

# IMPACT OF THE DROUGHT ON PRICES AND PRODUCTION

---

**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
ECONOMIC STABILIZATION  
OF THE  
COMMITTEE ON BANKING, FINANCE AND  
URBAN AFFAIRS  
HOUSE OF REPRESENTATIVES  
ONE-HUNDREDTH CONGRESS  
SECOND SESSION

\_\_\_\_\_  
JULY 6, 1988  
\_\_\_\_\_

Printed for the use of the Committee on Banking, Finance and Urban Affairs

**Serial No. 100-75**



U.S. GOVERNMENT PRINTING OFFICE

86-824-7

WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office  
U.S. Government Printing Office, Washington, DC 20402

## HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

FERNAND J. ST GERMAIN, Rhode Island, *Chairman*

HENRY B. GONZALEZ, Texas	CHALMERS P. WYLIE, Ohio
FRANK ANNUNZIO, Illinois	JIM LEACH, Iowa
WALTER E. FAUNTROY, District of Columbia	NORMAN D. SHUMWAY, California
STEPHEN L. NEAL, North Carolina	STAN PARRIS, Virginia
CARROLL HUBBARD, Jr., Kentucky	BILL McCOLLUM, Florida
JOHN J. LaFALCE, New York	GEORGE C. WORTLEY, New York
MARY ROSE OAKAR, Ohio	MARGE ROUKEMA, New Jersey
BRUCE F. VENTO, Minnesota	DOUG BEREUTER, Nebraska
DOUG BARNARD, Jr., Georgia	DAVID DREIER, California
ROBERT GARCIA, New York	JOHN HILER, Indiana
CHARLES E. SCHUMER, New York	THOMAS J. RIDGE, Pennsylvania
BARNEY FRANK, Massachusetts	STEVE BARTLETT, Texas
RICHARD H. LEHMAN, California	TOBY ROTH, Wisconsin
BRUCE A. MORRISON, Connecticut	AL McCANDLESS, California
MARCY KAPTUR, Ohio	J. ALEX McMILLAN, North Carolina
BEN ERDREICH, Alabama	JAMES SAXTON, New Jersey
THOMAS R. CARPER, Delaware	PATRICK L. SWINDALL, Georgia
ESTEBAN EDWARD TORRES, California	PATRICIA SAIKI, Hawaii
GERALD D. KLECZKA, Wisconsin	JAMES BUNNING, Kentucky
BILL NELSON, Florida	JOSEPH J. DiGUARDI, New York
PAUL E. KANJORSKI, Pennsylvania	
THOMAS J. MANTON, New York	
ELIZABETH J. PATTERSON, South Carolina	
THOMAS McMILLEN, Maryland	
JOSEPH P. KENNEDY II, Massachusetts	
FLOYD H. FLAKE, New York	
KWEISI MFUME, Maryland	
DAVID E. PRICE, North Carolina	
NANCY PELOSI, California	
GARY L. ACKERMAN, New York	

---

### SUBCOMMITTEE ON ECONOMIC STABILIZATION

MARY ROSE OAKAR, Ohio, *Chair*

JOHN J. LaFALCE, New York	NORMAN D. SHUMWAY, California
BRUCE F. VENTO, Minnesota	GEORGE C. WORTLEY, New York
MARCY KAPTUR, Ohio	AL McCANDLESS, California
PAUL E. KANJORSKI, Pennsylvania	J. ALEX McMILLAN, North Carolina
DOUG BARNARD, Jr., Georgia	TOBY ROTH, Wisconsin
ROBERT GARCIA, New York	JAMES SAXTON, New Jersey
ELIZABETH J. PATTERSON, South Carolina	PATRICIA SAIKI, Hawaii
THOMAS McMILLEN, Maryland	PATRICK L. SWINDALL, Georgia
FLOYD H. FLAKE, New York	JOSEPH DiGUARDI, New York
KWEISI MFUME, Maryland	
DAVID E. PRICE, North Carolina	
FRANK ANNUNZIO, Illinois	

# CONTENTS

## WITNESSES

	Page
Hearing held on:	
July 6, 1988.....	1
Appendix.....	31

WEDNESDAY, JULY 6, 1988

Seal, William E., Commissioner Commodity Futures Trading Commission.....	10
Wilson, Ewen, Assistant Secretary for Economics, U.S. Department of Agriculture.....	6

## APPENDIX

Prepared statements:	
Seal, William E. ....	32
Shumway, Hon. Norman P.....	50
Wilson, Ewen.....	39

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Oakar, Hon. Mary Rose:	
Map entitled "Drought's Worldwide Trade Impact" .....	49
Submitted a graft from the Department of Agriculture that shows what the farmer gets from the food sales in grocery stores.....	48
Webb, Jean A., cover letter dated July 22, 1988 with attachment.....	52
Wilson, Ewen, submitted table entitled, "Relative importance of food groups in consumer price index for urban consumers, December 1987" .....	47

# IMPACT OF THE DROUGHT ON PRICES AND PRODUCTION

Wednesday, July 6, 1988

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON ECONOMIC STABILIZATION,  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,  
*Washington, DC.*

The subcommittee met pursuant to call at 2:40 p.m. in room 311, Cannon House Office Building, Hon. Mary Rose Oakar [chair of the subcommittee] presiding.

Present: Chair Oakar, Representative Roth.

Chair OAKAR. The subcommittee will come to order. This afternoon the Subcommittee on Economic Stabilization is conducting this emergency hearing to assess the impact of the continuing drought on the stability of the economy. We will do so by looking at changes in prices and production of agricultural commodities affected by the drought. I don't know of any part of the country that isn't affected in some measure by this terrible situation.

Specifically, we are concerned about price increases for basic food items. What amount of increase may be justified, what might be attributable to speculative profiteering and what overall impact this will have on inflation. Crises have a way of bringing out the best in most, and unfortunately the worst in some.

This subcommittee will not sit idly by when consumers are gouged by artificial price hikes or speculative profiteering. I want to commend the Members of the respective agricultural committees in the House and the Senate and others who are working toward a bipartisan response to the conditions resulting from this crisis.

The Chair wishes that matters related to the drought such as crop insurance, and subsidy payments, regulation of grain storage are rightfully within the jurisdiction of the Agriculture Committee and therefore not the subject of this hearing today.

We have a response that is very, very distinct. This subcommittee is charged with overseeing relating to the economy and that is why we have called this hearing. The crisis that is the focus of the hearing today has many dimensions. It now extends to 30 States and has resulted in crop losses, reductions in stockpile surpluses, damage to the soil, and a near halting of traffic on our Nation's major rivers.

These factors are all being considered by the Congress and obviously by the administration. So we will try to focus today on the untold story, that is the impact on the family budget at the super-market and the national budget through inflation. At the begin-

ning of the year the Agriculture Department was predicting a 2- to 4-percent increase in retail food prices for 1988. That upward pressure on prices could be offset by the sale of supplies in storage which the Government has done.

Traders in the commodities pits are bidding prices higher. In fact, Kellogg Company and General Mills, two leading breakfast foodmakers, already moved to increase prices on their cereals, for example. Analysts predict more increases in the fall can be expected. Mindful that raw materials make up only a small portion of the overall cost of most foods, we will attempt to determine where the price increases may come, if any come, what is a fair increase to expect and what can be done to mitigate the cost to consumers.

We are delighted to have two outstanding witnesses in the series of hearings we will be conducting on this issue. We want to thank everyone for coming on short notice. I apologize that we were asked to attend a briefing today related to the Iranian, American situation in the Gulf, and I apologize to our witnesses.

I know you have a very busy schedule. The Chair and others—as you see, we don't have everybody here who wants to be here. Many Members are at another briefing. I know they would want to be here. Let me call on Mr. Roth for opening remarks. Thank you very much for attending, Toby.

[The opening statement of Chair Oakar follows:]

OPENING STATEMENT  
CONGRESSWOMAN MARY ROSE OAKAR, CHAIR  
SUBCOMMITTEE ON ECONOMIC STABILIZATION  
HEARING ON THE IMPACT OF THE DROUGHT  
ON PRICES AND PRODUCTION  
JULY 6, 1988

THIS AFTERNOON, THE SUBCOMMITTEE ON ECONOMIC STABILIZATION IS CONDUCTING AN EMERGENCY HEARING TO ASSESS THE IMPACT OF THE CONTINUING DROUGHT ON THE STABILITY OF THE ECONOMY. WE WILL DO SO BY LOOKING AT CHANGES IN PRICES AND PRODUCTION OF AGRICULTURAL COMMODITIES AFFECTED BY THE DROUGHT. SPECIFICALLY, WE ARE CONCERNED ABOUT PRICE INCREASES FOR BASIC FOOD ITEMS, WHAT AMOUNT OF INCREASE MAY BE JUSTIFIED, WHAT MIGHT BE ATTRIBUTABLE TO SPECULATIVE PROFITEERING, AND WHAT OVERALL IMPACT THIS WILL HAVE ON INFLATION. CRISES HAVE A WAY OF BRINGING OUT THE BEST IN MOST AND, UNFORTUNATELY, THE WORST IN SOME. THIS SUBCOMMITTEE WILL NOT SIT IDLY BY IF CONSUMERS ARE GOUGED BY ARTIFICIAL PRICE HIKES OR SPECULATIVE PROFITEERING.

I WANT TO COMMEND THE MEMBERS OF THE RESPECTIVE AGRICULTURE COMMITTEES IN THE HOUSE AND SENATE AND OTHERS WHO ARE WORKING TOWARD A BIPARTISAN RESPONSE TO THE CONDITIONS RESULTING FROM THE DROUGHT.

THE CHAIR IS MINDFUL OF ITS JURISDICTION AND THAT OF OTHER COMMITTEES. ACCORDINGLY, MATTERS RELATED TO THE DROUGHT, SUCH AS CROP INSURANCE, ENHANCED SUBSIDY PAYMENTS, AND REGULATION OF GRAIN STORAGE ARE RIGHTFULLY WITHIN THE JURISDICTION OF THE AGRICULTURE COMMITTEE AND THEREFORE NOT THE SUBJECT OF THIS

HEARING TODAY. OUR RESPONSIBILITY ON THE ISSUE IS SEPARATE AND DISTINCT.

