sold in fresh form. In the case of walnuts, whereas at the beginning of the thirties a few defective nuts were being cracked, shelled walnuts now absorb over half the crop.

Moreover, the market structure in the food trade has changed. Where private and cooperative handlers formerly sold largely to wholesalers and jobbers, sales are increasingly going directly from association to large retailer — the chains and supermarkets.

These market order programs seem to have been most consistently effective where there are strong grower organizations — Sunkist, Sun-Maid, Sunsweet, Diamond Walnut, etc. In these instances, the basic conflict between growers and handlers is largely absent. Some of the conflict of interests between growers and shippers involved in control plans arises out of the fact that price elasticity is low at the on-tree level, and that total returns schedules are maximum at smaller volumes at that level than at later market stages. Stokdyk found in his Tokay grape study that growers might expect the highest on-vine return by shipping 250 cars a week whereas the shippers, operating on a commission basis and at the

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f.o.b. level, would benefit by larger shipments."

It has frequently been pointed out that these control programs have long-term value mainly as standby services for use in occasional emergencies. Almost from the start objective observers have cautioned that they are not applicable to situations involving "chronic surpluses." That, in fact, crudely applied they would aggravate the problems."

In 1938, Wellman said of control schemes for oranges that: "... schemes which have for their sole purpose the regulation of the flow of shipments to market during the season and which do not involve actual limitation of the total supply marketed are likely to prove beneficial to growers both in the short run and in the long run. Such regulation is a device which can be used continuously with reasonable safety and is particularly applicable to fresh fruits and vegetables.""

But of schemes designed to limit the total supply for a season, he wrote:

"This type of control is essentially a palliative and should be treated as such. It should be used only in acute emergency situations; that is, when prices and returns to growers would otherwise be at distressingly low levels. Its use should be confined to raising returns to producers up to the returns obtained from alternative

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Average price elasticity coefficients for lemons (1925-1941) has been calculated for three market levels: Retail, -0.78; F.O.B., -0.49; and On-tree, -0.44. Sidney Hoos and R. E. Seltzer, *Lemons and Lemon Products*, California Agricultural Experiment Station Bul. 729 (Berkeley, 1952), p. 34.

43 I have in mind the numerous writings of men closely associated with the development of these plans — Wellman, Braun, Hoos, Mehren, and others.

44 H. R. Wellman, "Controlled Marketing with Special Reference to California Fruits and Vegetables," Address delivered at Twentieth Annual Meeting of the California Farm Bureau Federation, Sacramento, November 16, 1938.
INFLUENCE OF ENVIRONMENTAL FACTORS

crops. To go beyond that is to court disaster. On the other hand, if limitation of the total supply during the entire season is applied only in years of excessive surpluses arising out of unusually high yields or of unusually low demand conditions, and if a quantity no larger than the surplus is withheld from the market, the program may be of substantial temporary benefit to growers without endangering their returns in the long run."

It seems that, from the long-run point of view, Wellman was too optimistic about the judgment such control groups would use in deciding when and to what extent to exercise control over flow to market. Such groups tend strongly to the short-run viewpoint. They find difficulty in drawing fine time-span distinctions among the problems they face today.

In the cases of crops like lemons, oranges, cling peaches, and walnuts, which have been subject to one or another sort of control for at least a couple of short "long runs," two influences have been tending to move the equilibrium point toward greater volume and lower price. First is the fact that control plans, to the extent they are effective, cut off the price troughs but leave hope for a series of short crops (for the other fellow) and higher prices, thus raising the average prices. The last point is only partially offset by such devices as the "stabilization pool" set up to meet unexpected demands. The second influence is the tendency to plant on the promise of increased certainty as to outlet and price. I suspect that, like putting some funds in a savings account at a low but safe return, some farmers and others have been planting with added certainty in mind.

At any rate, after 30 years and new or continued surpluses dead ahead, a comment made by Hoos some two years ago

45 Ibid.
FUTURES TRADING SEMINAR

anent chronic surplus situations may be pertinent: "A marketing order and its provisions are in effect only an aspirin or two, or a Miltown, when what is really needed is some expert diagnosis and perhaps a substantial type of healing or even surgery." 46

Now I have been discussing marketing orders for products which are not traded on futures markets. I have largely ignored the one product which is currently involved on both counts — Maine potatoes. Futures trading in Maine potatoes began in 1941. 47 It had apparently grown out of the practice of forward contracting between potato growers and dealers that is said to date back to 1871. 48 A marketing agreement and order was established in September, 1948. 49 Its use has had an intermittent history; a new federal order was recently approved by growers and handlers. 50 It is my understanding that direct volume control has not been practiced under the Federal Order but that size and quality regulation has been used with one eye on volume reduction.

Size and quality control, if consistently practiced, should facilitate futures trading if there is cooperation between the control administration and the trading group. If used consistently, it should help increase demand; if used intermittently as a volume control device, its side effect on consumer demand is more likely to be negative; if used mainly for quality

48 Ibid., p. 2.
50 Federal Register, June 23, 1962, p. 5945.
INFLUENCE OF ENVIRONMENTAL FACTORS

improvements, a side effect may be to widen price swings—though at higher levels.

Long observation and recent study of the operation of marketing order programs in California leads me to doubt the effectiveness and more particularly the workability of national orders. The potato study just cited (footnote 49) implies that on the matter of quality alone the operating complications would preclude a successful national program. Too many conflicting ideas are involved; for example, equal size or quality regulation might well have widely different curtailment effects in different regions. On the other hand, it has frequently been noted that vigorous action on surplus control by regional groups is virtually impossible, at best dangerous. Simmons has suggested that size and quality regulation may have given Maine producers a degree of protection against competition from other regions.

Over the years I have often asked myself several questions about futures trading for which I have not found wholly satisfactory answers; they have repeatedly come to mind again as I have studied marketing orders:

1. If futures trading is as useful as its proponents claim, why is it used in the handling of so small a proportion of our important commodities?
2. What are the basic conditions necessary for the development of futures trading?
3. Why has futures trading developed and then withered away in some instances?
4. How do the business firms fare which do not hedge when competitors do?

I have given further thought to these questions while trying to answer the question before us now. They have seemed

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particularly pertinent to an understanding of any conflict which may exist between the marketing order approach and the futures trading-hedging approach. I have not found the answer to my query on why futures trading on northwestern apples failed after one season of trading (1948) on the Chicago Mercantile Exchange, nor why futures trading on potatoes at Chicago has become insignificant and erratic while that on the New York Exchange has continued (but why only on Maine potatoes?). I have noted numerous attempts to explain declines in futures trading by reference to price support activities — perhaps the most conspicuous instance was the decline in future trading in butter. These observations have strengthened my conviction that any adverse effect of market orders on futures trading should come in any future instances in which the amplitude of price swings is narrowed sufficiently to avoid the need for hedging.

Since I do not anticipate the application of marketing orders to the "basic" crops nor to others on a national basis, I have considered the possibilities in the list on which market orders are or have been used but am inclined to rule out most of them on grounds such as those outlined by Wesson in his study of Florida citrus. He listed the following group of industry characteristics as favorable to the development of futures trading, specifically, at that time, orange juice concentrate:

68 Trading began on August 16, 1948; was opposed by the International Apple Shippers Association; a few sales only were reported in 1949. See items in New York Times, July 29, August 11, August 19, and August 20, 1948, and Wall Street Journal, October 11, 1949.
INFLUENCE OF ENVIRONMENTAL FACTORS

"1. The organization pattern of the industry must be such that the responsibility for the various phases of production and marketing are, to a substantial degree, divided among different groups of specialized and fairly numerous firms, rather than among a few large integrated firms.

