Delivery Points Hearing -- Kansas City

February 19-20, 1976

Thursday, February 19:

9:30 A.M. -	Opening Remarks by Chairman William T. Bagley and Commissioner Gary L. Seevers
9:45 A.M. -	Dr. Roger Gray, Stanford
10:45 A.M. -	Dr. Willard Williams, Texas Tech
11:15 A.M. -	Dr. Robert Wisner Iowa State
12:00 NOON -	LUNCH (KCBOT for Hearing Panel)
2:00 P.M. -	Mr. David Seagren Former Member, CBOT Soybean Meal Committee
2:30 P.M. -	Mr. Robert Alexander Pillsbury Company
3:00 P.M. -	Mr. Dennis Gaydon Oscar Mayer
3:30 P.M. -	Dr. Tom Hieronymus University of Illinois
4:00 P.M. -	Mr. James Hogan (Ralston Purina) National Grain & Feed Association
4:30 P.M. -	Mr. Jack Block Illinois Agricultural Association

Delivery Points Hearing -- Kansas City

February 19-20, 1976

Friday, February 20:

9:30 A.M. -	Mr. Ronald Pratt Early & Daniels grain firm, Cincinnati
10:00 A.M. -	Mr. Chester W. Polson Kansas City Board of Trade
10:30 A.M. -	Mr. John H. Frazier Chicago Board of Trade
11:00 A.M. -	Mr. Alvin Donahoo Minneapolis Grain Exchange
11:30 A.M. -	Mr. Bryant Council Bluffs Chamber of Commerce
12:00 NOON -	LUNCH
1:30 P.M. -	Mr. Davis Anderson Chicago Mercantile Exchange
2:00 P.M. -	Mr. R. B. McWhite Peavey Company
2:30 P.M. -	Mr. Max Naylor Iowa Development Commission
3:00 P.M. -	Mr. Delmar Kloewer Cargill, Inc.
3:30 P.M. -	Mr. John Doherty, Illinois Grain Corporation
4:00 P.M. -	Dr. A. William Jasper American Farm Bureau Federation
4:15 P.M. -	Mr. Zeno Ratcliffe, Jr. Farmer, Representing North Carolina Farm Bureau Federation

Statement of Roger W. Gray, Professor
Food Research Institute, Stanford University

Mr. Chairman, members of the committee, and Commissioners, I am grateful for the invitation to appear before you today to discuss delivery locations for futures markets. This is one of the most important and complex issues for which you have responsibilities. I wish that I could simplify it for you and provide some clear cut answers, but I am afraid that if I succeed at all today, it will be in convincing you that there are no easy solutions.

My statement will stress the historical development of the delivery problem, with emphasis upon Chicago and the grains. Chicago is not being singled out because we are meeting in Kansas City, but rather because the historical emergence of the delivery problem is most clearly reflected with reference to Chicago. Remember, too, that Chicago has continued to be the world center of futures trading for more than a century, and that no manifestation of delivery problems is likely to alter this rank in the foreseeable future.

To start at the beginning, futures trading emerged at Chicago as a direct consequence of the opening of the Illinois-Michigan Canal in 1848, joining the Great Lakes to the Illinois waterways, and immediately setting the stage for the expansion of grain production in the Chicago hinterlands. Chicago became the spout of the funnel through which all of this grain moved, and as such was the ideal location for futures delivery. In later years, with the great railroad boom, Chicago contrived to entrench its preeminence as a transportation hub, by seeing to it that the major east-west railroads converged upon Chicago. I say "contrived" because if you read Belcher on "The Economic Rivalry Between Chicago and St. Louis" (written in 1930's) you find there the arguments why St. Louis, located at the confluence of two great rivers, should have become the railroad hub