THE SUBCOMMITTEE ON ECONOMIC STABILIZATION IS NO STRANGER TO EVALUATING ECONOMIC CRISES AND ACTING WHEN NECESSARY. THIS SUBCOMMITTEE, UNDER THE RULES OF THE HOUSE, IS RESPONSIBLE FOR MONITORING ALL ECONOMIC STABILIZATION MATTERS INCLUDING THE CONTROL OF PRICES OF COMMODITIES, RENTS, SERVICES, AND ALL MATTERS RELATING TO FINANCIAL AID TO ALL SECTORS AND ELEMENTS WITHIN THE ECONOMY. IT WAS IN EXERCISING THIS LATER RESPONSIBILITY THAT THIS SUBCOMMITTEE CRAFTED SUCCESSFUL FINANCIAL AID PACKAGES FOR CHRYSLER CORPORATION AND NEW YORK CITY SOME YEARS AGO.

THE CRISIS THAT IS THE FOCUS OF THIS HEARING TODAY HAS MANY DIMENSIONS. IT NOW EXTENDS TO 30 STATES, IT HAS RESULTED IN CROP LOSSES, REDUCTIONS IN STOCKPILE SURPLUSES, DAMAGE TO THE SOIL, AND A NEAR HALTING OF TRAFFIC ON OUR NATION'S MAJOR RIVERS. THESE FACTORS ARE ALL BEING CONSIDERED BY COMMITTEES IN THE CONGRESS AND THE ADMINISTRATION. OUR MISSION TODAY IS TO FOCUS ON THE UNTOLD STORY, THAT IS, THE IMPACT ON THE FAMILY BUDGET AT THE SUPERMARKET AND THE NATIONAL BUDGET THROUGH INFLATION.

AT THE BEGINNING OF THE YEAR, THE AGRICULTURE DEPARTMENT WAS PREDICTING A 2-4% INCREASE IN RETAIL FOOD PRICES FOR 1988. THAT

UPWARD PRESSURE ON PRICES COULD BE OFFSET BY THE SALE OF SUPPLIES IN STORAGE--WHICH THE GOVERNMENT HAS DONE--TRADERS IN THE COMMODITIES PITS ARE BIDDING PRICES HIGHER. IN FACT, KELLOGG COMPANY AND GENERAL MILLS--TWO LEADING BREAKFAST FOOD MAKERS--ALREADY MOVED TO INCREASE PRICES ON CEREALS. ANALYSTS PREDICT MORE INCREASES IN THE FALL CAN BE EXPECTED. MINDFUL THAT RAW MATERIALS MAKE UP ONLY A SMALL PORTION OF THE OVERALL COST OF MOST FOODS, WE WILL ATTEMPT TO DETERMINE WHERE THE PRICE INCREASES MAY COME, WHAT IS A FAIR INCREASE TO EXPECT, AND WHAT CAN BE DONE TO MITIGATE THE COST TO CONSUMERS.

WE ARE FORTUNATE TODAY TO HAVE TWO OUTSTANDING WITNESSES. OUR FIRST WITNESS IS MR. EWEN WILSON, ASSISTANT SECRETARY FOR ECONOMICS AT THE DEPARTMENT OF AGRICULTURE. OUR SECOND WITNESS IS THE HONORABLE WILLIAM SEALE, COMMISSIONER OF THE COMMODITY FUTURES TRADING COMMISSION. WE THANK YOU FOR COMING ON SUCH SHORT NOTICE, AND WE LOOK FORWARD TO YOUR REMARKS.

Mr. ROTH. Thank you, Madam Chairman. I am delighted that we are having this hearing this afternoon and this briefing. I have come back from Wisconsin where I worked a day on the farm and I can tell you that the hay bales used to weigh 80 pounds, now they weigh 35 to 40 pounds because there isn't much moisture content in the hay this year.

Our farmers are being hard hit because of the heat and the human toil is the highest cost of all now, not to say anything about the economic toll that is being extracted. So I am very much interested in this hearing this afternoon and I am here to ask some questions. We can't make it rain, but if there is something we can do, I would certainly want to do it. Thank you, Madam Chairman.

Chair OAKAR. I used to think one of my favorite plays was the Rain-maker but I have changed my mind since the real tragedies that are going on related to the drought.

Our first witness is Mr. Ewen Wilson, Assistant Secretary for Economics of the Department of Agriculture, and he will be followed by Hon. William Seale, commissioner of the Commodity Futures Trading Commission.

Mr. Wilson, thank you very much for coming, and if you want to introduce anyone who is with you who might want to say a few words, that would be fine.

#### STATEMENT OF EWEN WILSON, ASSISTANT SECRETARY FOR ECONOMICS, U.S. DEPARTMENT OF AGRICULTURE

Mr. WILSON. Thank you, Madam Chairperson, and Congressman Roth.

I do have with me today Keith Collins, who is director of the Economic Analysis Staff.

We appreciate the opportunity to appear before you at this hearing to discuss the impacts of the drought on major commodities and prices, and the implications for food supplies and prices.

Unusually intense drought for this stage of the growing season has spread over much of the farm land. The 30-day weather forecast issued last Wednesday indicated continued dry conditions in the Eastern Corn Belt. The drought has caused great turbulence in the commodity markets. The drought also has disrupted barge traffic, reduced power generation and increased the likelihood of forest fires.

As a result of the drought, cash grain prices are up sharply since early May—up  $\frac{1}{3}$  for wheat,  $\frac{3}{8}$  for corn and nearly double for oats. Cattle prices, however, are down reflecting distress sales because there is not enough forage for herd maintenance in some areas of the country. At the beginning of June, pasture and range conditions were rated at 68 percent of ideal, the lowest rating for this time of the year since 1934. Pasture conditions in the northern plains were particularly poor with severe drought reported in North Dakota.

USDA response: The Department of Agriculture has taken action to alleviate the distress of cattle producers. I think in the interest of time I would rather not go through all of those actions, but they are contained in my written testimony. Basically, those actions were attempts to increase supplies of forage.

**Livestock and Poultry:** Despite these actions, distress sales have forced down cattle prices. The price of utility cows is down sharply from \$50 per cwt. in early May. Cows are currently selling for around \$40 per cwt., down nearly  $\frac{1}{4}$ . Continued liquidation of the cattle herd will add to beef supplies, particularly processing grade beef, and will lead to lower prices than otherwise would have occurred.

Overall supplies of red meat and poultry are record large this year and the short-term impact of the drought will be to add to these supplies. Heat stress could limit rates of gain, of livestock and poultry on feed, but this will be more than offset by additional marketings. Higher feed grain and soybean prices have affected livestock feeding profitability, and if those higher prices continue, will lead to a reduction in the size of the national herd. Smaller cattle and hog numbers mean less meat production in future years, but the retail price impact of such reduced supplies will not be felt until next year at the earliest. If poultry flocks are reduced, the impact on poultry prices could come sooner—by the end of the year.

**Feed grains:** The impact of the drought on the livestock and poultry sectors depends, to a large extent, on the level of feed grain and soybean prices. Currently, 10 of the 17 major corn-producing States have  $\frac{1}{4}$  or more of the corn crop rated poor or worse, compared with none last year. Corn prices are currently around \$3 per bushel compared with about \$2 in April. However, projected stocks of 4.1 billion bushels carried into the 1988-1989 marketing year starting September 1, 1988—the second largest carry-in stocks ever—are expected to temper further price increases.

The key to avoiding runaway price increases in the corn market will be access to CCC-owned and FOR stocks. Catalogs listing CCC stocks available to the trade are periodically being issued. Stocks pledged as collateral for FOR loans are available through the use of commodity certificates at or before loan maturity. If CCC and FOR stocks continue to be made available to the market, then the damage to the livestock feeding and poultry sectors can be contained.

On June 27, corn prices rose to the level needed to allow farmer-owned reserve loans to be repaid before maturity. Over 1.2 billion bushels of reserve corn loans can profitability be redeemed and brought onto the market.

**Wheat:** The winter wheat harvest is well underway. As of last Sunday 65 percent of the winter wheat crop had been harvested. Normally 44 percent of the crop is harvested by this time. Winter wheat usually accounts for  $\frac{3}{4}$  of all wheat produced in the United States and the combination of an earlier than normal harvest and carry-over stocks from last year of 1.27 billion bushels on June 1 is an assurance of sufficient supplies to meet domestic and export needs.

The spring wheat crop, which normally accounts for  $\frac{1}{4}$  of U.S. production, has been damaged, and durum wheat and oats grown in the northern plains have been especially hard hit.

The prospect of reduced wheat yields has driven up Kansas City wheat prices by more than  $\frac{1}{3}$  since early May. Prices of durum wheat and oats have increased much more than this. Substantial

increases in wheat prices were expected during the 1988 crop year, even prior to the onset of the drought. The Department's early-season estimates indicated demand would exceed production by 450 million bushels, leading to a 10- to 25-percent rise in season-average farm prices of wheat. With the drought, the drawdown in stocks could be even greater than this.

If the drought persists and wheat prices go even higher, there will be some additional pressure on retail prices of bakery products and cereals. However, farm-level prices account for only 8 percent of the retail value of cereal and bakery products. If wheat prices for the entire season average 30 percent above last year, this alone would translate into a 2.4 percent rise in the retail price of cereal and bakery products. Actual price increases would also depend on changes in other processing and marketing charges.

**Soybeans:** The soybean crop is generally rated fair to poor. Eleven of 19 major soybean-producing States have a crop condition rating of poor to very poor for 25 percent or more of the crop. A year ago, no major-producing State had more than 15 percent of the crop rated poor or worse. Soybean prices had already been rising for several months in anticipation of very low carry-over stocks for the 1988-1989 season. However, the drought greatly accelerated the soybean price rise. Since early May, soybean and meal prices in southern Iowa have jumped about 50 percent and soybean oil is up 25 percent.

The soybean meal price increase will push up protein costs in animal feed rations. The soybean oil price increase will affect the entire fats and oils price complex. However, world oilseed production is expected to be record large in 1988 and competition from corn, palm, coconut, and cottonseed oil and animal fats will moderate the impact at the retail level.

Prior to the onset of dry weather, food prices were forecast by the USDA to rise 2 to 4 percent in 1988. If the drought continues, food prices will increase at a slightly higher rate during the second half of 1988 and the first half of 1989. Even so, the outlook is for moderate rather than sharp increases in the Consumer Price Index (CPI) for food.