"2. The commodity must be purchased and sold on the basis of quality standards that convey a common meaning to all buyers and sellers.

"3. Market information concerning supply, demand, and price for the commodity must be widely distributed and usable by a large number of potential buyers and sellers.

"4. The methods of buying and selling the commodity in the cash trade must be standardized to the point where the further standardization necessary in establishing a futures contract is consistent with trade interest.

"5. There should exist a potential trade interest in the type of financing afforded by futures trading."

On one ground or another, I have ruled out most of them other than perhaps apples, potatoes, onions, and perhaps orange juice (which Wesson ruled out on the basis of his rules above quoted.)

Newer Tendencies

It is my impression that there is a tendency on the part of advocates of marketing orders to depart from the older "orderly marketing" bundle of concepts to the new group centering on (1) quality improvement and (2) trade promotion and advertising. I have already commented on the first of these. The second has only an indirect bearing on my topic; namely,

that disappointment with the newer programs may lead to a search for a scapegoat — as with onions. Professor Black last year told this group that futures trading "has two powerful obstacles to overcome. One of these is that whenever prices of a product that has a futures market drop sharply, the producers are pretty sure to blame this on the traders. The other is that, especially in the smaller and newer markets, it is often possible for a small number of traders with short-run greedy interests, to stampede the market to serve their ends."

Summary and Conclusions

Our discussion here involves two different approaches to the reduction of risk from price changes, that is, (a) shifting risks by hedging on futures markets and (b) reduction of the risk itself by adjustment of market supplies.

With specialty crops produced far from market, the relative price fluctuations are exaggerated at the farm level where derived demand is usually inelastic within the range of ordinary experience.

Producers of specialty crops have long tried to bring about industry-wide supply adjustments by voluntary organization. Such plans have failed because of conflicting reactions of the industry and the individual as each saw the demand — inelastic for the industry but perfectly elastic for most individuals. Hence, the more successful a program the more pressure on the individual to avoid compliance.

Out of farmers' inability to adjust market supplies by voluntary organization has developed a new "social invention,"

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56 I am skeptical of the value of these programs, having tried my hand at evaluating them. See my papers: (1) "Self-Financed, State-Sponsored Advertising as a Form of Farm Relief," Proceedings, 19th Annual Conference, Pacific Coast Economics Association, December, 1940. (2) "To Advertise or Not to Advertise; the Cooperative's Soliloquy," unpublished paper, Giannini Foundation Library, March, 1941. See also Alois F. Wolf, "Measuring the Effect of Agricultural Advertising," Jour. Farm Econ., V. 26, No. 2, May, 1944, pp. 327-47.

INFLUENCE OF ENVIRONMENTAL FACTORS

the marketing order, designed to require a dissident minority to abide by a program approved by a preponderant majority, a principle long established in such matters as the formation and operation of drainage and irrigation districts.

After nearly three decades of experience with such programs, the results are difficult to evaluate. In the continuous "tendency toward an equilibrium" noted by John Stuart Mill and other early economists, the results have become diffused in the economy and intertwined with the results of other simultaneous or intermittently occurring changes.

The job of bringing about "orderly marketing" is more complicated — or should I say "sophisticated" — than is realized by most advisory boards set up to help administer the programs. Some saving features are that (1) both federal and state agencies set up to implement enabling legislation have trained economic analysts available, (2) many industry groups have among their members men who have acquired a lot of "know-how" on such matters, and (3) programs which do not work well may be discontinued on the judgment of the administrator, and must be discontinued on a majority vote of participants.

Two results seem to emerge, both of which would move the volume-price equilibrium to a new, larger volume, lower price point, thus encouraging increased plantings. They are:

(1) Programs tend to cut off price troughs but leave room for occasional high prices which would raise average prices.

(2) Operation of these programs may bring growers a degree of certainty for some outlet and avoidance of extremely low prices.

We have no direct evidence to indicate how the operation of agricultural programs will affect futures trading. Logically we may expect marketing orders, independently or in com-
FUTURES TRADING SEMINAR

bination with price support programs, to affect futures trading only as they succeed in lessening price swings sufficiently to remove the need for hedging. That seems to have been one result of a number of price support programs. The current tendency to shift emphasis from "orderly marketing" to trade promotion and quality improvement may have mixed effects on futures trading. Consistent size and quality control could be favorable for futures trading.
Marketing Orders and Agreements and Their Effects on Futures Markets

Wilbert E. Huge

I would interpret the comments we have just heard by Prof. Erdman, as indicating that he does not believe that marketing orders are a "cure-all" for agriculture.

I would acknowledge, also, that commodity futures markets do not provide a "cure-all".

The marketing order route is usually identified with "Production control" and "orderly marketing", whereas the commodity futures market route is identified with "intense competition and expanding markets". One might well raise the question as to whether these two routes are not quite incompatible in objective, and therefore, in route.

I hope I am not being unfair in classifying marketing orders as a "legalized cartel". This cartel method of reducing price risks has some unfortunate side effects. Principal among these side effects are price increases to the consumer, which inevitably must reflect the higher cost of each marketed unit, and the cost of administering and policing the cartel. There then follows the reduced per capita consumption of the product, the stifling of competition, destruction of the incentive to produce more for less, and, of course, the umbrella, thereby held over other potential producing areas of the world who are not subject to such limitations.

It may be that in the case of perishable commodities, where an industry sees little further market growth prospects, a marketing order may be a proper refuge.

However, I would submit that for the vast bulk of agricultural commodities, which are not immediately perishable, and have not attained a static period in their history, expand-
ing markets and competitive enterprise are a more desirable route.

In our capitalistic system, three major methods of risk sharing have developed.

1. Through public ownership of common stocks, the many risks inherent in a corporation are shared. Indeed, mutual funds perform the function of a further division and sharing of these risks.

2. The many casualty risks to which individuals and corporations are exposed, are shared through the medium of insurance and a complex of underwriters who thereby divide and share individual risks.

3. The price risk inherent in commodity ownership is shared through the function of commodity futures markets.

It should be emphasized that in each of these three cases, the risk underwriter performs his function voluntarily, and whether he experiences a profit, or loss, is largely dependent upon the quality of his judgment.

One might ask, “what are the benefits of such risk sharing?”

If a company carried no casualty insurance, it would save the insurance premium, but surely would require a larger margin of gross profit on its product or services to justify the risk exposure.

Those agricultural industries who have commodity future markets available, are able to pass price risk on to voluntary underwriters, and are thereby able to perform their service at narrower margins, thus benefiting both producer and consumer.

Undoubtedly, the prime example of the functions of commodity futures markets is contained in the history of the soybean industry.

In addition to an active, liquid, soybean market used by growers, elevators, merchants, exporters and processors, pro-
INFLUENCE OF ENVIRONMENTAL FACTORS

duct markets in oil and meal are useful to processors, refiners, feed manufacturers, and exporters.

In addition to domestic users, each of these three markets are being used in increasing volume by processors and other trade interests abroad.

By reason of the importance of soybean protein in poultry feeding, one might consider the egg futures market, and the recently adopted broiler and turkey futures markets, a further extension of the price risk underwriting of soybeans and soybean products.

While the large production and low consumer prices of foods dependent upon soybeans, cannot entirely be credited to futures markets, this price risk sharing has been an integral part of the rapid, sound, growth of the industry.