that Chicago did become, as well as the explanation in terms of civic aggressiveness, newspaper and chamber of commerce enthusiasm, why Chicago actually got the nod. One finds in Belcher also adumbration of the great resurgence in river barge traffic that was to occur following World War II. I am already suggesting that futures delivery depends upon commodity flows -- directions, modes of transport, and gathering or transhipment points that emerge. The more recent history of the railroads is well known -- having been established as monopolies, they went through a lengthy period in which they could not learn to act like competitors, and viewed rate increases as the only answer to any threat, thereby providing aid and comfort to all competition. The trucking and barge industries came on like gangbusters under this benign aegis, while the Interstate Commerce Commission indulged the railroads in their rusty-rail policies. There are lessons to be had: if St. Louis had been possessed of a more aggressive citizenry in 1870, or if the I.C.C. had been abolished in 1900, there might not be a need for a C.F.T.C. today. The more invigorating lesson for C.F.T.C., however, is "don't allow the exchanges to succumb to their own rusty-rails policies." To state more broadly the present implications, it is not too late to abolish the I.C.C., although it is still too early to abolish the C.F.T.C.

In recent decades Chicago's primacy as a grain terminal has rapidly dwindled. The emergence of a multifarious transportation system, truck-barge combinations, and the response which this finally evoked from the railroads, including larger cars, unit trains, rental trains, ten-car rates, and all of the associated facilities built by grain merchandisers, has largely by-passed Chicago. But

for all of its complexities, its central thrust has been a north to south movement on the rivers, focused upon an export movement, and southern livestock and poultry feeding, and in wheat a rail to Gulf movement with an export focus. The basic mode of tranpport has come full circle back to the water; but the basic direction, which a century ago was toward Chicago, is today away from Chicago.

Early Official Concern

As early as 1926 the Federal Trade Commission expressed concern over the Chicago delivery problem in the following words:

> The historical development which has made the proposal under donsideration a practical question is the tendency toward a loss by Chicago of its primacy as a market for the physical handling of grain, especially as regards wheat, while maintaining its dominant position in futures. An increasing quantity of grain that never goes to Chicago is hedged in Chicago futures. Outside deliveries might be considered a further logical step in making the national market for future trading, so far as practicable, also national in some sense as regards the facilities offered for delivery on its futures 1/

Subsequent events would suggest minor modifications to the 1926 view, but its major thrust is even stronger today. It was not then foreseen that Chicago would lose priority as a primary market for oats more suddenly and dramatically than for wheat.

The Federal Trade Commission, in its studies culminating in 1926, did not strongly urge "multiple" or "outside" delivery points for Chicago wheat. Instead they recommended to the Congress "That the Chicago Board of Trade be requested to permit the delivery of grain on futures contracts at other important markets than Chicago, under proper safeguards and equitable terms, whenever

---

1/ "Effects of Future Trading," Report of the Federal Trade Commission on The Grain Trade, VII, June 1926, p 286

necessary in order to prevent a squeeze or corner in the Chicago market."2/ This suggestion of "whenever necessary" implied occasional action of an emergency nature, in contrast to the cotton recommendation "that some form of southern delivery on New York contracts should be adopted and recommends that Congress enact legislation to that end,"3/ which clearly implied a change in the standard delivery terms for cotton. Their study of New York cotton futures contained evidence that New York City was no longer a viable primary cotton terminal, having become too expensive in storage and handling charges, and that futures market performance suffered in consequence. It was shown that price distortions were caused by small and unrepresentative stocks adjustments in New York, that cotton often moved there for which commercial demand was lacking, and that hedging positions had to be protected by spreads, etc.; in short, the same allegations more recently encountered regarding Chicago grains were made regarding New York cotton at that time. The New York cotton exchange did adopt multiple deliveries at a series of southern locations, and has continued to employ such a contract.

Meanwhile, both the FTC and the Commodity Exchange Authority expressed concern over the need for multiple deliveries in grains at various times after 1926.

2/ "Effects of Future Trading," Report of the Federal Trade Commission on The Grain Trade, VII, June 1926, p. 287.

3/ Federal Trade Commission Report on The Cotton Trade, 1924, p. 241

Why Chicago Did Not Designate Additional Delivery Points Until The 1970's: Focus Upon Wheat.

With ongoing recognition of Chicago's decline as a grain terminal, both at the exchange and governmental levels, during four or five decades, why did it take so long to do something about it? It is an oversimplification at best and misrepresentation at worst to blame the delay upon sheer apathy or upon the recalcitrance of vested interests. There were fundamental economic factors which militated against departure from the Chicago delivery. Chicago's dislocation was to become first and most strongly manifest in the cases of wheat and oats, each for its own reasons, whereas the corn and soybean dislocations came into view later and less conspicuously. Let us consider first in some detail what the mitigating factors were for wheat deliveries, then more briefly consider the oats delivery.