USDA will release an official food price projection on July 10, but based on preliminary analysis, it appears that the new forecast will place overall food-price increases for 1988 in the 3- to 5-percent range. In other words, it appears that the drought will add about 1 percentage point to 1988 food price inflation. We could see price run-ups in certain foods, for example, pasta products made from durum wheat and oat-based cereals, but overall food price inflation in 1988 will be held to moderate levels.

The upward adjustment of our food price estimate will have a negligible impact on the overall rate of inflation in the United States.

Food accounts for approximately 16 percent of the Consumer Price Index for urban consumers—the most widely used measure of inflation. Food prepared at home accounts for about 10 percent of the overall CPI while the remaining 6 percent reflects food purchased or consumed away from home, mainly restaurant meals (see attached table).

[The table referred to can be found in the appendix.]

Meat, poultry and fish consumed at home accounts for almost 3 percent of the index, and fruits and vegetables 2 percent. Dairy products, cereals and bakery products each represent a little over 1 percent, and fats and oils, less than  $\frac{1}{3}$  of 1 percent of the index.

Since food accounts for 16 percent of the overall CPI, a 1 percent boost in food prices translates into an increase of less than  $\frac{2}{10}$  of 1 percent in the overall CPI. However, inflation is a monetary phenomenon dependent upon monetary policy. There is no reason to believe that a one-time, drought-induced boost in farm commodity prices will lead to higher overall inflation.

Higher farm commodity prices this year will bring about a production response next year. More than 78 million acres of U.S. farm land have been removed from production this year under Federal programs, 24 million acres of which are in the long-term Conservation Reserve Program. Some idled land will be released for planting under the 1989 wheat program, and the remainder serves as a buffer against serious crop short-falls in this country. This country has an enormous capacity to increase food and fiber supplies by returning idled acreage to production.

It is still too early in the crop production cycle to assess the full extent of the drought damage. The Department will issue a crop report on July 12 that will reflect the impact of the drought on production based on July 1 conditions. If drought conditions persist, yields on this year's spring-planted crops will be further affected. However, the impact on 1988 food prices and supplies will be modest for a number of reasons:

Accelerated marketings of livestock will add to already record supplies of meat and poultry.

Large feed grain stocks can help mitigate the damage to livestock and poultry feeding operations.

Diverse production areas and irrigation mean fruits and vegetable prices will be largely unaffected, even though production in certain Lake States will be down.

Soybeans and wheat will be affected, but the farm price of these commodities accounts for a relatively small share of the retail value of their products.

Record-large global supplies of vegetable oils will moderate the price impact on cooking and salad oils.

The most seriously affected crops, such as oats and durum wheat, will have a retail impact, but products made from these crops represent only a very small component of the CPI.

The immediate problem is not one of food shortage or food price inflation, except in certain specific instances, but rather the problem is one of the responding in a compassionate way to the losses faced by American farmers.

Madam Chairman, that concludes my testimony. I would be pleased to respond to any questions you or other Members of the subcommittee might have.

[The prepared statement of Ewen Wilson can be found in the appendix.]

Chair OAKAR. Thank you.

I think we will go on to Mr. Seale and then we will ask questions afterwards. Thank you.

Mr. Seale.

**STATEMENT OF HON. WILLIAM E. SEALE, COMMISSIONER  
COMMODITY FUTURES TRADING COMMISSION**

Mr. SEALE. Thank you, Madam Chair. I am William E. Seale. I hold a Ph.D. in economics and I am a member of the Commodity Futures Trading Commission since 1983.

I have with me today Dr. Paul Tasini, the director of the Division of Economic Analysis at CFTC and John Melki, chief of the CFTC Market Surveillance Section.

Normally, the responsibility of testifying before committees and subcommittees of the Congress falls on the chairman of the CFTC. However, Dr. Gramm was unable to be here today and asked me to appear in her place and provide the views of the Commodity Futures Trading Commission.

I will briefly explain how the Commission's surveillance of the agricultural futures markets has responded to the drought-induced price volatility in those markets, and I will be pleased to answer any questions you may have.

As the Federal regulator of commodity futures markets by encouraging their competitiveness and efficiency, by ensuring their integrity, and by protecting market participants against manipulation, abusive trading practices and fraud. Through the maintenance of fair and freely competitive markets, the CFTC better enables the futures markets to perform their economic functions of price discovery and risk shifting.

During the past 2 months, but particularly in June, agricultural futures markets have been buffeted by the changing prospects of a severe drought in this country's most productive croplands. Prices of grain and soybean complex futures rose rapidly until about the third week of June. Although prices have retreated somewhat in response to some rainfall, cooler weather, and ample near-term supplies, the markets have remained quite volatile.

For example, from May 22 through June 23, 1988, new crop corn futures prices increased 53 percent, soybean futures prices increased 48 percent, spring wheat futures prices increased 43 percent, and oat futures prices increased 108 percent. As market participants collectively try to assess the severity of the drought, its impact on U.S. production, and the effect of higher prices on the export and domestic demand for these commodities, the markets react swiftly to new information—particularly weather reports. We expect this volatility to continue until the extent and impact of the drought is better known.

In response to the drought and ensuing price volatility, the CFTC has intensified its surveillance efforts on several fronts. Our market surveillance staff is monitoring the markets for any indications of price manipulation and for violations of the CFTC's speculative position limit rules. The CFTC financial surveillance staff is monitoring the financial condition of futures commission merchants with respect to the minimum capital requirements and the segregation of customer funds. In addition, the CFTC's contract markets staff has expanded its monitoring of floor trading practices. Chairman Gramm also is participating in the Presidential Interagency Drought Policy Committee.

At weekly surveillance briefings and on a special request basis, the Commission has been advised by senior staff of ongoing developments in agricultural markets. Our surveillance emphasis has been on these markets since the prospects for a severe drought emerged. The Commission has been advised of large trader positions, price trends and significant market news regarding these agricultural futures markets. Representatives of the U.S. Department of Agriculture have attended these meetings as part of our inter-agency liaison activities and have provided insights regarding market developments.

Our surveillance of the agricultural futures markets during this period of rapidly rising and volatile futures prices has not disclosed any evidence of price manipulation. Nor has our surveillance staff encountered any unusual problems enforcing the Commission's speculative position limit rules. It is worth noting that the largest individual futures positions in the grain and soybean markets during the major price advance were short rather than long. During this volatile period these positions were held by large grain merchants to hedge their grain inventories and forward purchases.

For the near term at least, the current high levels of trading volume and widespread participation tend to reduce the potential for the activities of one trader to affect the market. Furthermore, the Commission does not have any serious concerns over the availability of deliverable supplies.

While the drought may significantly reduce this year's crops, it should not affect free market supplies until late this year or next because of the large supplies carried into this crop year from prior harvests. In addition, to the extent that higher prices attract grain from Government stocks or farmer-owned reserves, free market supplies may be augmented significantly in the near term.

The Commission's market surveillance staff will be monitoring closely the deliverable supply situation as well as the activities of large traders in these markets in the coming months to detect any evidence of a threat of manipulation or of any other form of major market disruption. The Commission also will continue its review of these markets through its weekly surveillance briefings and special briefings, as circumstances may warrant.

As I previously mentioned, during this period the Commission also has intensified its financial and trade practice surveillance, as is the normal practice whenever volatile markets develop. Specifically, based upon preset parameters the Commission's financial audit staff initiated its "major market move" surveillance and oversight procedure to ensure that the exchanges are conducting adequate financial surveillance of members and to contact individual firms where necessary to verify the collection of margins and continued compliance with the Commission's segregation and capital requirements.

While cash-flows at the clearing organizations of several futures markets have increased significantly due to the increased price volatility in their agricultural futures and option contracts, no financial problems have developed. Commission staff has confirmed through frequent contacts with the respective clearing system routinely. In this connection it is useful to note that the two largest futures exchanges routinely assess intra-day margin settlements on

their clearing member firms, which tends to reduce settlement cash-flows and to alleviate potential strains on their clearing systems.

In addition to increasing their financial surveillance, the grain exchanges also have increased margins in response to the increased price volatility prevailing in the grain and soybean complex futures markets. Initial speculative corn futures margins, for example, have increased from \$750 to as much as \$1,800 per contract, and soybean futures margins have increased from \$2,000 to \$5,250 per contract.

The Commission's contract markets staff also expanded its monitoring of floor trading practices by establishing an increased presence on the trading floors. Specifically, the Commission staff has been monitoring the opening and closing periods of trading in the grain markets in addition to observing other periods during each trading session. During floor surveillance, Commission staff observe trading for possible illegal activity, converse with market participants about trading activity generally, and follow up any information they may obtain on rumors or problems which may require further investigation. To date, no problems have been identified.

Thank you for the opportunity to appear before the subcommittee. I would be pleased to answer your questions at this time.

[The prepared statement of William Seale can be found in the appendix.]

Chair OAKAR. Thank you very much, commissioner. I want to submit for the record a Department of Agriculture graph that shows what the farmer gets from the food sales in grocery stores. I am sure you are familiar with it.

[The Department of Agriculture graph referred to above can be found in the appendix.]

Chair OAKAR. For example, fats and oils are 18.5 percent. Processed fruits and vegetables are 24.2 percent; eggs, 53.9 percent, and it goes on. Cereal and bakery products are only 7.6 percent, yet we see this fairly substantial rise in those prices I mentioned, such as Kellogg and General Mills.

Isn't it, to either who want to answer, and Mr. Wilson, maybe you would want to answer. Is it too soon for companies to be experiencing the effects of the drought, and are these companies passing on these higher prices to consumers in anticipation or is it, you know, because of the sort of feeling that maybe it is the right time to raise prices?

Is it justified, all these increases that we are seeing lately?

Mr. WILSON. We have a situation in some very specific commodities where prices have risen more than in all other commodities. One of those commodities is durum wheat that is grown in this country. About 80 percent is grown in one State, the State of North Dakota. That is where the drought has been particularly severe. So the market has reacted very strongly in recognition of the fact that we have suffered a major loss in that durum wheat crop in North Dakota.

Another crop that is in a similar condition is oats. Oats are grown in several of the Northern Plain States, but the Dakota's, Minnesota, and Montana tend to be the States where most oats in

this country are grown. So we have seen a run up in oats prices as well.

In the case of oats, we came into the season with very low stock levels, so the price run-up that has occurred in those commodities reflects a real situation in the market.