The abundance and low consumer prices of turkeys was threatened recently, when turkeys nearly became entangled in the marketing order proposals for their industry.

Surely it would have been a cruel paradox if this Thanksgiving Day symbol of a courageous people, who pioneered a new nation in the search for liberty and opportunity, had been consigned to the ranks of marketing orders and controls.

Prof. Erdman poses four questions concerning futures trading, and I would like to offer my response to these questions.

Prof. Erdman asks, "What are the basic conditions necessary for the development of futures trading?"

I would suggest the five points which Prof. Erdman outlined in quoting Wesson, plus two further conditions . . .

"That the commodity must be relatively free of artificial price influences" . . .

"That the interest of potential price risk underwriters can be attracted to the commodity."

Prof. Erdman's first and third questions are related, and I should like to discuss them simultaneously. They are, "If
futures trading is as useful as its proponents claim, why is it used in the handling of so small a proportion of our important commodities?” . . . “Why has futures trading developed, and then withered away in some instances?”

An increasing number of our agricultural commodities have fallen victim to politically oriented price support methods, resulting in the price support level actually functioning as a price ceiling.

The accumulated supply of the price supported commodity, functions as an effective club, preventing price increases beyond the ceiling and, therefore, produces no incentive for price risk underwriters to indulge in ownership of the commodity. Furthermore, questions as to how, and at what price level the tired long might elect to dispose of the accumulations, further deters the price risk underwriter.

The corn market during this past crop year might be viewed as a typical example which may serve to answer both of Prof. Erdman's questions.

The major long in the corn market, Commodity Credit Corporation, through price support activities has been buying corn at $1.20 per bushel, and this price, of course, has attracted large purchases.

This same long, has been selling corn at prices averaging less than $1.00 a bushel.

Therefore . . . the only reason left for the hedging of corn ownership in the futures market are the uncertainties arising from the action of one long in the market . . . Will this long market 300 million, 600 million, or one billion bushels of corn . . . and, at what prices will this one long sell this corn?

Certainly the market price will be, and has been, determined by the action of this one owner.

As this process is repeated in other commodities, it inevitably reduces the use of the futures market.
INFLUENCE OF ENVIRONMENTAL FACTORS

Futures markets are a part of the normal function of the law of supply and demand. Periodic tinkering with the law of supply and demand, which has been attempted at many times over past centuries, will, of course, limit the usefulness of commodity futures markets. However, for those commodities which can avoid such entanglements, commodity futures markets can provide a useful hedging tool.

With respect to Prof. Erdman’s fourth question, and that is, “How do business firms fare which do not hedge when competitors do?”

I can present no factual data, but presume that some parallel might be drawn to companies who do, or do not, insure casualties. Those who do not insure, and are fortunate enough not to have a fire, or other accident, are better off than those who do insure. However, such route may not inspire utmost confidence on the part of their bank or stockholders.

I would acknowledge, that removing price risk is a desirable objective, but in many cases an exorbitant price is paid for such stability.

Is it not possible that in many cases so-called removal of price risk is in reality a case of hiding the price risk?

The over 400 million lbs. of butter straining storage facilities are a by-product of price risk removal . . . But, is it not a part of the price tag?

The other price tags are: High prices to the consumer. Shrinking markets. Stifling of competition.

Destruction of the incentive to produce more for less.

Stimulant to competitive producers and products.

I am convinced that risk is inherent in any human endeavor. When we seek to reduce risks, we must surely consider the costs of various routes of such protection.

Such calculations must consider all costs . . . hidden and apparent.

[93]
Marketing Orders and Agreements and Their Effects on Futures Markets

Robert L. Clodius

Preparing this discussion has given me some difficulty, not because of Dr. Erdman's paper which is a good one, but because of the subject. There is fairly general agreement about what marketing agreements and orders are, what they try to do, and the provisions through which they attempt to reach their objectives. However, I find no such general agreement about the fundamental objectives underlying a futures market operation.

The traditional point of view is that a futures market can be justified on the basis of the opportunity for hedging that it provides. The social purposes to be served through hedging come first and the futures market is the means to that end. Another point of view is that futures markets exist because speculators want to buy and sell contracts with one another in hope of a personal gain. It may be justified on this basis alone but has incidental benefits of providing an opportunity for hedging, indicating directions of price movements, establishing a basis for pricing in spot markets, assembling and disseminating price information and of facilitating trade in specific commodities.

Any analysis that a person makes of the effects of something on the futures market depends in large part upon his conception of the futures market. For example, let us assume a perfect economic world in which there are large numbers of buyers and sellers in close contact with one another and with knowledge of market supplies and demands of some standard commodity. In such a circumstance prices in space would differ by the costs of transfer and prices in time would differ by the costs of storage. In a world such as this there would
FUTURES TRADING SEMINAR

not be much need for hedging and if this were the only justification for a futures market, it would likely not appear. However, there might well be a market for futures contracts in the commodity if there were enough speculators who wanted to play the game and bet that prices through time might be more or less than storage costs.

If the latter concept of a futures market were to be assumed, then it would largely be immaterial whether marketing agreements and orders existed or not. Futures markets could exist for their own sake alone, or rather for the sake of the speculators who like to, want to, and can afford to play the market.

In his paper, Dr. Erdman has assumed that the futures market depends upon hedging. The analysis of agreements and orders becomes one of appraising their effect on hedging. Hedging in turn is related to price instability. As agreements and orders reduce price instability, they reduce the need for hedging, and accordingly reduce the need for futures markets. This is the frame of logic within which he places his analysis. Further, he considers the institutional setting — past, present, and prospective commodities appropriate for orders and the likelihood of their being traded in futures.

The early history of agreements and orders suggests their purpose was to stabilize markets but the over-riding consideration is to improve returns to agricultural producers. This is the reason the provisions of orders other than milk include volume control, quality and size control, industry promotion, research, and elimination of unfair trade practices. The provisions most likely to have a price stabilization effect are volume control and these quality and size controls that have an effect on volume. At least it is theoretically possible that management of supplies set against demands can stabilize
INFLUENCE OF ENVIRONMENTAL FACTORS

prices. This could lessen the need for hedging and futures markets.

What the facts are with respect to the stabilization of prices through management of marketings is still a subject of research as Dr. Erdman has indicated. It is possible that mismanagement could increase price swings, or that quality control, promotion, and the like might put prices on a higher level generally without reducing their instability. The end effect might be neutral or perhaps encouraging to futures trading.

In this area of price stability-instability there is a conflict between the market order approach and the futures trading-hedging approach with respect to their secondary consequences. A market order seeks first to raise incomes to producers but its secondary consequence may be to stabilize prices through orderly marketing. The conservative objective of futures trading is to provide an opportunity for hedging, but its secondary consequence may be to stabilize spot prices. Incidentally neither of these secondary effects has been proven to my knowledge, but they are dearly held by the proponents of the two approaches. If the market order is successful in stabilizing prices, hedging is not necessary and presumably the futures market is not necessary. But if futures trading is successful in stabilizing cash prices, it still may not raise the level of farm prices and incomes and eliminate the need for market order operations. These statements merely reflect historical and present facts of economic life that market orders are social inventions of, by, and for agricultural producers while futures markets are social inventions of, by, and for members of boards of trade.