I shall argue in the case of wheat that during the"twenties and thirties" Kansas City was in effect, if not in fact, an outside delivery point to Chicago -- a relationship which was not perceived as such in the F.T.C. study. Then during the loan, or price-support, period (roughly from the late "forties" until 1964) when the grain futures markets lost much of their business, it mattered less, in the first place, where futures delivery occurred because there just wasn't that much need for futures; and in the second place, Chicago gained relative advantage over the hard wheat markets, providing additional disincentive

for Chicago to change. Each of these two eras, and relationships, is next discussed in greater detail.

The Nineteen-Twenties and Thirties

It was essentially true of Kansas City that it was a "freight-off Chicago" market through the mid-ninetwen-thirties. This placed limits uppn the possibilities of natural squeezes owing to stocks shortages at Chicago-- even though it did not absolutely forestall such distortions. Another, and perhaps more revealing, way of looking at this is that it enabled Chicago futures spreads to accurately reflect the more general stocks picture -- rather than reflecting sometimes small and sometimes unrepresentative Chicago stocks. The stability of the Chicago - Kansas City basis enabled the carrying charge basis to appropriately reflect the general stocks picture. Thus it was not really necessary to designate an outside delivery point for Chicago futures.

Chicago, during the nineteen-twenties and thirties, attracted three classes of wheat (Spring, Yellow Hard, and Soft Red Winter) in quantity (although receipts of Spring wheat, which at one time had been the delivery grade at Chicago, were dwindling during this period). Yellow Hard wheat was the cheapest grade during most of this period, although frequently priced close to Soft Red. Most of the actual deliveries on futures were of Yellow Hard wheat. The Kansas City and Chicago markets were thus linked by the Hard Winters and Yellow Hards.

Spreading to Chicago afforded good ~~badge~~ hedge protection for Kansas City, whereas wheat movement kept prices in line. The relationship among the three major wheat futures markets, with special emphasis upon the Chicago - Kansas City relationship, has been xxxx analyzed in two of my published studies. 4/

The Loan Period

A major change in this relationship was brought out in an episode at Kansas City which was studied by Working. 5/ Kansas City had always specified a Hard Winter Wheat delivery until 1940, when the contract was revised to allow Soft Red deliveries. By 1953, largely because of the differential influence of the loan program xxxx upon prices of the different classes of wheat, Soft Red prices went to large discounts under Hard Winters, and deliveries of Soft Reds at Kansas City alienated the (largely mill) buyers, threatening the very existence of the market. Kansas City reintroduced a "hard only" contract in 1954, which quickly attracted all of the trade and stimulated the revival of the market. Meanwhile, since 1949 Chicago has become basically a soft wheat market, with episodic instances in which hard wheats were delivered. This is the chief explanation for the separation of Chicago from outside stocks, but the divorcement has been exacerbated by changing freight and movement patterns which will be considered in a later section.

4/ Roger W. Gray, "The Relationship Among Three Futures Markets," Food Research Institute Studies, II, I, 1961 and "Price Effects of a Lack of Speculation,", Supplement to Food Research Institute Studies, VII, 1967.

5/ Holbrook Working, "Whose Markets? Evidence on Some Aspects of Futures Trading, Journal of Marketing XIX, I, 1954

During every year between 1948-49 and 1963-64 inclusive, Chicago May wheat futures prices have at one time or another (early in the crop year) fallen below the Chicago loan rate, which ranged from 2.07 to 2.58. During most of these years, May futures prices subsequently rose to levels above the loan rate; and when the loan level was not exceeded there were strong price increases toward the loan level. The circumstances giving rise to this pronounced price bias were described in an earlier publication 6/, and need only be briefly summarized here in order to update the analysis and focus upon the Chicago situation. In essence the Chicago price pattern stemmed from the lower level of participation in the loan program by producers of soft red winter wheats as compared to the producers of hard wheats. About 50 percent of the SRW growers participated in the program, in contrast to 90-95 percent of the hard wheat growers. This meant that a free supply of SRW was priced early in the season, whereas movement into loan regularly induced an artificial scarcity later in the season. At Minneapolis and Kansas City, because hard wheat growers were "better" loan users, prices did not fall much below loan levels and hence did not provide such pronounced seasonal swings. Thus while the loan program was inimical to futures trading on all markets, Chicago's market was affected least because a higher proportion of soft wheat was sold in the free market.

