

COMMERCE

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Commodity Markets: An Integral Part of Our Free Market System

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by detractors; all kinds of good by benefactors.*

by Leo Melamed
chairman
International Monetary Market

DURING THE PAST several months, a number of Congressional committees, federal agencies, and a host of consumer groups have suddenly become most interested in commodity exchanges. This sudden burst of joint interest—aside from its somewhat flattering aspects—has caused us to ponder upon the cause.

It did not take us long to come to an obvious conclusion. Agricultural commodities, particularly food products, have experienced an inordinate rise in prices during this year, and commodity exchanges are inexorably interrelated with the agricultural complex of this nation. That this price rise is of major concern to our nation is clear. That futures markets, with their continuous predictions of even higher prices, were most prominent in the public eye is equally clear.

As a matter of fact, futures markets as would be expected by their very definition, provided the nation with the first glimpse of what was coming, and during the year continued to warn us of our problems as their prices climbed upwards. This, in fact, is one



of the functions of such markets—price projection—and if it had not given visible and public display of the prospective reflection of conditions, it would have indeed failed in one of its primary duties to this nation; alas, its failure might have given it shelter from the eventual torrent of unfavorable publicity.

However, bad publicity notwithstanding, the truth of supply and demand, or at least the consensus about the economic picture as it developed and was assessed, displayed itself in the public arena called futures markets.

Futures markets are a complex mechanism and hard to understand. In fact, they are quite often misunderstood. All kinds of evil are laid to it by detractors, and all kinds of good are claimed by its benefactors. Actually, and in the simplest terms, futures markets represent a giant computer—a computer that offers immediate and moment-to-moment analysis of the projected computations of all concerned with or in the market. This barometric effect is attained by the interaction of commercial users and speculative action on the basis of their

use and interpretation of the economic factors regarding a given commodity. These factors are in constant flux and variance; their interpretations may be real or imagined. The result is a projected price which changes from moment to moment, day to day, and week to week until it reaches the time when it is no longer a projection; i.e., until it matures into reality and is phased into the price structure of the cash product.

Insurance for the Farmer

During its life span, a futures market offers unique and varied uses for the agricultural community. It can and does serve equally the producer and consumer. It acts as a marketing tool which has no equal and cannot be duplicated in any other form. Over a period of time, it levels out the natural and sometimes severe valleys and peaks of prices of cash products. It acts as an insurance policy for the gambler of all gamblers—the farmer. It aids in assuring the consumer of a constant flow of products at relatively stable prices and prevents total lack of supply during the slack periods when we await the arrival of new seasonal production. It serves as a prominent educator. It organizes and disseminates statistical information relating to prices, supply and demand with an efficiency that is second to none.

Unfortunately, by its very nature, it is often damned. Because in order for it to function properly—in fact, in order for it to function at all—it needs speculators as well as commercial users. And speculators are considered at best an off-color bunch. That this is not so, that speculators are not necessarily doing anything wrong, that in fact they are risking their money and performing an important function, unfortunately are arguments which do not always seem to make much difference.

Moreover, the operation of commodity markets requires open and continuous access to mass media. This, of course, is advantageous to producers and consumers for it gives them opportunity for planning and guidance. Through full disclosure, it intensifies competition which furthers the result of open, efficient and honest marketing of food. However, this means that the gyrations and fluctuations are readily and loudly visible and prominent in the public eye. As a result, futures markets have a mysterious and wild aura about them.

Little wonder, then, that when prices started rising, it was the commodity markets that called primary attention to this fact. Little wonder, then, that when the search for a cause was begun, commodity markets were on the primary suspect list.

Will it help if we of the exchanges emphatically protest that we were not a causation factor? Will it help if we state that we did not effect the short supply of any product or cause the large demand? Will we prove our case when we tell you that futures prices predominantly remained below cash prices during the entire spiraling cycle? Will it be understood when we explain that in any event our prices were only reflecting a prediction—one that, by the way, has already drastically changed, thank God. Perhaps it will help.

Perhaps, however, it will be more help if we suggest what some of the fundamental causes of the spiral really were. Perhaps it is more important for us to examine who the real "villains" of this scenario were.

A Lot of "Whys"

To get to the bottom of the causes of the price spiral, we should begin by asking some of our own government officials, both past and present, why we maintained a deficit budget for such an extended period of time? Why we allowed our balance of payments structure to get so unfavorably out of hand? Why didn't they realize sooner that the inevitable result of such policies would be inflation and eventual dollar devaluation? Wasn't it obvious that devaluation would act as a further pressure on inflation? That a cheaper dollar would allow foreign dollar holders to pay less and get more of our relatively cheap commodities? And while our officials are before us, let them admit that they, in fact, encouraged foreign agricultural sales because it was in the long run beneficial to our balance of payments although in the short run it would hurt our supply. And allow us also to ask them why they instituted freezes and price controls on agriculture, when they must have known that such actions would prove counter-productive, causing shortages and higher prices?

Next, perhaps we should call on the officials of Germany, France, England, Belgium, Switzerland, Italy, Japan and others and determine from them why they allowed their country's inflation

to get out of hand and why they created so much more disposable income with which their people could demand and purchase so much of our food grains and beef.

Then we should ask some of our own consumer representatives why they created so much pressure on our government to act in lowering food prices so as to push our officials into action? Didn't they realize that they were asking for action in a field that could not be quickly acted upon, in an area where there were no instant remedies or magic answers? Allow us also to ask them for the reasons why the public's eating habits have changed so much that each person is now eating 87% more beef than he did 20 years ago? And why our consumer now wants all this ready-made or easy-to-prepare food, which is more costly, instead of the old-fashioned food he used to prepare laboriously by bending over a hot stove the better part of the day? And why our public has so much more disposable income with which they can demand all these fancy steaks and beef?