Dr. Erdman's analysis of the institutional setting of market orders as they relate to commodities that are presently or conceivably objects of futures trading is too conservative
in my opinion. The only commodities he finds as possibilities for joint market order-futures trading operations are apples, potatoes, onions, and perhaps orange juice. These conclusions seem valid but are limited to those commodities for which market orders are or have been used. What conclusions can be reached if a person starts with those commodities that are or have been traded in futures contracts? How many of them might be subject to marketing orders and agreements? Is Dr. Erdman’s assumption realistic that market orders will not be applied “to the ‘basic’ crops nor to others on a national basis?” Answering this requires a brief discussion of political economics.

As all of you know, the Administration has proposed legislation that will permit “supply management” on a national basis. In many respects this can be viewed as marketing order legislation on a national basis with the major exception that control over production is visualized rather than control over marketings. The farm bills advocating supply management have had rough going in Congress, but marketing order legislation has been on the books since 1933. It is conceivable to me that amendments might broaden this legislation to cover more and more commodities. Furthermore, it is not too big a step from market control to supply management.

Is there any reality to supply management? Its logic goes back to the technological revolution in agriculture that is a continuing fact of life in the real world. Equally real are the low demand and supply elasticities, the atomistic numbers of farm firms, inadequate mobility of resources, and the consequent squeeze on net farm incomes. The determination of the Secretary of Agriculture is also real. Thus it seems entirely possible to me that supply management as a cousin of volume control in a marketing order is something to be reckoned with in futures trading. The primary objective, as
INFLUENCE OF ENVIRONMENTAL FACTORS

with a marketing order, is raising farm income but the secondary consequence may well be the stabilization of prices. In this event the necessity of hedging decreases and the use of futures contracts could decline even further.

Here again we see the conflict in interest between the producer on one hand and the handler, processor, and trader. The farmer wants the level of his income to increase. This is no concern of the other agents in the marketing channel. The handler and processor want to protect their margin and to make their profits on the services they provide so they hedge. The exchange member is interested in a large volume of business so he can collect his service charges, and the speculator is interested in an active market with sufficient price movement so he can hope for a killing. In all these latter instances the welfare of the farmer represented by high or low farm income is really not significant. But futures market operators may become the unwitting and protesting recipients of the consequences of farmers trying to improve their incomes. If use of futures declines, it makes little difference to them whether the instrument was a marketing agreement and order or supply management.

Discussion

Marketing Orders and Agreements and Their Effects on Futures Markets

William S. Farris, Chairman

FARRIS: Thanks, Bob, for bringing us this analysis and discussion of Professor Erdman's paper and these other points. We have plenty of time for some discussion and the floor
is yours as long as you don't call names and stay relatively close to the subject.

KOHLs: Before we go off on to areas which I suspect we will before the afternoon is out, I would like to ask a question of Dr. Erdman, of a fact, I presume. Mr. Huge alluded to it, and it has very often been alluded to, that a product under market order cannot take advantage of a growing market.

What has been factually the issues in oranges, walnuts, prunes, cling peaches — have they been able to capitalize on the growing market? What does the research show for this one question of fact?

ERDMAN: They have in most of those cases strong marketing organizations which spend a lot on advertising and, in addition, have made additional levies on non-association producers in the industry in order to do just that, to expand a demand.

KOHLs: So this issue that a so-called orderly marketing approach necessarily stagnates the market, at least, doesn't happen out there?

ERDMAN: I don't believe that does. No, in those cases where they have been going long enough so you can see any results, they actually seem to be increasing the production. They may in some cases be losing out in the market, but that is not because of the curtailment. They are too eager to do some selling.

CLODIUS: I would like to expand on that, too, Dick. As I studied the early history of some of these voluntary programs and then the compulsory programs, the first time the control committee gets ahold of one of these orders they feel "Oh boy, we are in the saddle now", and they really try to limit marketing so as to enhance price. But they do this for only about two seasons and they see what happens to
INFLUENCE OF ENVIRONMENTAL FACTORS

their markets, and then they become more sophisticated as their experience grows. They realize that there are such things as inter-dependent demands, both with other commodities and through time, and that this is not the cure-all to their problems. They also realize that if you get the price up too high you are going to induce a supply response and this complicates their problems. So at least in the older orders where people have gained a great deal of experience, you don’t find this kind of undue limiting of marketings with the undesirable further consequences.

HUGE: I may be able to shed a little light from the annual summary of U.S.D.A. Are prunes a typical product pertinent to that subject, are they subject to marketing orders?

FARRIS: Yes. They have an order, as I understand it, but mainly on quality control.

HUGE: Here are production statistics and I am not sure it answers the question, but for the United States as a whole for the 1950-59 period, the average annual production was 457,000 tons. In 1960 it was 372,000 tons. In 1961, 412,000 tons. So obviously the per capita availability has declined, because we have had a substantial increase in population since that time.

KOHLS: Of course, this would fit the pattern of prunes, which is a low level income desirability fruit, I presume.

I would be more interested in watching whether oranges or other high level vegetables for which there is income elasticity, supposedly have been able to capitalize. We never cast this aspersion at a highly organized industry by saying that when an industry becomes organized it can’t develop its market and yet we always seem to cast it at attempts of agriculture. I would like to see us put more facts on the table on some of these issues.

HUGE: I have the figures here on California oranges.
KOHLS: Not fresh ones, please, nor California. I would be more interested in the total orange market.
HUGE: Here is the total then for all states. The 1950-59 average, and this is converted into tons, is 2,780,000 tons; 1960, 2,751,000 tons; 1961, 2,831,000 tons. I might point out there that Florida represents a substantial increase, I presume because of the juice angle. California, a substantial decline, from 544,000 average down to 281,000 this past year.

How about grapes, is that an example?
KOHLS: You see, this is not getting at my point. One can always quote production figures. This isn’t the issue. I was wondering what research has shown us concerning the ability of these organizations to stay vigorous in their marketing expansion. I mean I think this is more pertinent. I don’t care to pursue it.
HUGE: If their markets have expanded, their production would expand, would it not? It would have to.
KOHLS: Yes, but one has to watch what product they are dealing with and all the various ramifications that go with it, of course.
GRAY: I think that Bob Clodius is certainly right in saying that before we can talk about the effect on futures markets we’ve got to agree as to what these are and what their functioning is.

I think, further, that we owe Bob a debt of gratitude for stating the issue as clearly as he has stated it here this afternoon. Let me just review what has been said.

Bob said that sometimes the futures market is viewed as a place which enables hedging; sometimes it is viewed as a place which enables speculation. I would say that it is neither of these primarily, and I would say, further, that it is not primarily what Mr. Huge says it is, namely, a place which enables risk transfer.
INFLUENCE OF ENVIRONMENTAL FACTORS

I think that any market is a coordinating device, a device which coordinates economic activity. I think that a futures market is no exception to this. I think that we have to judge the performance of futures markets according to how well they do coordinate activity.

A futures market does refine this somewhat, because it enables the greater centralization of information than most markets and it also adds the time dimension, which most markets do not have.

Other than that, however, a futures market is pretty much what any other market is and the real issue is whether you are going to have an organized market or whether you are going to have marketing orders and agreements.

I spoke, as George Wilkins, if he is here will attest, to his group at Minneapolis, saying that it was my feeling that if we continue to try to defend futures markets — those of us who think that we see something good about them and therefore do try to defend them — if we continue to try to defend them in terms of whether or not they facilitate hedging, whether or not they facilitate speculation, whether or not risk can be economically transferred on these markets, I think that we are damning them with faint praise. I think they’ve got to be evaluated in terms of whether or not they are successful coordinators of economic activity.