A clear view of this phenomenon is obtained in the contrasting patterns of carrying charges at Kansas City and Chicago during

---

6/ Roger W. Gray, "Seasonal Pattern of Wheat Futures Prices Under the Loan Program," Food Research Institute Studies, Vol. III, No. I, February 1962

the era of two-dollar and higher Chicago loan levels; and the early season short hedging which emerged in response to these patterns. Generally speaking, wider carrying charges at Chicago attracted larger increments of hedging than occurred at Kansas City. Beyond this, year-to-year differences in total short hedging, and in its allocation between the markets, also conform to absolute and relative carrying charges. Of special interest also is the fact that full carrying charges to December were not often accompanied by full carrying charges extending to May. In several instances September-May spreads were narrower than the nearby September-December spreads; and this contrast was sharper at Kansas City, where the distant spread was smaller than the nearby in more than half the years, and where on occasion May futures were sharply inverted from nearby September futures. Meanwhile the end of season spreads (May-July) were characteristically inverse or very narrow on both markets, with Chicago in some cases manifesting the more extreme tightness.

The overall pattern during the two-dollar loan era was one of limited free supplies early in the saason, providing incentive to short hedging, especially at Chicago. This short hedging peaked early and then declined as free supplies rapidly diminished with the movement of wheat under loan. Chicago of course had long enjoyed greater hedging capacity than Kansas City, owing to the breadth and liquidity provided by speculation at Chicago - now this advantage was enhanced by the relative freedom of soft

Footnote? & correct?

wheat supplies. The limited incentive to hedge short at Kansas City during the two-dollar loan era resulted in ratios even higher than its traditionally high ratios of long to short hedging, and hence required a net short spread to Chicago for the period.

The constraints imposed by the loan program upon wheat futures trading generally was so severe that they overshadowed other underlying factors. Chiefly, Chicago gained relative advantage from the fact that its prices reflected soft wheat values during this era. There was little concern consequently over its estrangement from hard wheats, since these did not provide the most viable hedging trade. The rude awakening which lay ahead was that the return of relative freedom to wheat prices generally, under the reduced loan levels since 1964, would reveal this estrangement, which may have appeared temporary and was relatively costless, to have become permanent and costly. Thus the more lasting effect of the loan program was to have painted over the serious breach that was developing between Chicago and the major hard wheat crop. Chicago's increasing isolation from the major wheat movement, its failure to attract stocks from this movement and to reflect hard wheat values, was partially obscured during an era when it served this role for the smaller fraction of wheat which was in relatively free supply for a portion of the marketing season.

Price Relationships During Three Eras

7 In order to demonstrate the current problem at Chicago, we need to consider its price relationship to Kansas City during three eras -- one a pre-loan era during which it reflected soft

wheat values; and then a "post-loan" era during which all wheat prices have become relatively free with reduced loan levels and Chicago's estrangement from hard wheats is revealed.

Having examined the two earlier periods, we may now look at Chicago-Kansas City Wheat price relationships during those two and the subsequent "post-loan" period (since 1964).

<u>First Period</u>.-- The early period ('twenties and 'thirties) was one in which soft red winter wheat prices were higher than those of other classes, hence very little SRW was delivered against Chicago futures. There was no significant government influence on prices during this interval, beyond the temporary and mostly abortive influence of the Federal Farm Board; whereas the influence of World War I had worn off by 1921. While the Federal Trade Commission had already documented Chicago's decline as a cash wheat market, Chicago proved to be a viable futures market during this intervval <u>because it continued to reflect all wheat values.</u>

Chicago price spreads reflected the total United States stocks picture with great accuracy-- and of course these stocks were free. The major vehicle in which we carry the contrast among three periods is the Chicago-Kansas City price relationship. There are two key attributes of this relationship for the first period. First, the relationship from year to year was relatively constant. There are three points to be made: (1) While the difference did indeed vary from year to year, the variance is small in the perspective of later observations. Kansas City was for all practical purposes an "outside delivery point" to