Chair OAKAR. Well, soybeans, am I not correct about this? I am from the greenhouse capital of the country, Cleveland, OH, but I don't pretend to be an authority on agriculture. We do an awful lot of soybean growing in my State of Ohio, not too far from my congressional district, and soybeans are said to be the most drought resistant.

Is that correct, am I correct about that?

Mr. WILSON. Soybeans is a fairly drought resistant crop, but we do need rain on the soybeans in the month of July when they start flowering and then in the month of August when the pods start forming. If we don't get rain in that period, we are in bad trouble.

Chair OAKAR. Why is the price shooting up so much from \$6 last year to \$10.30 this year?

Mr. WILSON. Soybean stocks, which were fairly large as of 2 years ago have been drawn down substantially. Government-owned stocks have been virtually depleted. We have a very, very small amount of stocks left in Government hands now. However, we did do a survey of total soybean stocks as of June 1, and that survey indicated that we have 655 billion bushels of soybeans in stocks in all positions in this country as of June 1.

That amount of stocks would be enough to carry us for 4 months and satisfy all our domestic and export needs. That stock level will get us to the next harvest. The only question is, what kind of yield can we expect on this next harvest? That is why the price has gone up.

Chair OAKAR. Well, the Government had—it has embarked on a massive sell-off program. Apparently the idea is to dampen the expected increases in prices of the commodities that would result from reductions in supply. What precautions are being taken to ensure that major food processors and food companies, as well as overseas trading partners are not buying U.S. Government-owned grain in order to hoard it or sell it off later at inflated prices?

Mr. WILSON. Where the Government has had a fairly aggressive policy of releasing stocks from commodity credit corporation reserves, we have done that mostly in the case of feed grains. The immediate impact of this drought is on the livestock sector. It has been felt particularly in dairy producing areas and where there are beef cow herds that don't have enough forage or grass and water levels are down. So, they are having to sell off those cattle.

The secondary impact is on the feeding operations—cattle feed lots, poultry, and hog finishing operations. What is impacting that sector is high corn prices and high soybean prices. To the extent that the Government has stocks, the worse thing we can do would be to hold those stocks back from the market.

We have to get those stocks out there to try and meet the needs of those livestock feeding operations and try to contain the damage to that livestock sector.

Chair OAKAR. Dr. Seale, in the past 2 months we have seen incredible price swings in the commodity markets. You alluded to

this somewhat in your testimony, and I wanted you to elaborate a little bit, because of the severity of the drought or possibly not because of the severity of the drought. But is this simply individuals profiteering from other's misfortune, or are there signs that prices on the soybean and corn futures are indeed being manipulated, and if there are any signs of that, what can you do, what authority do you really have to halt this kind of manipulation?

Mr. SEALE. The answer to the latter question, first, we have a great deal of authority, but we see no evidence of a market manipulation in the grains at this time.

Chair OAKAR. What could you do if you did see evidence of it?

Mr. SEALE. Well, certainly there are—the CFTC has the authority up to and including stopping trading, that is closing of a market. That would not be the normal kind of response to a manipulation. The more normal type response would be an administrative enforcement action which the agency has brought on occasion over the years.

Chair OAKAR. Well, you know, there have been these terrific swings, in prices. I mean, aren't you a little surprised at the ups and downs?

Mr. SEALE. The market places tend to react to stress with volatility, and what I think we are seeing essentially is a market place that is trading on expectations of traders and weather is an enormous unknown. Remembering all the time that this is a commodity trading is a net zero sum game.

One person's gain is another person's loss. We see again no evidence of any individual or groups of individuals who are pushing this market and causing prices to be higher than what we would view as a reasonable equilibrium price.

Chair OAKAR. Can you give me a for instance? What would be some signals if there was manipulation? Can you give an anecdotal example?

Mr. SEALE. If I were to—generally speaking, text book manipulations would occur as follows: One would have a marketplace in which was fairly lightly traded, where the individual who is going to manipulate the market place on the long side could in fact control the underlying, physical, deliverable supply.

That would be an entry level, necessary condition for a manipulation. Then in fact you would see a price that was unsupported by fundamentals. And you would at that point be into the entry level area of manipulation.

Chair OAKAR. Well, yesterday, on the Board of Trade—there was a tremendous plunging of the soybean futures area as a result of, I guess, of possibly the weather forecast. But as the drought persists are we going to witness these artificially high price tags that are attached to a futures contract?

Mr. SEALE. Madam Chairman, I am not sure that the prices we are seeing are artificially high. I think the prices we are seeing are the equilibrium prices at the moment for sometime in the future based upon the expectation of traders. I think certainly as the drought continues that we would see continued high volatility.

Chair OAKAR. When you see prices go up from \$6 to \$10.30 for a crop that does not—or a commodity that really isn't as affected by the drought as others, it seems to me that what I think the Chair

is interested in is how this is impacting on the consumer and whether or not there is some manipulation going on, and frankly, I look forward to the report of Mr. Wilson.

You mentioned it is coming out July 20, but you seem to give the idea that we are not going to see tremendous increases in prices, and yet, when you take a look at the exchange, you know you are seeing all this activity and increases in sales in the amounts of the commodities.

So I am just wondering how all this fits together. Obviously we are in a state of crisis, but we don't want to see the consumer violated upon just because there is sort of an advantage taken at a time when people are very aware of the effects of the drought and, yet, I am not so sure that some of what is going on is really justified.

That is why I thought maybe you would come today and give us some idea of what we can anticipate in that report.

Mr. WILSON. The real key question is what is going to happen from the weather from here on out. As we watch these markets, they have reacted very strongly to changes and perceptions about the weather.

Last Wednesday, I believe it was, there was an indication that there would be some rain up in the north central areas and the following day we saw the nearby soybean contracts drop by 83 cents. There are no limits on that contract because it was a nearby expiring contract.

The previous few days we had seen the market raise the limit because the forecast had been for dry weather. Every time there is a weather forecast the market reacts to it. We saw that again yesterday.

We put out three times a week, on Monday, Wednesday and Friday, a short-term, 6- to 10-day weather outlook. The USDA and the National Weather Service do that jointly. The report they put out yesterday indicated that we might get a little bit more rain over this 6- to 10-day period and I noticed this morning that the markets were down quite sharply in response to that.

So the markets are very, very sensitive to what the weather forecasters are saying.

Chair OAKAR. Let me ask you this: I mentioned examples of prices going up fairly dramatically in the last few weeks in the cereal industry. Do you think those markups were justified?

Mr. WILSON. Based on what we know about those specific commodities, the oats and the durum wheat, in particular, that there is no reason to think that those price increases were too high. I think they are reflecting what is going on in the market place.

Chair OAKAR. Let me call on Mr. Roth.

Mr. ROTH. Thank you, Madam Chairman.

I appreciate the good testimony we had here this afternoon. I think we are all looking for answers and sometimes there are no answers to some of these questions.

I know Mr. Wilson is sensitive to the problems that are taking place in the dairy industry, especially, and I would like to ask what is being done to mitigate the effect of the drought on our dairy farms.

Mr. WILSON. Let me go through a list of some of the things we have done, Mr. Roth. The immediate problem is that we don't have enough hay for the dairy people and feed prices have gone up. As far as hay goes, we have allowed hay to be cut from land which normally we wouldn't allow hay to be cut from. We are doing that on a county-by-county basis.

As of yesterday, we had 1,819 counties, in 36 States where we have approved emergency haying and also allowed livestock cattle farmers to run their cattle on that land. Normally they wouldn't be allowed to do that.

Mr. ROTH. If I may interrupt, Mr. Wilson, you have an emergency feed assistance program. That is what you are referring to, right?

Mr. WILSON. Yes. That is a separate program. We also have approved 323 counties in 20 States to participate in that emergency program.

Mr. ROTH. I am more or less interested in Wisconsin and we have only four counties in Wisconsin which have been approved and what I would like to know is are you expanding that program and how is that developing?

Mr. WILSON. That program has been expanded, or is being expanded every day. It started off slow. The immediate action was to free up additional hay supplies. This emergency feed program is the second level of response. We are seeing more counties coming in every day applying for that program.

We are turning around those applications on a 1-day basis. So they are building each day.

Mr. ROTH. I didn't mean to interrupt the answer you were giving, but since you stopped, I will throw this other question in. I am interested also in the 50-cent proposed cut as of January 1 in the dairy price support.

Are you advocating that we do not implement that price support?

Mr. WILSON. Well, that is something of a different question. The law, as currently, written says that we should estimate how much the Government is going to buy from the dairy producers in the calendar year of 1989, how much we will remove and put in CCC storage.

If we estimate that we will take more than 5 billion pounds off the market, the law gives us no flexibility there. There is no discretion. The Secretary has to cut 50 cents off the support price of milk.

Mr. ROTH. Well, we are going to hopefully change that law. The other thing is you are not going to have 5 million pounds because the dairy industry is down in Wisconsin 5 percentage points and it is going down lower.

Mr. WILSON. The question is will we even hit that 5 billion pounds next year. Everybody thought we would but, under current conditions we have a very different picture and the prospects are different.

Mr. ROTH. As Madam Chairman mentioned, the price of certain commodities going up, the American consumer is going to be lucky if they have dairy products after a while because there is not going to be enough production to take care of the need as I see it.

Mr. WILSON. I don't think there is any fear we will run out of dairy products. We have enormous capacity to produce. I don't want to minimize the damage to certain areas of the country and your State has been very hard hit by this drought, but there is no way that we are going to run out of dairy products.

In fact, fairly recently there was a national commission on dairy policy which was made up of 18 dairymen, dairy operators, and they reported in that report that we should see some tremendous new technology in the years ahead which will result in additional supplies of dairy products.

Mr. ROTH. I am sure that is going to take place because of growth hormones and so on. We have the question that we in Congress are going to be asking and others will be asking, how much corn do we have in storage? How much wheat do we have in storage and dairy products. We get a lot of information and I have never been able to talk to anyone and pin them down and say this is how much corn we have.

Mr. WILSON. I can tell you the precise numbers. We did a survey on June 1 and nationwide we have 5.8 billion bushels of corn. That would be enough to carry us through the next 8 months and satisfy all our domestic livestock industry, all our other domestic use and all our export customers.