CLODIUS: I will engage in a little speculation here, but not of the futures market variety.

I tried to play around with this idea, too, that the futures price is a price and it ought to function as price does in the economy. That there is a demand for futures contracts and there is a supply of futures contracts, and somewhere these two reach the Marshallian Cross, and the quantity and the price is determined. Then I began to try to think further about the traditional role that price plays in an enterprise
economy and see if this fitted exactly futures prices.

We think of prices performing the function of allocating resources, we think of price in the role of rationing demand — quantities among alternative outlets, we think of price as being associated with the distribution of income, we think of price as registering wants, as price measuring the intensity of wants and so on. This began to break down a little bit in my own thinking and so I sort of abandoned it, Roger, and went back to the traditional stuff that you find in literature.

GRAY: I wish you stayed with it, because I think the stereotype needs to be abandoned. Take a case in point. Let us say the well-known sort of cobweb phenomenon in potatoes that existed before you had futures markets and before you had the sort of thing that Verne Sorenson and I studied. Now, a futures market is there today for producers of Maine potatoes to coordinate economic activity in a way that an open free market for potatoes without the futures aspect to it could not coordinate economic activity. That is to say a producer now has something in the springtime other than last year's potato price to look at and base his decision upon. Indeed, if he so desires he can actually sell this year's crop in the November contract. A little exercise here, by the way, in whether or not this would have provided successful coordination of economic activity for the grower who just routinely approached it in this way will quickly demonstrate that it will have — and it would have incidentally eliminated the risk you are talking about and which I keep insisting is only incidental.

By the way, on this hedging, it is certainly important that most of the evidence shows that a futures market will depend upon hedging, which is a different thing from saying that it exists in order to enable hedging. The level of use of any futures market does tend to depend upon hedging.
INFLUENCE OF ENVIRONMENTAL FACTORS

ERDMAN: You speak of some of the instances in which there has been a withering away. I wonder, for example, whether in some of the failures, like in apple marketing and maybe in the Chicago potatoes, the difficulty was largely one of the growers going in with the idea that here was a way of selling their product. Their experience has not been good when they have thought of the futures market as a place where they can sell potatoes or onions or apples. You know that hedging is the reason, or price spreads or whatever you are thinking of is an important element, but not the selling of the apples and then delivering. There was a lot of misunderstanding. It is difficult for the Board of Trade and others to overcome.

GRAY: I started to interrupt you, Henry, because I thought you were saying something other than what you said. I fully agree with what you said, that a futures market tends not to be an efficient market through which to procure supplies or through which to market supplies directly. So misunderstanding can certainly be one of the things that would cause it to wither. But I think we also have to recognize that users of futures markets, like any users of any markets, are continuously looking at the alternatives and if one tends to be better than the futures market — then they are going to use the alternative. This has caused the withering away of some markets quite readily. The coffee futures market has now withered away because the alternative is better.

HUGE: I wonder whether you and I disagree on the purposes of futures markets. In my opinion, its primary function is the sharing of price risk. It aids in marketing of production only as a by-product. It naturally becomes a fountain of information by reason of that very activity.

GRAY: I think the answer to your question is, we do disagree, Mr. Huge.
FUTURES TRADING SEMINAR

HUGE: Well, I must emphasize that I am —
GRAY: I am not sure we can resolve our disagreement here and I don’t mean to be smart alecky in putting it that way. I think it would take too much time for us to try to resolve that disagreement, but let me suggest this as a course of action.

Ben Raskin, who spoke to us this morning also spoke at the Eleventh Annual Symposium, and I would like to refer to the fact that he explained the use of futures markets without ever using the word risk. I subscribe to Ben Raskin’s view of futures markets instead of yours.

HUGE: It is difference of opinion that makes markets — and I take it that we have a “gray” area here.

BAKKEN: I would like to direct this question to Mr. Huge. Are market orders, for specialty crops not sold in futures, inimical to futures trading?

HUGE: I would question the prospect of an effective futures market in a crop subject to marketing orders, because I would consider a hazard there similar to the artificial price influence I spoke of. There is an item of volume control or a type of monopoly that is not subject to public knowledge day to day, and I think one of the points Professor Erdman quoted as being an element necessary to successful futures markets does not exist. The knowledge of the crop must be public information at all times and there must be participants of a wide variety rather than a small integrated group. Those two elements would make it rather difficult to have a successful futures market in a crop subject to marketing orders.

CLODIUS: I was wondering if I could respond to this, because many of the people that have studied marketing agreements and orders come to the conclusion that the best thing about them is that they produce public knowledge about supplies, demand, marketing, shippings and all the rest of these.
INFLUENCE OF ENVIRONMENTAL FACTORS

All of these orders operate either under the Director of Agriculture or under the Secretary of Agriculture in the federal government; all the information that they generate is public information.

HUGE: Let me raise a point. Suppose there were a futures market in cling peaches and the question of a 12% green drop arose. As I understand it, that is 12% destruction of the crop. I can imagine some volatile futures markets, but I wonder whether that futures market could serve a constructive purpose?

FARRIS: Anybody from California want to expand on that?

BAKKEN: Well, I am not from California but, I dropped in on the general manager of the Prune and ApricotGrowers Association in California about three years ago. I asked him about his experience under marketing orders and he said that that year they diverted 17,000 tons to cattle feed.

Now, this means that they diverted the low grades of their crop, I presume — at least he implied that. The quality of the crop put on the market therefore was generally higher and better than it would have been if they put the total crop on the market. The growers saved their necks by this diversion of the crop and the consumers were not hurt. If the value of the crop were increased the commissions on sales will probably be increased, so who was hurt in this proposition? And I submit this, that if prunes were sold in futures and the current volume was known, could this in any way affect the futures?

They operate on known supplies, on information that they have, on the possibilities that the growers may divert in such a very heavy crop. All this would be discounted, wouldn’t it, or taken into account in the price?

HUGE: I think I would have to leave that to a speculator to say whether or not he would buy such a contract, at what
price, or whether he would ever buy it or sell it.

ERDMAN: He'd do both certainly, one time one and at one time another. (Laughter).

ARTHUR: I would gather that this would greatly enhance the value of a good pipeline to state or national headquarters. This seems like a safe conclusion to the question, but it isn't a good answer.

FARRIS: Would this be any different in principle than the announcement of the degree of participation in a feed grain program? This knowledge becomes known all of a sudden.

CLODIUS: Actually it would be more predictable, because these orders don't operate on the basis of whim, caprice and fancy. They are hardheaded businessmen trying to figure out the best way to handle their marketings so as to make a profit, and I would think that a study of these programs would produce a person who could predict pretty darn well what the outcome of their operations might very well be.

Anybody who has followed the cling peach order over the years and knows that they have a surplus crop coming up knows darn well there is going to be a drop order. You might not know whether it is going to be 12 or 13 percent, but the information on which that decision is made is information based on economic analysis that anyone else could do.

GRAY: Right, and so long as there exists any reasonable basis for prediction, I think you will find the speculator is willing to predict. If it is predictable, then I think a 12% green drop is not too much different as the yellow drop we have had in corn this year.

HUGE: I think this pipeline question, of course, is the focal point, too. Those who are instrumental in deciding whether it is 8%, 10% or 12% green drop have considerable advantage, and I am not sure whether speculators would be willing to fight with one hand behind their backs in effect, because
INFLUENCE OF ENVIRONMENTAL FACTORS

they would be at a little disadvantage compared to those who were capable of determining the percentage of green drop.