Chicago, resultant from the constancy of the year to year price differences. (2) There was also a relatively constant tnedency for Chicago prices to gain seasonally on Kansas City prices. This tendency was regular enough to be predictable--it did not sever Chicago from Kansas City for hedging purposes. (3) There were indeed some Chicago May squeezes, but the only sharp ones occurred later in the month: the later (1938) seven-day delivery rule ameliorated this problem. (4) Perhaps most importantly, Chicago-Kansas City price differences were *not* systematically related to Chicago stocks. Perhaps in one year it would be Chicago stocks, in another Kansas City stocks, and in another relative demands or still other factors that dictated the small departures from the "normal" constant differential. But most importantly, it was not Chicago stocks which uniquely dominated these minor departures.

Second Period--The next period (loan program) was one in which SRW prices first went dramatically below HRW prices, and in which the loan program (which had triggered this change) was dominant. Chicago now sometimes traded above Kansas City, but also frequently far below, which it had not done in the previous era. The single year changes were striking between 1955 and 1956, and between 1958, 1959, and 1960. In the second attribute mentioned earlier, Chicago's seasonal price gain relative to Kansas City persists but becomes more erratic and wider. Thirdly, there are indications of natural squeezes after the adoption of the seven-day rule. *But finally and most importantly these price differences ~~are~~ were systematic relfections of Chicago stocks.* This of course was

logical under the ciroumstances. Chicago was the freer market, soft wheats being freer than hard wheats --so when soft wheats were plentiful Chicago stocks would rise and prices decline and vice versa for shortages. Meanwhile the persistent tightness at Kansas City (hard wheats) held it within narrower ranges of stocks and prices while Chicago would pivot around it both seasonally and year to year. It is noteworthy that Chicago stocks exert great leverage upon prices in this situation, and that it could scarcely pass unnoticed by the owners of such stocks that movements in and out of Chicago, and their Chicago delivery posture, would have market effects out of proportion to the relative magnitudes of these stocks. In these circumstances much greater trade attention was given to Chicago stocks than their relative magnitude warranted, and the line between skillful merchandising (or speculation for that matter) and price manipulation became much fuzzier than it is in broad markets. One consequence of this was that tradespeople, grown accustomed to the new influences,and government officials, not fully appreciating the changes wrought by government programs, came to widely disparate views of what constitutes price manipulation.

During this"loan period", year end carry-overs of wheat in private hands had diminished to unprecedented low levels, averaging about 60 million bushels and ranging from near zero to 130 million bushels.

Third Period.--The third and final period, which we have called a "post loan" period begins with the new wheat program that took

effect with the 1964-65 crop year, marked by reductions of more than fifty cents per bushel from the 1963-64 loan level, and slight further reductions since. The general extent of the return of wheat stocks into private hands is perhaps best indicated in the fact that year end "free" carryovers have averaged three times as high in this period as in period two. From 60 million bushels the average has risen to 180 million bushels. This program change would logically benefit the futures markets, as indeed it did. But Chicago, having become estranged from hard wheats, and having lost out relatively in the economic attraction of wheat, failed and is failing to gain its share of the benefits from the new freer marketing program. It is to the evidence of this failure that we next turn.

Since the advent of the new wheat program, final prices of Chicago May futures have continued to gyrate wildly around those at Kansas City, closing ten cents lower in 1967 and 1968, ten cents higher in 1970 and seventeen cents higher in 1971. This price difference also continues to reflect Chicago stocks levels. However, a shift has occurred in this relationship which reflects Chicago's failure to attract representative wheat stocks. It requires approximately a ten cent increase in the price differential to maintain the same level of stocks in Chicago as during period two. What this shift reflects is that the demand for wheat stocks in Chicago has undergone a secular decline--a decline which was partially obscured by the loan program, which, by reducing the demand for wheat stocks generally to a bare minimum while influencing Chicago demand relatively less, had created an impression that Chicago attracted <u>more</u> than its share of stocks.