We should also ask some of our labor leaders to admit that wages have risen by 140% in the last 20 years while home food prices went up by only 40%. And that because of the higher cost in everything else, farm products often became unprofitable to produce and over the years had to be subsidized and were long overdue for a large adjustment.

We should also question some farmers and find out if it's true that because of the unprofitability of breeding cows, their herds have been diminishing over the years. And at the same time, shouldn't we allow them to testify about their rising costs of production?

Acts of God

I'm afraid that before we would be through with this investigation we would face some impossible tasks also. We would have to ask the Almighty why did He cause the Peruvian anchovies to change their normal pattern and move their schools of fish to different shorelines and thereby cause a dramatic shortage in our fish meal supply. And why also did He cause such incredibly bad weather last year throughout the U.S., Russia, China and Africa which resulted in such poor crops and large death loss to livestock? And, particularly, why He allowed all of the foregoing and other factors to converge and climax at one time?

We could go on with other suggestions, but I think the point is clear. These were some of the fundamental causes for the spiral in food prices which we experienced. These were the real "villains." They were simply a terrible combination of economic factors and acts of God which, unfortunately, built up to an intensified degree and climaxed within the same time frame.

It is true that some of these causes require action, but much of the action concerns basic changes in our budget management and production incentives. As to those factors which are cyclical in nature or temporary, no action is required. In fact, no action is desirable. What we must fear most is action which may look good on the surface, but does not relate to the real problem—or worse, interferes with a system that has worked so well.

A good case in point is our recent food price controls—controls which many of us in agricultural marketing implored our government not to impose.

If we learned anything from this lesson, it should have been that the only fundamental law that governs prices is supply and demand, and that there is no magic remedy for short supply or high demand, and more importantly, that in this complex area of agriculture, the best medicine is to further encourage our free and highly productive system to continue in its previous successful ways.

Shall we in our search to find and correct some basic cause of the food

spiral, again look for a single remedy or culprit such as the "retailer," the "middleman," the "packer," the "producer," or the "commodity markets?" If we do, we will again be making the same mistake. We will again be interfering with a remarkable system that has worked to a degree that its success is a marvel and model for the rest of the world.

Remarkable Statistics

Our nation and its agriculture during the last 100 years proved to be the only one in the world that can continue to produce more food products than we can consume and of higher quality and at lower prices than anybody else.

While Americans spend only 16% of their disposable income for food (that's 7% less than they did in 1959), South Africans spend 70%, India's citizens 60%, East Europeans anywhere from 36 to 54%, West Europeans and Japanese 38%, and even Canadians 20%.

Only 4% of our people farm the land and produce the highest standard of living.

While our mid-March price of sirloin steak was \$1.69 per pound, it was \$1.88 per pound in London and \$2.79 in Rome; round steak was \$2.57 in Paris and beef roasts \$2.08 in Bonn; and in Japan, beef loin was \$11.90 per pound. Americans eat on an average of 115 pounds of beef annually, while in Japan—now also a prosperous nation—the average is 27 pounds.

While in 1972 we had a 4.3% increase in food prices, Germany had a 6.2% increase, Canada 6.7%, the United Kingdom 7.5%, Sweden 7.6%, France 8.0%, Finland 8.8% and Spain 8.9%. Only two nations, Austria and Japan, had a recordable smaller increase in food prices than the U.S.

During the past decade, home food costs rose by 30%, while clothing rose by 33%, auto repair by 45%, restaurant meals by 52%, home maintenance by 56%, public transportation by 63%, doctor bills by 64%, postal costs by 73%, auto insurance by 81% and hospital rooms by 165%.

If food prices had kept pace with wages, then milk would be up today by an additional 35%, eggs by an additional 161%, hamburger by an additional 151% and a pound of round steak by an additional 267%.

Incidentally, the farmer's share of the market basket of food purchased by the average family was only 40% in 1972. That is just 1% more than it was

five years before and it is less by 10% than it was 25 years ago.

These are but samples of the extraordinary results of our free enterprise agriculture and marketing system. It is a system whose productivity has risen beyond anyone's dream. Our farm output per man-hour is 3.1 times higher than it was 20 years ago (manufacturing industries have increased 1.7 times). Twenty years ago, one farm worker supplied 16 people with food. Now he produces enough for 51 people. This record is unmatched anywhere else in the world. In the past 10 years, livestock production per man-hour is up 60%, crop production up 49%, and the average yield per acre up 19%. These are truly facts we can be proud of.

Commodity markets are part and parcel of this successful system of farming and marketing. Commodity markets have been around for over 100 years in the U.S. and are integrally intertwined with our present agriculture and agribusiness complex. It has been unequivocally proven, time and time again, through government, private and academic studies, that commodity markets provide some of the most useful and irreplaceable tools for producers and consumers alike; that the degree of economic benefit by such markets is in fact greater than most would realize; that without these tools and services, our agriculture would indeed be severely impaired and far less efficient.

The foregoing, however, is not intended to imply that we of commodity markets, and of the CME in particular, are flawless. Far from it. Utopia, I fear, has not yet arrived at our threshold either. It is, therefore, axiomatic that we can always stand improvement. Our foremost desire has been, and continues to be, to serve the agricultural community and public in the best and most honest fashion possible. We submit that in this imperfect world our record has been very good.

Our exchange does not need legislation thrust upon it to better its rules or enforcement policies. Our primary motivation has been self-regulation, spurred by the underlying philosophy that industry itself should be its own best policeman regardless of what other governmental agencies also do in that capacity. It is our fundamental belief that no system will work, no institution will be best, until or unless the system or institution is itself responsible and responsive to the needs of the American people. □