COOTNER: What about comparing the price supports that the Congressional committee is going to come out with for wheat next year? Is that Congressional committee decision on a price support program any different from the group that determines the marketing percentages of green drop?

GRAY: Twelve per cent green drop is almost a closer analogy I think, Paul, to the U.S.D.A. estimate of the size of crop. What is a 12% green drop order other than an estimate of the size of the forthcoming crop?

ERDMAN: Of course, it is based on an estimated drop that is very large; this year's crop is estimated to be the largest they have had for quite some time.

GRAY: And if they did have a larger crop estimated, they'd have a largest estimated green drop.

ERDMAN: Depending on their analysis for the outlook for sales.

PADBERG: Mr. Huge quoted some conditions under which futures trading can develop or can work. I have some question about this.

It is my impression that there is no other country or no other part of the grain trading system that has a futures market, is that correct?

HUGE: There have been futures markets for centuries in other countries, but I know of none in grain presently except Canada. Let's see, the Liverpool wheat futures market was the center of wheat trading for many, many years. However, there is government administration of imports and exports in these countries and therefore there is no price risk. I am sure there is no future market in Russia, either.

KRISTJANSON: There is a futures market in oats and bar-
FUTURES TRADING SEMINAR

ley in Canada.

HUGE: Also in flax, is there not?

KRISTJANSON: In flax and rye, but there is no futures market in wheat and there hasn't been since 1941. There has been a Marketing Board since 1935, administering a quota system.

HUGE: Is there a futures market in any country other than Canada and the United States?

KRISTJANSON: There is a barley market in Liverpool, isn't there?

GRAY: Numerous. In Buenos Aires, in India — there are many around the world. Rarely are they as important as they are in this country, however.

PADBERG: My question is really why, why is this? Maybe my impression is that they aren't as important as they are here. You suggested that the reason is because of government intervention in Liverpool. Would you say this is the reason that futures trading is not as important in other countries as it is here?

HUGE: Surely, where the government agency is the importer and the distributor, there is no price risk to be hedged. I see little reason. You don't have wheat trading in Winnipeg?

KRISTJANSON: That is right, it was abolished and the Wheat Board has complete control over the movement of the wheat from the producer to export position. The reason for this is, I think, that out of the experience of the 20's and 30's farm groups decided that they wanted control over this marketing mechanism and it was a political decision that a Wheat Board would be established.

Now from time to time there is talk of abolishing it, but no political party in Canada has seen fit to come up against the Wheat Board system of marketing. They have in the past years had a conservative government. Anticipation would
be that this party, if any, would re-institute the open market. This has not been the case.

GRAY: I would like to comment on this last one and then I will keep quiet. I think by and large the reason that futures markets have not developed so far in other parts of the world as they have in the United States, with the possible exception of the former Liverpool wheat futures market, lies in just the fact that the rest of the world is relatively under-developed or has been. Secondly, these markets that have reached a certain level of development and have subsequently declined nearly always have been related to some sort of government intervention in the pricing of the commodity.

KRISTJANSON: Can I have a chance on that one? We did have a futures market back in the 20's and early 30's, and I don't think it is a question of Canada being under-developed. (Laughter).

COOTNER: I think that the question of under-development is not really the point at issue. Malaya, which is hardly considered a developed country, has a pretty good rubber futures market. Surely rubber should count as well as grain, and there are a number of futures markets in other than grains in Germany and Holland, places like this.

HUGE: There has been a burlap futures market in India for years.

COOTNER: While I have the floor, though, I would like to comment on two other points. One, Mr. Huge before, when he was discussing futures markets and government intervention, pointed out the difficulties operating in the corn market with one seller and one buyer. It seemed to me particularly an inappropriate example since this particular kind of government intervention has resulted in record participation. It seems to me that it is not so much the fact of government intervention that operates against the efficacy
of futures market, but the manner in which it takes place. In this particular case the effect of the government intervention was to buy the corn directly from the farmers on the farm where it would not have normally moved into commercial channels and sell from its stocks in Chicago and major terminals, where it was removed directly to processors who had to hedge it if they were going to finance it. So that it is true that government intervention can ruin futures markets, but it will do so only if it pegs the price too high or if it monopolizes purchases and sale in such a way as no corn moves through the commercial channels.

Another point, I never realized that agricultural economics required a course in semantics. I have never heard so much quibbling about what markets are free or not free.

The particular point I want to raise right now is the one that you and Professor Gray were tossing about. I have had this point at issue with both Professor Gray and Professor Working. I still think that it is a semantic problem and not a point in issue, although I can’t ever get Professor Gray or Professor Working to admit it.

It is true, as they are prone to argue, that hedgers hedge in great part because they expect to make money on the basis — or similar sorts of motives — or what they call convenience, which means you buy in the futures market when you can get large quantities there and you can’t get just what you want in the cash market. In each one of these cases it seems to me if you analyze it closely there was another alternative to the buyer which did not involve futures markets, and which would have been more risky. So the particular technique that was chosen was chosen because it did reduce risk, even though its primary objective may have been involved with convenience, fluctuations or something like that. The only point I want to make is I don’t think that you and
INFLUENCE OF ENVIRONMENTAL FACTORS

Professor Gray are in as deep disagreement as he thinks. As he does say, it is a very complicated subject and not one that we can clear up in print, let alone here.

GOLDSCHMIDT: I would just like to add emphasis to what the gentleman just said and take a little issue with you, Roger. There have been several allusions to futures markets. I am with a company that uses futures markets. I think that there are two kinds of people that use them — those that intend to eliminate their risk and then, obviously, the others who are quite willing and able to take these risks. Yet, Roger maintains that the risk, the transfer, is not the function, is not part of the futures market — correct me if I am mis-quoting your intention. Then what is it? However, I will agree with Roger that it does serve to eliminate risk for us and provide an investment medium for the speculator.

GRAY: First to correct you where you were wrong, since you asked me to. I do not say that risk is not transferred on a futures market, nor do I say that this is not a function of the futures markets, as best as I can put that. The transfer of risk is done incidentally and indifferently by futures markets in general.

As a user you say, “We use it for this purpose”. Fine, I give you that, that is the purpose for which you use the market. So be it, I can’t deny this. I am not even going to accuse you of being semantically confused.

But, I say the only way to evaluate the performance of a futures market in terms of economics is whether or not it is a good, efficient coordinator of economic activities. This is the primary criterion on which the performance of a futures market should be judged.

Now, it will enable hedgers to transfer risk to speculators, incidentally. It will enable hedgers to hedge for other purposes than transferring risk.

[113]
FUTURES TRADING SEMINAR

FLOOR: I wonder if you can give us some examples, so that we could try to pin this down a little? What would a purpose other than the purpose of avoid risk be, for example?
GRAY: The most obvious one I suppose is that terminal elevators employ — that of garnering the carrying charge on a commodity that they want to put into storage. They would not buy a commodity, say a grain, and say, “Oh, my God, I own this stuff. I am afraid the price might go down, I will therefore sell the contract.” That is not the way they approach it. They approach it in terms of the carrying charge.

Correct me if I am wrong, Walter. If the carrying charge is attractive or if they anticipate the basis movement is going to be in their favor then they make the double transaction of buying the grain and selling the futures. That is the simplest kind of illustration, and most hedging is some variant of that kind of transaction.