Another view of the problem is obtained from the Chicago stocks picture. Chicago, as noted earlier, attracted a higher

level of peak stocks under the Second Period than it had under the First Period. This appears anomalous in light of the generally lower level of free stocks in the Second Period, but as noted above, soft wheats were relatively free. In the Third Period, Chicago's peak stocks have not only failed to rise in reflection of greater free supplies, but in 1966 and 1970 peaked at the lowest levels since 1951, and in 1971 and 1972 peaked even lower at about half the average peaks reached during the Second Period.

Hedging Under this Pattern

Under circumstances in which Chicago futures prices reflect Chicago stocks it is alleged that the large merchants who control Chicago space "push" stocks into Chicago in order to protect their hedges. Carrying charges may be thus widened beyond levels that would otherwise prevail, and the delivery threat may enable merchants to move hedges to a later delivery month at a favorable relationship, then buy back their own deliveries. Alternatively they may endeavor to protect their hedges with spreads.

Futures delivery should be at a major concentration point--if stocks are diverted from normal channels to satisfy futures contracts, or to influence their prices, optimal futures performance is not achieved, and alternative pricing media will be sought. And if superior alternative delivery locations are available, the full trading potential will not be realized unless these are adopted. For these reasons we present some evidence from which it may be inferred, if not conclusively demonstrated, that Chicago stocks have been managed in such a way as to influence futures prices. It needs to be emphasized that it is an obligation of the exchange to maintain contracts which will allow all participants to pursue their economic self-interest, so we are not implying illegal price manipulation.

their economic self-interest, ~~so we are not implying illegal price manipulation.~~

Two pieces of evidence, in addition to those already shown, from which some inference may be drawn, pertain to the relative level of Chicago stocks in Periods II and III, and to the behavior of the December-May price spread during December. Both may be interpreted quite simply. Chicago stocks in Period III have comprised a much smaller proportion of total free stocks than was the case during Period II ~~(Table 7)~~. This at least lends credence to the interpretation that Chicago stocks levels in Period II were maintained in part to protect hedges, whereas in Period III they have become a truer reflection of Chicago's ability to attract stocks in a generally freer era. The December-May relationship during December ~~(Table 8)~~ has been characterized by a pronounced tendency for current futures to gain on May as the December contract expires. This in effect enables the "earning of a carrying charge" during the delivery period, whether or not it is a manifestation of deliberate efforts to do so. It is perhaps worth noting that the Federal Trade Commission (1926, Vol. VII) drew a similar inference from a less pronounced tendency than that exhibited ~~here~~ recently.

Summary With Respect To Wheat

As it now stands, Chicago with its outside deliveries continues to be essentially a soft wheat market which also serves the hard wheat market at Kansas City through spreading. Whether the additional delivery points will help reduce Chicago price swings around Kansas City remains to be seen, but the relationship depends upon wheat classes as well as Chicago stocks, so it will presumably vary with relative supplies of soft and hard wheats. It can at least be seen that there was good reason for Chicago's reluctance to add outside delivery points in wheat until recently, and that the complexities are such in the case of wheat that the "ideal" hedging market for hard and soft winters and hard springs (not to mention durums and western wheat) may be very difficult to achieve. The Gulf wheat contract at Chicago, which was aimed at hard wheat deliveries in the Kansas City area, failed to attract trade. Whether this contract would have succeeded had trading in the soft wheat contract been suspended we cannot know--nor do we know how well it would have served soft wheat interests.

The Chicago Oats Contract

Hedging in oats futures underwent a sharp decline in the latter half of the 1960s--just at the time when grain futures markets had emerged from the loan program influence. This came largely in reflection of underlying changes which had been more or less obscured, or made less consequential, by the loan program. Production of oats in the area tributary to Chicago had undergone a long secular decline, as soybeans replaced oats in the cropping pattern in the corn belt. But total oats production was sustained, as plantings shifted to the upper midwest states.

It became quite clear after 1965 that the hedging of oats stored in Minneapolis and Duluth, where most commercial stocks are accumulated, with Chicago futures, was a losing proposition. Chicago does not attract

enough oats to protect these hedges, and Minneapolis cash values displayed a pronounced tendency to decline relative to Chicago futures values. As hedgers deserted the futures market, the Board of Trade revised the contract to include Minneapolis at a fixed difference under Chicago. It was my feeling at the time that this should have been a Minneapolis only delivery, but others felt that this would not be fair to eastern buyers whose requirements could be protected by a long hedge in Chicago.