Mr. ROTH. So if the drought continues, we have 8 months supply. That means we are going to have a shortage sometime next spring.

Mr. WILSON. We will start harvesting a new crop September 1 this year. At that point, we will—

Mr. ROTH. If we have a crop, of course.

Mr. WILSON. We are not going to lose the entire corn crop. We will go into that year with at least 4 billion bushels, which would keep us going 6 months.

Under the worst possible case scenario, we may see a crop that was 4 to 4.5 billion bushels. That would still be over 8 billion bushels total, which is more than we have ever used in a year.

Mr. ROTH. We are not sure. I have been out in these corn fields. I don't know if I would agree with that assessment, but that is my opinion.

Mr. WILSON. I think in certain areas of the country there will be people losing their entire crop, but we will harvest a smaller corn crop this year and combined with the huge supplies that we have on hand today, we have enough to carry us over the next year.

Mr. ROTH. My fear is that what is going to happen to corn in Wisconsin and Iowa is pretty much the same thing that happened to durum wheat in North Dakota.

Mr. WILSON. Corn is grown in many more States of the Nation. The big problem with this drought is that there is a terrible impact in the heart of the Corn Belt, and if we don't get rain in the Corn Belt, then we will suffer tremendous losses.

Mr. ROTH. Thank you very much. Thank you, Madam Chairman.

Chair OAKAR. Let's just talk a little bit about the corn issue. Last year the corn crop approached approximately 7 billion bushels. What do you anticipate from this year's corn harvest we will have? I took a little ride out in Ohio's corn crop area, and my gosh, usually at this time of the year you see those corn stalks really high, and it doesn't look like it has grown at all.

What do you anticipate will happen to the corn crop? Do you think we will have any?

Mr. WILSON. The crop looks terrible in your State, I know that. Earlier this year we made an estimate, projection, of a 7.3 billion bushel crop prior to the onset of the drought. We know now that we are not going to reach that level. Next Tuesday we will be putting out a new estimate of what we think that crop will be. I don't know what that estimate is going to be.

Let's just take a look at some possibilities. If we were to suffer a 25 percent cut in yield, which would be catastrophic by historical terms, we would still have a 5.5 billion bushel corn crop. If you get an even greater loss in yield, 33 percent, which I don't think we have ever suffered in history, we would still end up with a 4.9 billion bushel crop.

If you said the worse possible thing you can imagine would be a 40 percent cut, you would have a 4.4 billion bushel crop.

Chair OAKAR. Well, how many bushels are there in storage right now?

Mr. WILSON. 5.8 billion as of June 1. Now, we have used some of that, so it is less than 5.8 today.

Chair OAKAR. How much are you selling off a day?

Mr. WILSON. Out of the Commodity Credit Corp., it has varied, anything between 20 million bushels up to—the week of June 22, we did 72 million bushels. That was for the week.

Chair OAKAR. Well, see, my staff gave me the figure of 4.2 billion bushels of corn in storage. Your's is slightly higher than that.

Mr. WILSON. I think that 4.2 billion would be the figure for September 1 of this year. They are projecting ahead which is—it may be a little low, but I think it will be a bit more than that.

Chair OAKAR. If you took that rate as of September then, and you sell it off at 20 to 45 or 25 million bushels a day, then you would drop to 1.1 billion bushels in July, and—or in the future, and you would really exceed the minimum level of the law; am I correct about that?

Mr. WILSON. But we will be harvesting a new crop before we get to that point.

Chair OAKAR. Aren't you anticipating that the new crop is not going to do so well?

Mr. WILSON. Yes, but even if you assume the worst possible reduction in yields, we will still have enough with that 4.1 or 4.2 billion bushels to get us through the next year.

Chair OAKAR. Why are we on this big selling spree? I mean, aren't we on kind of a selling spree at a time when we can't afford to be on the selling spree?

Mr. WILSON. The worst possible—

Chair OAKAR. You really make it sound so optimistic and yet to be honest with you, when you talk about prices increasing 3 to 5 percent, and we haven't gotten into the revised estimate of retail prices, are you just being overly optimistic and yet you are selling off at sort of a record pace?

I guess I am trying to get a handle on what the Government's philosophy of what the current situation really is, and how you really are trying to address this problem. I don't think there is a

real rhyme or reason in terms of how you are trying to address the problem.

Mr. WILSON. Well, the immediate problem is the livestock sector. The livestock sector has been adversely effected by higher feed costs. The Government owns a lot of corn which is the primary livestock feed. The worst possible thing we could do right now would be to hold that corn off the market when there is such a need to try and get it out to the livestock sector.

If we were to hold it back, we would only worsen the damage to the livestock sector. We can contain the damage to the livestock sector. That then will result in maintaining herd sizes and we won't have the big run up in meat prices in 1989 and 1990.

Chair OAKAR. Let me ask Dr. Seale or you, Mr. Wilson, what warning signals you see in terms of profiteering and speculation. Are there any, and what factors do you think will go into having an inflationary triggering take place?

Do you see that happening at all with respect to materials that are processed by food processors and will consumers then decide that they might have to stockpile certain commodities themselves? How do you fit the whole picture in or are there any futuristic kinds of views about the possible inflationary triggering that might take place and what we can do to prevent this?

Mr. WILSON. I don't think there is any need or any fear that we are going to run out of food. We have large grain stocks. We have record large supplies of meat and poultry which will actually be bigger this year because of the drought than if we hadn't had the drought. There simply is no way that we can run out of food.

There will be some items where we see some shortages, things like oats, where the crop has been hard hit, durum wheat, but across the board it is very unlikely that there will be any major impact on the food prices or any widespread shortages.

Chair OAKAR. You don't think that consumers should be apprehensive and because of this apprehension, act in such a way as to produce inflationary impact? You don't see that as a possible scenario, I gather?

Mr. WILSON. No, because we have large enough stockpiles to get us through this year and then we have a huge acreage of land that is not in production this year that can be called back into production next year.

We already have announced that we will allow farmers to plant 12 million more acres of wheat next year. If the corn crop comes down, we could allow them to plant more corn next year. So we have an enormous capacity to produce and I have no doubt that we will see supplies increasing again next year.

Chair OAKAR. Well, it doesn't seem if that is taking place, though, Mr. Wilson. I mean I am glad you are optimistic, the Chair doesn't see where you are basing your optimistic views. Can you be more specific about all these enormous supplies, because my figures are a little different than yours to begin with, and you are really selling off a lot of the storage materials, and I am just wondering on what basis you can be so optimistic.

Mr. WILSON. I am only optimistic in the sense that we are not going to have runaway food prices. There is no indication that that will happen because we have large supplies.

As we look at the stocks on hand and we look at the livestock numbers and look at poultry production, there is just no reason to assume that we are going to be in an inflationary situation in food.

Chair OAKAR. So the consumer should anticipate, based on your optimism, that the prices of food commodities will not be dramatically increased; is that—there won't be the justification for increases that some might like to have?

Mr. WILSON. We are estimating that the impact of this drought will be a 1 percent increase on food prices this year.

Chair OAKAR. So about a penny on every loaf of bread or that would be the most—

Mr. WILSON. The wheat situation is fairly stable. We are now well into the winter wheat harvest. Over  $\frac{3}{4}$  of all the wheat we grow in this country is winter wheat. As of last Sunday, we had harvested 65 percent of that crop, so that the crop harvest is well ahead of normal, one of the reasons is that in this dry weather you can get the combines out into the field and get the crop off.

In Oklahoma they have got an excellent crop. In several other States the wheat crop looks fairly good. Now, the problem in wheat is related to the spring wheat crop which was planted this spring and is now developing up in the Northern Plains States and there is no question that when you look at the spring wheat crop, there will be some substantial losses.

Chair OAKAR. Let me ask you, are there any conditions currently severe enough to warrant Federal emergency relief to the drought stricken areas?

Mr. WILSON. The Department of Agriculture has implemented a lot of emergency programs. Essentially those programs are providing additional hay and forage. We are doing that in over 1,800 counties.

We also have an emergency feed program and an emergency feed assistance program, one of which provides cost sharing when the farmer buys feed, another of which provides Government owned grain at a subsidized price. Those programs have already been put into effect.

Chair OAKAR. Well, how do we protect the consumer if we see that there aren't emergency needs that need to be remedied, other than what you have described, and we shouldn't be overly apprehensive about the increase in places, that it will be somewhat modest increase based on the situation, then who protects the consumer from possible food companies and food processors? How do we avoid those individuals overtaking the market in such a way as to increase their prices without the justification?

Mr. WILSON. The food processing industry is a highly competitive industry. If we had situations where we had one company or a small number of companies controlling the entire markets, then there may be reason to be fearful. But that is not the situation. We have a lot of companies engaged in the business and there is very vigorous competition between those companies. So, I just don't see any real threat of food prices being driven up by profiteering of the food processors.

Chair OAKAR. Mr. Seale, would you want to comment on this? Because on page 2, you talk about—let me just read the section, because I think I have to go through the whole section.

"In response to the drought insuring price volatility, the CFTC has intensified its surveillance efforts on several fronts. Our market surveillance staff is monitoring the markets for any indications of price manipulation and for violations of the CFTC speculative position limit rules."

Would you like to describe what that is?

Mr. SEALE. Madam Chairman, in the grains there are limits to the size of a position, either long or short, that a speculator might hold. These limits are essentially 3 million bushels in soybeans and wheat and in the spot month and in all months combined they are somewhat larger than that.

Our staff, on a routine basis, weekly basis, looks at what we call the Federal spec limits, those limits that we administer, and adopt via CFTC rulemaking to determine if, in fact, any speculators are in excess of those limits, either long or short. We have not found violations of that nature.

Chair OAKAR. You are closely monitoring, obviously from your testimony, and your remarks today, you are really closely monitoring this situation, correct?

Mr. SEALE. Madam Chairman, price volatility is a signal to us always and that signal, in fact, triggers numerous things at the agency, including increased market surveillance of those markets. We will continue to do that until, in fact, the volatility looks something like normal, or what we would be used to in a normal year and which would mean that we would be looking at these markets, I would assume, for the ensuing 12 month period on a very, very close basis.

Chair OAKAR. To what extent—for both of you gentlemen—to what extent does the Agriculture Department, in terms of your staff, for example, Mr. Wilson, relate to what Mr. Seale is doing in terms of what he just described? Do you communicate? Are you briefing each other? I would think that in a time like this you would be more in communication than ever before.