GOLDSCHMIDT: Just one point. The carrying charge is an outgrowth of the futures market, but it merely projects the cost of financing and the storage charge that one incurs from the time that the grain is harvested to the time that it is finally used.
GRAY: And it is agreed it doesn’t merely do that. I refer you again to Ben Raskin’s discussion in the Eleventh Annual Symposium, in which he made it very clear that it doesn’t.

GOLDSCHMIDT: Let’s say you weren’t worried about risk; then just why don’t you buy the cash product and not bother to sell futures at all?
GRAY: The futures market, for instance, can be a very useful way of fixing the margins — other margins than the difference between the value of the cash commodity and the futures commodity. It is not merely because you fear that price might decline that you will sell a futures contract. You usually will sell a futures contract. You usually will sell a
INFLUENCE OF ENVIRONMENTAL FACTORS

futures contract jointly with the purchase of some cash commodity, because you think it is a profitable thing to do.

COOTNER: But if you are really not worried about the price going down, why bother with this extra transaction that results in commissions?

GRAY: That is a little bit like saying why bother when, as a retail grocer you stamp 20¢ on a can of beans which you bought for 17¢. Why bother? If you are not afraid that the price is going to drop from 20¢, why bother to fix this price at 20¢ in your mind? To a certain extent it is a convention, but this is the device that you use for fixing the price on something you’re going to sell.

COOTNER: But it is a little different, because you can fix the price at which you want to sell the grain without selling the future.

GRAY: It is a great deal different, because this is competitive pricing and you don’t have the ability to maintain that price other than by going to the futures market. That is what makes the difference.

COOTNER: Why not?

GRAY: How can you? Who is standing there ready to buy this grain for the price that you want to sell it for three months from now?

COOTNER: Then the whole point of your selling is you are afraid you are not going to be able to find somebody to sell to at the price you want to sell it.

GRAY: This is not a matter of fear, this is a matter of seizing your opportunities. You have this opportunity to sell something into the futures and this is a profitable opportunity. Take it, not for fear of missing more profitable opportunities, but because here is a profitable opportunity.

COOTNER: You would have more profit if you didn’t.

GRAY: Maybe.
FUTURES TRADING SEMINAR

FARRIS: Let's get a fresh angle on this thing.
KOHLS: I think all of us are involved. Anyone who is a student of marketing knows that sometimes something gets started and we don't even argue what it was started for. Then the people involved develop their own mythology of what goes on — some parts of it true, some part of it false. In the process of growth in any organization, side events grow and develop over time. Maybe here we have a very vital issue. Perhaps the Board needs to ask itself, "What is this phenomenon of the futures market in today's world and what does it contribute to it?" Any country organizes its markets for its goals and its goals don't have to be solely economics. The world is full of proof that there are all kinds of ways of organizing markets.

If we have something here which is of value for our goals and for our organization, it is very pertinent for people as Mr. Gray and others, to really look at this thing in a fresh light and ask themselves what does this market organization contribute. I think we have here a perfect example that operates in every marketing organization. The primary purpose of the organization which people talk to themselves about oftentimes is moved into second or third place importance and something else is making the major contribution. It is, I think, an excellent discussion of marketing evolution.

HENDEL: The discussion this afternoon is marketing orders and agreements and their effect on markets. Well, let's interpret it differently. What makes a good futures market, what are the fundamentals, and let us forget the definition.

There is no question, I would say — incidentally I did not listen to Professor Gray's paper in Minneapolis — whether it is for the hedgers or whether it isn't for the hedgers or whether it coordinates. I think I would agree that it coordinates possibly supply and demand, and because of the mere fact that
we do have a futures market, the margin between producer and consumer narrows. You try to get along without a futures market, and then you will see how wide the margin is. What I want to say, in all this discussion, what are the fundamentals that make a good futures market?

To start with, the buyer and seller must be fairly treated, so they can get in and get out — and you can’t do it in potatoes and you can’t do it in onions. It is too narrow a market.

Now, what are the things that make it possible? You have to have large storage capacity, you have to have a certain standard, you have to have a quality of product that can be carried not only for two, three, four, five months, but also be carried into the next year.

Now, lard wasn’t so good. Why? Because at the end of the year you had to take the lard or you could not re-deliver. It isn’t liquid.

Now, I am not interested in definition. I think both of you are right and both of you are wrong. (Laughter).

The futures market is not there to help the hedgers. The hedgers are taking advantage of the futures market. The futures market is there because some people feel that they can, I would say, make a little money, because my advance information is better than yours, and by doing so they coordinate the price, and I can frankly say the grey hair is due to watching the futures market. (Laughter).

Now, a man does not use the futures market and put a hedge because there is a carrying charge. God knows, during the 30’s there were no carrying charges. We had to protect ourselves on inventories. The only thing is we kept inventories at a minimum, so we don’t pay a tribute to the speculator from going over from one future to the other for the privilege of owning inventories.

Now, what are the fundamentals to have a good futures
market? Number one, it has to be liquid. What makes it liquid? You have to have stocks to be able to deliver and when you want to take delivery, you want to know what you are getting. I think those are the two most important fundamentals. The rest of them flow from that particular thing.

Now, why don’t you have futures trading in other countries? Of course, the stocks are very small. The government has interfered and as you get more free stocks naturally it just turns over so much more. Now, why did we have a fairly decent and high volume of future trading in corn? I think this year we had the biggest stock of free corn in the United States during the months of December, January and February. Some hedged, some didn’t, but there were free stocks, people were just buying and selling.

Now, go ahead and have a futures market in a commodity which squeezes itself; I think you are better off without it. HALCROW: I was about to express a desire to return to the topic of the afternoon, which is marketing orders and agreements and their effects on futures markets, and this recent comment sort of introduced the question I was about to ask.

It seems to me as I summarize the comments of Professor Erdman and some of the panel members that they have confined their remarks largely to the commodities which generally are not traded on futures markets. It seems to me that they have concluded that the marketing agreements and orders on fruits and vegetables have had sort of a passive effect as far as futures markets are concerned, being an alternative way of organizing economic activity.

Now, it seems to me we have reached the point of agreeing that the function of the futures market and the many devices you develop is to be tested largely in terms of efficiency or its effectiveness in organizing resources and in producing goods for the consumer use.
INFLUENCE OF ENVIRONMENTAL FACTORS

I feel the crucial question, however, goes beyond this subject and this discussion, and gets into the question of what would be the effect on futures markets of a further extension of marketing agreements and orders into the things that are already traded in large volume on futures markets.

We have seen the emergency feed grain program and its operation in the past year. We have seen a large volume of trade in corn and this is attributed to the large open supply or free supply of the product.

If this device were to be extended, however, so that you eliminated the large free supply, what then would be the effect of marketing orders and agreements on the futures markets?

FARRIS: Are you asking what happens if we had marketing orders on soybeans; is that your question?

HALCROW: On soybeans or on wheat and on various other things.

HUGE: I would volunteer an answer to that. If the marketing order were effective in its objective of accomplishing a supply management that worked, it would destroy the futures market. However, you would require virtually a police state in agriculture to bring it about, and that again is one of these hidden prices I speak of. Are we willing to pay such price for such thing?

ERDMAN: If we had a marketing agreement on potatoes, you would have to have it pretty much on a national basis in order to do anything with it. The inter-relations between regions are such that you could not handle it on a regional basis and do the kinds of things you talk about doing in the way of eliminating these fluctuations. When you get into it on a national basis, where you have so much regional specialization there would be many controversies that I can't conceive that the orders would work. I cannot conceive of
the areas resolving their differences.