Alternative Approaches to Delivery Problems

I would hope that the wheat and oats examples, without going into other commodities, would support several general observations. First, that there are delivery problems, that some of them have very deep roots, and that Chicago's decline as a grain terminal presents some of the more serious ones. Second, that there is a general awareness of these problems among exchange members, whose long run interests are best served by markets which continue to thrive. Third, that the problems are not easily resolved, and that some attempted cures might be worse than the disease. Finally, that "multiple" delivery points are not necessarily the best or even a good solution, depending on circumstances and on what is meant by "multiple" deliveries.

Before considering some of the alternatives which are available, I should like to stress one warning. It is not desirable to designate delivery points throughout the producing areas just to satisfy the demands of producers. The producers' best interests are served if there are buyers on liquid markets. To allow deliveries wherever grain is produced would only depress futures prices to the level of the most disadvantaged location. Where producers lack access to the most efficient transport modes, any attempt

to redress their disadvantage in futures would only harm that majority of producers who are served well by the system. Futures delivery has to relate as closely as possible to the great bulk of the movement--it cannot reach into all the hinterlands without subjecting the bulk of the movement to the uncertainties of each production area. Nor can futures trading resolve the problems of occasional boxcar shortages, localized storage congestion, dock strikes, or a host of other interruptions that are reflected in temporary price distortions. Market realities need to be reflected in all locations at all times--even when these realities include mistakes by farmers, merchants, or speculators.

Among the alternatives which are proposed when the futures delivery point provides inadequate capability, as in some Chicago contracts, are the following:

1. The delivery period can be extended. The seven-day rule was introduced at Chicago in 1938 by regulation. This undoubtedly ameliorated the squeeze problem in the last few days of the delivery month, which had been especially acute in old crop futures. To extend the period still further, say to 14 instead of 7 business days, is worth considering, if not as a long term solution at least as a temporary palliative while better solutions are being sought.

2. The delivery capability at Chicago could be expanded. Stronger assurance of space for delivery purposes could be provided or different delivery modes, such as on barges, could be explored. This too has short-term appeal, but it must be considered with the caveat that it is undesirable in the longer run to provide futures delivery capability in an out-of-position location.

3. Provide additional delivery point(s). If this is done there are several methods of relating prices at other points to Chicago prices.

a. Freight off Chicago makes sense for those commodities that move to Chicago in substantial volume by a common freight mode.

b. Fixed differences based upon recent historical price relationships makes sense only if those differences are quite stable; or alternatively if the buyer is given the option at these differences.

c. Fixed differences, as above, but shaded somewhat in favor of Chicago under normal circumstances is another way to protect the buyer. This makes sense under certain assumptions (1) that a primary concern is to prevent any serious squeezes (2) that merchant hedgers who own Chicago space derive some advantage from that, which should be compensated for by protecting the buyer (3) that Chicago is either viable as one delivery point in the longer run, or if this is not the case, that a transition to delivery locations <u>other</u> than Chicago can be effected in this manner.

d. A system of variable differences, such as has prevailed in the cotton trade, is another possibility. This relies heavily upon there being a liquid cash trade at each delivery point at all times. It is questionable whether Chicago would qualify for some grains.

4. Finally, alternative delivery locations <u>not</u> including Chicago need to be considered. It seems to me that the thrust of history is in this direction, but that the transition may well be smoother if Chicago is protected while outside deliveries are tried out and developed. The ultimate answer for corn and soybeans may have to reflect the dominant north to south barge movement, all the way from Minneapolis to the Gulf. I should think that a careful study of the feasibility of such a system, in which CFTC staff would enlist

the cooperation of knowledgeable traders, would be worthwhile. The rather more complex interrelationships in the wheat economy may mean that some combination of markets will continue to do the job best. Cotton, of course, presents a similar cross-hedging problem to wheat, in that Texas and California cottons are quite different from deliverable cottons. I regret not having solutions to propose, and I urge the CFTC to continue studying the delivery location problem along with other aspects of deliveries.