Can you describe how you comprehensively have an overview of the situation?

Mr. WILSON. We do have a regular liaison between the Department of Agriculture and the CFTC. That liaison is conducted between people who report to me and the surveillance people over at CFTC. I know they communicate weekly and often participate in the CFTC meetings. We exchange information. I talk to Commissioner Gramm periodically, so we do have a fairly close working relationship.

Chair OAKAR. Mr. Seale, on page 4, at the bottom of the page, you talk about your surveillance and oversight procedures and that the Exchange conducted adequate function surveillance of members and they contact firms when necessary. Under what conditions would you contact firms necessary to verify their margins and compliance? What would trigger your wanting to contact a firm?

Mr. SEALE. Madam Chairman, would you give me a second and let me read the sentence we are referring to here?

Chair OAKAR. OK.

Mr. SEALE. We would be interested basically in two things. The first one would be concentrated positions; that is, if a carrying

FCM had extremely large portions of the market within that firm, whether it is combination of customer accounts or proprietary trading.

The second thing we would be interested in is we have capital requirements for our futures commission merchants who are our registrants and do business with the public, and we are continually monitoring these firms to see that they are in capital compliance and have sufficient capital to carry the size of the position with which they are carrying.

Chair OAKAR. Have you in the last month or so had to contact any firms? You don't necessarily have to go into who they are, but I am just curious. Are there any firms that you have contacted?

Mr. SEALE. Madam Chairman, I have Paul Bjarnson, who is our chief accountant, with us. Let me ask him to respond to that question, if I might.

Mr. BJARNSON. Generally, we follow what the exchanges do in this regard. For example, in the case of the Chicago Board of Trade—

Chair OAKAR. Would you like to just pull up a chair for a second there? It would probably be easier.

Mr. BJARNSON. It is the staffs of the exchanges, such as the Chicago Board of Trade, in this case where the markets that are so volatile that follow the financial positions of the firms. In the case where the market is moving against the positions of a firm, the exchanges can anticipate when there is a large margin call going to be made, and what they worry about is whether or not the firms are going to be able to meet the margin call at the clearinghouse.

There have been occasions over the last month when they have been contacted. But in no case has there been any failure.

Chair OAKAR. Why did you contact them?

Mr. BJARNSON. Our records show what the capital, the size of the capital positions is, and, for example, if a firm has \$3 million in net capital and they are anticipating that a \$6 or \$7 million margin call will be made, then they would call a firm to find out who the customers are that need to bring the margin in and whether those customers are expected to meet the margin call.

Chair OAKAR. Are expected to what? I am sorry.

Mr. BJARNSON. To find out whether the customers are expected to meet the margin call.

For example, in the current market many of the large firms, rather, many of the large customers that have to meet the margin calls are large commercial firms. So where the customer is a large grain processor, a margin call of \$20 million wouldn't be large for that customer.

Chair OAKAR. When you—you are an auditor, is that correct?

Mr. BJARNSON. I am the chief accountant. We have a staff of auditors at the Commission.

Chair OAKAR. Right. When you contacted these firms what convinced you that everything is fine? How—what standards do you have to monitor this? Can a Member of the Banking Committee—I guess we are more aware of—not that it is totally comparable I know the rivalry between Wall Street, Chicago and so on. But it is a false one, but nonetheless, we are somewhat more familiar with

how that is operated and some of the problems we have had recently.

I am just wondering how—you don't hear too much about the oversight of this exchange and how it is monitored. That is why I think for the benefit of the committee, since it could have a tremendous impact on the consumer and on prices, I just thought maybe you would go through the process somewhat for us.

Mr. BJARNSON. OK. Well, over time, we have had many volatile markets. These firms have a known history to our staff and the staffs of the exchanges. We receive regular financial reports from the firms. The annual financial statements are audited so we know we can rely on the correctness of the financial statements.

We also coordinate with our Division of Economic—the Commission's Division of Economic Analysis, and look at who the large traders are.

There is also a known history of certain large customers that appear regularly as holding large positions.

So at any point in time, such as the recent volatile market, the firms that have large margin calls to meet at the clearinghouse as well as many of the large customers—or rather, large traders is the correct term—who have to meet these margin calls, they are not new actors. They are not new players.

So, through a learned history of experiences with these firms and large traders, and our experience with the exchanges, we can develop a feel for when there might be a problem.

Chair OAKAR. Have you ever—I don't know how long you have worked at your present place of employment, but have you ever found any that you felt were problematic?

Mr. BJARNSON. Well, we have had occasions when there have been margin problems, such as the case in 1983 of Volume Investors Corp., which is not in the agricultural products. That was a case in metals markets.

Chair OAKAR. Mr. Seale, what do you do in a case of any perceived abuses? Do you try to profit or do you import it to another agency or—

Mr. SEALE. Well, Madam Chairman, the problems with what we are talking about here is a problem of a clearing firm not having cash to put in a margin call. That is pretty obvious. You are going to know that overnight. The best of all worlds solution is basically a transfer of those positions to another carrying of FCM and get the fellow who doesn't have any money left, and has used his capital out of business.

It is pretty rare that we have had situations occur where there hasn't been a voluntary dissolution of a business. Oftentimes a firm will recognize its approaching financial problems and will say I want to sell my customers. I want to transfer my customers. I want to move someplace else, along with the original margin.

The marketplaces have been unique in the fact that there have not been enormous customer losses, nor defaults. There haven't been problems in these marketplaces. Over the years the problems we have seen have basically been isolated, and have been fairly small problems.

The clearinghouses that hold the money, particularly at the larger exchanges, have become very, very sophisticated. At the

smaller exchanges they are very sophisticated in getting the financial integrity of the marketplace issue resolved on a daily basis. We have not seen, and don't anticipate seeing, problems with collection of margin on a day to day basis in these markets.

It is always in every clearinghouse's, every exchange's best interest to see that the pot is right at night before you trade tomorrow, because you really can't trade tomorrow, and, in fact, it is sort of a self-destruction to allow yourself to fall into a situation where your clearinghouse isn't collecting margin, has not been a problem.

The exchanges in the United States are unique in the fact that they are old and they tend to know their customers to a great extent. Some of the exchanges are 140-150 years old. Several of them are over a hundred years old. They have become extremely sophisticated in being able to identify what they think might be problems and resolving those problems before they reach the level of being a problem.

Chair OAKAR. So you don't have any Ivan Boesky's in your exchange, is that what you are telling the Chair?

Mr. SEALE. Madam Chairman, I don't mean to imply—let me say that Mr. Boesky was a participant in the futures market, although he was not a problem in those markets.

Chair OAKAR. I didn't know that, but you don't have that kind of manipulation that—have you ever seen anything—

Mr. SEALE. There have been from time to time manipulation cases brought by the predecessor of the agency which was at the USDA before 1974, and there have been manipulation cases brought by CFTC since 1974. They are not our bread and butter kind of business at the CFTC. They are very, very rare occurrences when you see one that a person attempts to manipulate a marketplace.

Chair OAKAR. Just one last question before I turn it over to my friend, Ms. Kaptur.

The USDA report is going to come out in the near future. Are you setting up—I would think in this climate you would be on the alert, maybe a little more sensitive than you might be otherwise. Maybe you are always monitoring with the full impact of what monitoring is supposed to produce, but are you taking any special precautions at this point in time in anticipation of that report?

Mr. SEALE. Our Authorizing Act of 1974 provides for liaison with the USDA. We have had for some 4 or more months now regular participation by the USDA personnel in our Friday surveillance meetings, and we look forward to continuing that, as long as the market volatility remains, in the future.

Very frankly, I suspect that if you were to ask a surveillance economist how you make a living, they would say we go to where volatility is. There is volatility in those markets and as long as there is volatility there there is going to be close scrutiny.

There is also the issue in these markets that we are dealing with something that everybody has got to do, and that is eat, and as a consequence, I think there is some overtone of urgency of our taking a look at these and we will continue to do that over the next few months as diligently as we have over the past few.

Chair OAKAR. Really, the futures trading really was completely agricultural, as I recall, and now there is a tremendous diversifica-

tion where you are dealing now with raw materials and currency, foreign currencies, and commercial interest rates. I don't mean you, but the monitoring that you have to do is a little different than it was 10 years ago. Am I correct about that?

Mr. SEALE. Markedly, markedly different. But the agency's roots are in the Department of Agriculture and a number of individuals that we still have on our staff in 1988 came to the agency when it was formed in 1974 from the old CEA, which is at the Department of Agriculture. We pay very particular attention to agricultural commodities.

Chair OAKAR. But see, I think there is a relationship between the agricultural commodities and the whole issue of trading, and possibly the area of currencies and interest rates, which are now becoming more and more obvious in terms of the Futures Trading Commission—at least it should be more obvious.

I don't know to the degree that you can compare it with Wall Street in some of these areas, but I will tell you something. I am guessing we haven't done enough in this area to take a look at it. I don't even cast any negative aspersions at all on the work you are doing. I am just saying that I think this is an interesting time, where we really should be doing more oversight hearings on what is going on.

Ms. Kaptur.

Ms. KAPTUR. Thank you, Madam Chair.

I first want to commend the Chair for being the first subcommittee Chair on the Banking Committee to hold hearings in this extremely important area. I think our financial system is not only being affected but will be affected by this and I appreciate the witnesses being here today.

I wanted to ask Mr. Wilson—I read your testimony even though I was not here for it. I am interested in worst case scenarios at this point. I come from northwestern Ohio. We are in the extreme designation by the Department of Agriculture now, extreme to severe, but believe me, it is severe. Everything is burned up. We have lost our corn, at least in my district. I don't speak for every area in Ohio, but we have had no rain since May. This has never happened in the history of our area. So it is becoming serious. Our lake has dropped 18 inches. A lot of our wells are starting to dry up.

I am curious, first from a national standpoint. Let's say that we get no rain. How long do our supplies hold out before we have to start importing more and paying for more imported goods, whether they be beef or grains?

Let's say that nothing changes this year. We continue to draw down existing supplies and then we have a drought next year. How long do we have? Not being on the Agriculture Committee, I am not someone who follows that that closely. But could you set this, drawing a worst case scenario, how long do we have in terms of our built-up supplies? How long will it take us to draw them down?