HALCROW: Could I ask this one quick question. Professor Erdman, you say you can't conceive of a national marketing order for potatoes?

ERDMAN: Not one that would be satisfactory for a very long time. There would be too much resentment over such things as curtailment on any quality basis or keeping them out of certain markets.

HALCROW: Are you implying then that the reason the marketing orders have worked well in California, or worked to the degree they have in California is largely due to the tightness with which you have been able to control supply in a limited area?

ERDMAN: The relative concentration in a relatively uniform type of situation. You wouldn't get California and Florida together ever.

REICHMANN: We don't have to theorize on this completely. We had in the futures markets something that was really supply management or an attempt at it during the second World War. You'd almost have to stand on your head to get the right picture, but during that period when we had the OPA prices, futures trading was practically eliminated. In fact there came a time when we liquidated our wheat contracts and discontinued trading wheat futures. We did continue trading in corn and rye and oats.

I don't think it was a completely successful venture into supply management. It certainly wasn't a successful venture into price control. The price on the blackboards, the price as recorded down in the exchange did comply with the orders, but all through the country we know that the prices were paid under the counter and showed a great range that made the actual OPA prices very unrealistic and we know that it
INFLUENCE OF ENVIRONMENTAL FACTORS

really didn't work when you came out.
FLOOR: I simply wanted to offer a pivot around which we could talk. We have a commodity, turkeys, that was put to referendum and the vote was fifty-fifty, pretty close, on a volume basis. Now, we have had active futures trading in turkeys for about nine months, ten months. I simply would like to offer the commodity as a peculiarly adaptable one to our discussion. What do we think if the order proposal is re-activated?
FARRIS: This symposium is not to be especially for or against one of these things, but to get the issues out on the table.
CLODIUS: I might be able to get to this one, but I wanted to clear up what I thought was a misunderstanding in the interchange between Halcrow and Dr. Erdman.

The market agreements and orders, when there is a volume control in them, limits this to volume of marketings, not supply. Supply in the terms of output production is not controlled, merely the movement of supplies to market. This was why Dr. Erdman said in his judgment such market orders on a national basis were not feasible, because output is not controlled. You can control marketings from one area of the country and you can get a large increase of production response in some other part and so on, and you generate equity problems if you try to go to a larger geographic basis of control.

Now, the people that have studied these things say that several features are required for a successful market order program. Among these is limiting the geographic area of the program to the smallest possible. Another feature is to have some large organization that has an interest in this commodity and wants to see the order and will take some responsibility for it, like a cooperative, and so on. So this is why he thinks — I am putting my words into Dr. Erdman's
mouth — but this is why he feels that market orders as applied to the specialty crops in California are not appropriate on a national basis or for the basic commodities.

I think you can drop it there, but then you come around to — well, is there anything that has features like market orders that might be considered on a national basis and then you come to supply management. But supply management, as I understand it, is not price control.

REICHHMANN: I know that. I realize the distinction between the two. I just brought that out as a sort of a contrasting economic control which we know something about.

CLODIUS: But the difference between market order and supply management is that a market order does not control supply, supply management presumably does. Then we come to turkeys, and at least I argued in my discussion that if a market order reduces price instability then certainly it reduces the need for futures markets.

KOHLIS: This point, though, is the crucial issue, isn’t it? As Dr. Erdman in his paper pointed out, these demand curves are not hung out there all ready to pick off. If at least in the initial phases of this turkey order, we are no more accurate in predicting what prices are to be from these allocated supplies than we are from our present available data of production, there would still be considerable price risk. I am merely raising the question that if we said, “There will be 10% less turkeys next year,” would this fact reduce the price risk to such an extent that would kill the futures market at least in the interim phase.

CLODIUS: It conceivably would reduce the low-income-to-farmers risk, but it might not reduce the price risk any more.

KRISTJANSON: I wonder whether there isn’t something that could be learned from looking at the international experience on marketing orders and marketing boards. Here
INFLUENCE OF ENVIRONMENTAL FACTORS

in the United States apparently the experience is concentrated in milk sheds and specialty crops, but certainly there is all kinds of experience in Australia, France and Canada on marketing orders or marketing boards on a national scale.

I think it is possible to see some of the potential advantages and some of the potential problems connected with this type of market organization by studying these. I grant that you can't transfer them directly, but for example this comment that you'd have to have a police state control to make it work.

In the Canadian wheat marketing system we have a permit book and control the deliveries of wheat — a marketing quota. Here in the United States you have acreage controls. I don't think ours is any more police state than the acreage control, and yet it has been working.

HUGE: I am responsible for that police state comment. I think it is probably like a girl being just a little bit pregnant. It is a matter of degree. I grant that our acreage controls are a step in that direction.

FARRIS: Of course, on some crops these are tied to marketing quotas, too.

REICHHMANN: In wheat we have marketing quotas here and we have had them for quite a few years now.

THUROCZY: If marketing orders limit the amount of sales, then what happens if the producer — whom you cannot control because of the weather conditions and so on — really produces twice as much as his quota might be or his order, what happens to the rest of the production?

CLODIUS: These pro ratas operate on the basis of the proportion of the total crop that is under the ownership or market control of each individual grower shipper. First you need an estimate of the total supply and then you identify the proportion that each individual has of that total supply. That becomes his pro rata base.

[123]
THUROCZY: I see.
KRISTJANSON: It is one way, but another way is simply to let them market as long as you’ve got outlets for it and then the marketing is cut off at the point where you can’t sell any more and then the balance accumulates back on the farm. In our system they have to pay the storage themselves, and this becomes a supply control mechanism. The wheat acreage in Canada hasn’t expanded over a twenty-five year period, until this year.
ERDMAN: Who decides whether you can sell or not?
KRISTJANSON: Your Wheat Board.
ERDMAN: On what basis?
KRISTJANSON: There is a market quota based on a farmer’s specified acreage. The quota goes up during the year as crop is marketed.
ERDMAN: Suppose I have a poor yield and my neighbor has a good yield, does that make a difference?
KRISTJANSON: Your neighbor with a good yield winds up with a surplus on his farm and you market what you’ve got.
ARTHUR: Is this transferable?
KRISTJANSON: No, it isn’t.
ARTHUR: Not under the regulation, I suppose. In fact, does the truck stop at the neighbor’s farm?
KRISTJANSON: They are not supposed to. But this really doesn’t make a great deal of difference from the standpoint of working of the overall mechanism. I mean it doesn’t destroy the mechanism itself.
FARRIS: It is still a pro rata type operation. Any other questions?
ROY: Dr. Clodius made a good point there. I think the poultry people who are growing or would grow turkeys, broilers and eggs, would vote against marketing orders. In the first place, Dr. Clodius, they would agree that national orders
INFLUENCE OF ENVIRONMENTAL FACTORS

would be useless in themselves without supply control, and, secondly, the southern poultrymen believe very sincerely that marketing orders would be an exercise for future supply management. Therefore they would be led to the trough, so to speak, of supply management. So in rejecting supply management they in fact say first we must reject marketing orders, because it is a precedent to supply control. This is the way a lot of poultrymen view the situation.

HUGE: While we are on turkeys — wasn't there this problem in this turkey marketing order, that the small turkey producer was exempt and wasn't it likely there would be more small turkey producers crop up over the country to make the whole thing unworkable. Is that not the same prospect in broilers or in eggs? How can the small producer be controlled under such cases?

FARRIS: They didn't mean to control the small producer.

I think we can give this panel a vote of thanks for their papers and their participation.

(Applause)