Mr. WILSON. We have pretty good stock levels right now for our major commodities. Wheat stocks are plentiful and we are well into the winter wheat harvest. Almost  $\frac{2}{3}$  of the winter wheat crop is already in the bins as of this past weekend. So as you look at that, we have today more than 2 billion bushels of wheat. If we didn't harvest a single additional bushel from here on out—and of course

we will complete the winter wheat harvest—we would have enough to keep us going for 10 to 12 months.

Ms. KAPTUR. In other words, you might not anticipate a price increase until sometime—

Mr. WILSON. You will see price increases if the market believed we were never going to have another harvest, and certainly you would have problems.

As we look at corn, we have plenty of corn. On June 1 we went out and we measured that. We had 5.8 billion bushels then. We won't start the new corn harvest until September of this year, but even at that point we should have well in excess of 4 billion bushels left. At that point that would be enough to keep us going for 6 months, if we didn't harvest a single bushel out of this crop.

But as we look at history, we have never had a year where we had a yield reduction of more than 28 percent. So you say, well, this is the worst year on record, and what happens if we have a cut of 33 percent? And we have taken a look at that. If we did that, we would still have a corn crop of 4.9 billion bushels. So you add the 4 billion bushels we will carry into the new crop year with the 4.9 billion, you are up close to 9 billion bushels of corn. We have never used that total amount in a year domestically plus satisfying all our export customers.

So we are not about to run out. Now, we are going to see substantial losses in certain areas. Ohio has been very, very hard hit. The Eastern Corn Belt is the area of the country that just hasn't seen any precipitation for well over a month now, and that is a terrible problem.

Chair OAKAR. Will the gentle lady yield on that, because your line of questioning was similar to what I asked. I guess the issue here is that what we are trying to do really is establish a kind of record on this whole issue. I know you can't predict every little thing that is going to take place in the future, but I think this optimism which we hope takes place, we hope is warranted I should say, is terrific, but it is on the record.

So I think from time to time we are going to be having hearings on these and other interrelated issues, and make some judgment comparisons.

Ms. KAPTUR. I think that you are an excellent witness. You answered my question and you gave me some outer time horizon to look at. I hope it wasn't repetitive based on what the Chair asked.

Chair OAKAR. No, no. It was an important question.

Ms. KAPTUR. Could you also give me some idea on what has been happening? We have got the people here from the Commodity Futures Trading Commission. I have not been monitoring the prices as closely as I could on the Chicago markets, but are we yet seeing any reflection in the marketplace of a rise in a commodity like bread? Is any of that happening yet?

Mr. SEALE. I don't understand the question.

Ms. KAPTUR. Based on the market's anticipation of future draw-downs in supply, are we yet witnessing any price inflation in any sector due to—or is it too early?

Mr. SEALE. That is Mr. Wilson's question.

Ms. KAPTUR. There is a relationship between what is sold over in Chicago and what happens to bread in Toledo?

Mr. WILSON. The latest price estimate we have—and these are put out monthly by the Bureau of Labor Statistics—is for the month of May. Price of white bread in the month of May was up  $\frac{1}{10}$  of 1 percent. That is prior to the onset of this drought, but there had been some increase in wheat prices at that point in time simply because our stock levels this year were lower than they were a year ago.

There was no anticipation at that time in May that the drought would be quite so severe. It was too early in the season.

Ms. KAPTUR. With the storage that we have, with the commodities in storage now, would you anticipate that the markets would reflect any price increase or are they going—from your knowledge of what has happened in past years, are they going to remain fairly steady through the rest of the year?

Mr. WILSON. We think there will be some impact, but we think the impact will be moderate. If we look at bakery products and cereals, things that are made out of wheat, typically the farm price of those products accounts for about 8 percent of the retail value of those products. So if you have prices at the farm gate going up by 30 percent, that would be equivalent to about 2.4 percent at the retail level.

We will see some of that price increase at the retail level, because of this drought, but I don't think it is going to be any case of runaway prices. The overall inflation for food will be fairly moderate this year.

Ms. KAPTUR. Would you expect that that would effect all food categories equally or do you think it would reflect it more in products that have a lot of grain? It is obviously affecting livestock already. I haven't seen what has happened to beef prices but imagine we are getting a temporary decline, temporary.

Mr. WILSON. That is exactly right. The situation for beef people right now is that they don't have any way of maintaining these animals. They are short of forage.

Ms. KAPTUR. What about poultry?

Mr. WILSON. Poultry we had seen some price run-ups prior to this, but I don't think that was associated with the drought. Now, to the extent that it is going to be more expensive to feed poultry because corn prices have gone up, and soybean meal prices have gone up, that is going to have an impact on future production of poultry. It will discourage growth in that industry and by the end of this year, we could see some increases in poultry.

Ms. KAPTUR. Thank you for that.

I did have one other line of questioning, Madam Chair, I would like to pursue just a second here with the people who came from the Commodity Futures Trading Commission.

Your chairman—is it Mr. Gramm? Chairman Gramm is on that Interagency Drought Policy Committee, I believe. Is that correct?

Mr. SEALE. Chairman Wendy Gramm is on the committee, yes.

Ms. KAPTUR. All right. Do they meet on a weekly basis?

Mr. SEALE. I am uncertain of their meeting. They met—to my knowledge, they are meeting weekly.

Ms. KAPTUR. I would like to give you an issue to take to that group. We have our own Congressional Drought Task Force here. It is an issue I am particularly concerned about, coming from the

Eastern edge of the Corn Belt. That is, if things don't get any better, how we are going to provide liquidity to the markets in the trading that is occurring?

I come from a district that sits on the Great Lakes and we have many elevators. We have participants, companies that participate in futures trading very heavily, because we store the grain, and we ship it from my district. So we have very large elevators. Most of these companies have to get their financing out of New York from major financial institutions. Since May their margin calls have been very heavy, multi-millions of dollars at this point.

I guess I haven't heard much from the administration on this, nor from Congress, but I think, depending on how things go, we will probably hear more. If you could do me a favor, from the executive side, that would be to introduce the issue of liquidity to the markets in the weeks ahead, how are we dealing with that?

I am particularly concerned with the grain trade, obviously, there. There is a national, I think it is called National Grain and Feed Association or Feed and Grain Association, and most of their members are getting caught in this. I think we have to look very closely now at some of the financial questions that would involve the New York Federal Reserve and at least anticipate a worst case scenarios if we don't get rain, and what is going to happen to a lot of these firms.

I think the banking system has a very important role to play here. I think it is an issue that at least one could look at in the context of an interagency task force. I think that really falls on your shoulders, Mr. Seale.

Mr. SEALE. I would be happy to bring the matter to Chairman Gramm's attention. However, do be advised we have nothing to do, as an independent regulatory agency with the cash marketing of grain or the financing of grain. But I will bring that to her attention.

Ms. KAPTUR. Fine. I brought it up with the chairman of the full committee today and I came here today specifically to do that, because when the October 19 situation hit, really it was the New York Fed that operated with a cool head and they had anticipated and they were prepared to keep liquidity in the markets.

So you are the first people I have been able to get to who serve on the executive side, so that is why I am presenting it to you. I think there may be difficulties. In fact, I think the gentleman in the beige suit there—I didn't catch your name—the accountant, you mentioned some calls had been made concerning margin calls these past several days.

Mr. SEALE. We have not seen a problem at this point with the pace and collection. All margin calls have been met on a timely basis, and are being met.

Ms. KAPTUR. Right. There is some screaming among the smaller firms that it is really getting tight. I am saying even some of the larger firms, they are really monitoring this now and they are worried.

Mr. SEALE. I thoroughly agree, and it takes me back to my days as a university professor when I would explain to the banking sector vociferously that once a hedge was on, in fact you had to hang with your commercial end and make money available for var-

iation margin payment no matter which way the market went. I think—certainly I will be happy to bring that to Chairman Gramm's attention.

Ms. KAPTUR. Thank you kindly.

Thank you, Madam Chairman.

Chair OAKAR. Thank you.

I just want to ask one more question about this wheat issue. First, let me ask you an easier question. Are we experiencing a worldwide drought situation that could have an impact on our trade with other countries?

Mr. WILSON. The crop conditions in other areas of the world look about normal. The Canadians, of course, are suffering from the same weather pattern that we are suffering from, so if you look at some of the western wheat growing provinces of Canada, particularly close to the United States border, they are suffering and have experienced some loss in their spring wheat areas. When you go north in Canada, they do have pretty good rainfall. So it is fairly localized.

Chair OAKAR. I am going to put in the record this map that really in kind of a nutshell—I am not sure it is totally detailed—but at least in general terms it goes into the drought's worldwide trade impact and shows India, for example, and China, are experiencing this kind of drought, and Africa—that our drought may affect the famine in Africa because we may not be able to market the grains that we potentially should have, but may not have.

That is why I want to get back to the spring wheat crop, winter wheat crop issue. The drought, you mentioned, has severely damaged the spring wheat crop. Am I correct about that?

[The map referred to above entitled "Drought's Worldwide Trade Impact" can be found in the appendix.]

Mr. WILSON. We will get a better assessment of that next week when we come out with the July crop report, but based on what we know at this point of the season, we would have to assume that there has been some substantial damage.

Chair OAKAR. Well, the winter wheat crop is being harvested now and as a result, it is not hurt yet, correct?

Mr. WILSON. The winter wheat crop looks fairly good.

Chair OAKAR. That accounts for  $\frac{3}{4}$  of the Nation's wheat production, correct?

Mr. WILSON. Yes.

Chair OAKAR. Doesn't that then argue against these price increases and shouldn't that be reflected in the trading on the commodity exchanges?

Mr. SEALE. Wheat futures have risen less than other futures, that is, corn, oats and soybeans. We are not in a position, as the CFTC, we don't make absolutely price judgments other than does it appear to be an equilibrium price, which is supported by fundamentals in the marketplace. Our visualization or our view of the market is that that is the case.

Chair OAKAR. What is the case? I am sorry.

Mr. SEALE. That the prices, the futures prices that one is currently seeing in the marketplace are in fact not manipulated and in fact are true equilibrium prices that are supported by fundamentals.

Chair OAKAR. All right. I mean, if you feel that it is not being manipulated, or you don't anticipate it being manipulated. But I asked the question because to the extent we are able, we are going to try to monitor these kinds of activities a little more closely. I think we can be justly criticized—Congress—for not having more oversight over these kinds of activities, to the extent that we have more oversight over other kinds of exchanges. I think we should, I really do, particularly now that we see the impact of a drought or are beginning to sift through that impact.

So I am glad to hear you say that. I just hope it is accurate in whatever the fundamentals are that you mentioned. Maybe for the record you could just put in some standards or points that refer to that kind of oversight.

Mr. SEALE. I would be happy to supply for the record why we believe the price is an equilibrium price.

Chair OAKAR. Sure.

Mr. SEALE. As we see it, the current volatility is not without historic precedent. The marketplace behaved the same way that it is behaving now in the last drought, which was 1983. The impact of that drought obviously wasn't as broad as this one, but I will be happy to do that for the record.

Chair OAKAR. Thank you.

Thank you both very, very much. I appreciate your coming at such short notice. It is deeply appreciated by the Chair.

Thank you.

[Whereupon, at 4:30 p.m., the hearing was adjourned, subject to the call of the Chair.]

A P P E N D I X

WEDNESDAY, JULY 6, 1988

Testimony of

Honorable William E. Seale

Commissioner

Commodity Futures Trading Commission

July 6, 1988

Before The

Subcommittee on Economic Stabilization

of the

House Committee on Banking, Finance, and Urban Affairs

Madam Chair and members of the Subcommittee, I am pleased to be here today to provide the views of the Commodity Futures Trading Commission. I will briefly explain how the Commission's surveillance of the agricultural futures markets has responded to the drought-induced price volatility in those markets, and I will be pleased to answer any questions you may have.

As the federal regulator of commodity futures markets, the Congress has charged the CFTC with the responsibility of maintaining the economic utility of futures markets by encouraging their competitiveness and efficiency, by ensuring their integrity, and by protecting market participants against manipulation, abusive trading practices and fraud. Through the maintenance of fair and freely competitive markets, the CFTC better enables the futures markets to perform their economic functions of price discovery and risk shifting.

During the past two months--but particularly in June--agricultural futures markets have been buffeted by the changing prospects of a severe drought in this country's most productive croplands. Prices of grain and soybean complex futures rose rapidly until about the third week of June. Although prices have retreated somewhat in response to some rainfall, cooler weather, and ample near-term supplies, the markets have remained quite volatile.

For example, from May 22 through June 23, 1988, new crop corn futures prices increased 53 percent, soybean futures prices increased 48 percent, spring wheat futures prices increased 43 percent, and oat futures prices increased 108 percent. As market participants collectively try to assess the severity of the drought, its impact on U.S. production, and the effect of higher prices on the export and domestic demand for these commodities, the markets react swiftly to new information--particularly weather reports. We expect this volatility to continue until the extent and impact of the drought is better known.

In response to the drought and ensuing price volatility, the CFTC has intensified its surveillance efforts on several fronts. Our market surveillance staff is monitoring the markets for any indications of price manipulation and for violations of the CFTC's speculative position limit rules. The CFTC financial surveillance staff is monitoring the financial condition of futures commission merchants with respect to the minimum capital requirements and the segregation of customer funds. In addition, the CFTC's contract markets staff has expanded its monitoring of floor trading practices. Chairman Gramm also is participating in the Presidential Interagency Drought Policy Committee.

At weekly surveillance briefings and on a special request basis, the Commission has been advised by senior staff of ongoing developments in agricultural markets. Our surveillance emphasis

has been on these markets since the prospects for a severe drought emerged. The Commission has been advised of large-trader positions, price trends and significant market news regarding these agricultural futures markets. Representatives of the U.S. Department of Agriculture have attended these meetings as part of our interagency liaison activities and have provided insights regarding market developments.

Our surveillance of the agricultural futures markets during this period of rapidly rising and volatile futures prices has not disclosed any evidence of price manipulation. Nor has our surveillance staff encountered any unusual problems enforcing the Commission's speculative position limit rules. It is worth noting that the largest individual futures positions in the grain and soybean markets during the major price advance were short rather than long. During this volatile period these positions were held by large grain merchants to hedge their grain inventories and forward purchases. The largest share of the long positions in the markets were held by smaller traders with positions below the Commission's reporting level.

For the near term at least, the current high levels of trading volume and widespread participation tend to reduce the potential for the activities of one trader to affect the market. Furthermore, the Commission does not have any serious concerns over the availability of deliverable supplies. While the drought

may significantly reduce this year's crops, it should not affect free market supplies until late this year or next because of the large supplies carried into this crop year from prior harvests. In addition, to the extent that higher prices attract grain from government stocks or farmer-owned reserves, free market supplies may be augmented significantly in the near term. In fact, the current liquidations of July 1988 grain and soybean futures contracts have experienced large deliveries thus far.

The Commission's market surveillance staff will be monitoring closely the deliverable supply situation as well as the activities of large traders in these markets in the coming months to detect any evidence of a threat of manipulation or of any other form of major market disruption. The Commission also will continue its review of these markets through its weekly surveillance briefings and special briefings, as circumstances may warrant.

As I previously mentioned, during this period the Commission also has intensified its financial and trade practice surveillance, as is the normal practice whenever volatile markets develop. Specifically, based upon preset parameters the Commission's financial audit staff initiated its "major market move" surveillance and oversight procedures to ensure that the exchanges are conducting adequate financial surveillance of members and to contact individual firms where necessary to verify

the collection of margins and continued compliance with the Commission's segregation and capital requirements. Also, as deemed necessary, on-site visits to firms are being made.

While cash flows at the clearing organizations of several futures markets have increased significantly due to the increased price volatility in their agricultural futures and option contracts, no financial problems have developed. Commission staff has confirmed through frequent contacts with the respective clearing organizations the timeliness of the collection of the daily settlement cash flows during this period. No problems have been identified. Furthermore, the exchanges have provided reports indicating that the cash flows, although very large, have been handled by the clearing system routinely. In this connection it is useful to note that the two largest futures exchanges routinely assess intra-day margin settlements on their clearing member firms, which tends to reduce settlement cash flows and to alleviate potential strains on their clearing systems.

In addition to increasing their financial surveillance, the grain exchanges also have increased margins in response to the increased price volatility prevailing in the grain and soybean complex futures markets. Initial speculative corn futures margins, for example, have increased from \$750 to as much as \$1,800 per contract, and soybean futures margins have increased from \$2,000 to \$5,250 per contract.

The Commission's contract markets staff also expanded its monitoring of floor trading practices by establishing an increased presence on the trading floors. Specifically, the Commission staff has been monitoring the opening and closing periods of trading in the grain markets in addition to observing other periods during each trading session. During floor surveillance, Commission staff observe trading for possible illegal activity, converse with market participants about trading activity generally, and follow up any information they may obtain on rumors or problems which may require further investigation. To date, no problems have been identified.

Thank you for the opportunity to appear before the Subcommittee. I would be pleased to answer your questions at this time.

Statement of Ewen M. Wilson  
Assistant Secretary for Economics  
before the  
Subcommittee on Economic Stabilization  
Committee on Banking, Finance, and Urban Affairs  
U.S. House of Representatives  
Washington, D. C. 20515  
July 6, 1988

Madam Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before you at this hearing to discuss the impacts of the drought on major commodities and prices, and the implications for food supplies and prices.

Overview

Unusually intense drought for this stage of the growing season has spread over much of the farm land. The 30-day weather forecast issued last Wednesday indicated continued dry conditions in the Eastern Corn Belt. The drought has caused great turbulence in the commodity markets. The drought also has disrupted barge traffic, reduced power generation and increased the likelihood of forest fires.

Major Commodity Markets Reacting Sharply

As a result of the drought, cash grain prices are up sharply since early May--up a third for wheat, three-fifths for corn and nearly double for oats. Cattle prices, however, are down reflecting distress sales because there is not enough forage for herd maintenance in some areas of the country. At the beginning of June, pasture and range conditions were rated at 68 percent of ideal, the lowest rating for this time of the year since 1934. Pasture conditions in the Northern Plains were particularly poor with severe drought reported in North Dakota.

- 2 -

USDA Response. The Department of Agriculture has taken action to alleviate the distress of cattle producers. As of July 5, 1,819 counties in 36 states have been approved for emergency haying and grazing of land idled under annual commodity programs, that is, acreage conservation reserve (ACR) and conservation use (CU) acres. Secretary Lyng also announced that producers in these same counties suffering from severe drought will be authorized to harvest hay for a 30-day period on land in the long-term Conservation Reserve Program (CRP). Also, 323 counties in 20 states have been approved for participation in the Emergency Feed Program and the Emergency Feed Assistance Program. The Emergency Feed Program provides cost share assistance by the Commodity Credit Corporation (CCC) for livestock producers who must purchase feed in excess of normal purchases due to production losses. The Emergency Feed Assistance Program allows producers to purchase surplus, government-owned feed at reduced prices. In addition producers in 54 counties in 12 states who had previously enrolled in the 1988 wheat and feed grain programs are eligible to receive program payments on acreage which could not be planted because of dry conditions.

To also help cattle producers hurt by the drought, the Secretary announced on June 27, 1988 that an additional \$50 million has been set aside under Section 32 authority to purchase meat for domestic food assistance programs. This will help sagging beef prices as a result of distress sales. On the same day, the Secretary announced that producers with farmer-owned-reserve (FOR) loans could repay those loans without having to pay a penalty. The reserve was triggered on June 27 when the 5-day average national price of corn reached \$3.05 per bushel. This last action will benefit both crop and livestock producers.

Livestock and Poultry. Despite these actions, distress sales have forced down cattle prices. The price of utility cows is down sharply from \$50 per cwt in early May. Cows are currently selling for around \$40 per cwt, down nearly one-fourth. Continued liquidation of the cattle herd will add to beef supplies, particularly processing grade beef, and will lead to lower prices than otherwise would have occurred.

Overall supplies of red meat and poultry are record large this year and the short-term impact of the drought will be to add to these supplies. Heat stress could limit rates of gain of livestock and poultry on feed, but this will be more than offset by additional marketings. Higher feedgrain and soybean prices have affected livestock feeding profitability, and if those higher prices continue, will lead to a reduction in the size of the national herd. Smaller cattle and hog numbers mean less meat production in future years, but the retail price impact of such reduced supplies will not be felt until next year at the earliest. If poultry flocks are reduced, the impact on poultry prices could come sooner--by the end of the year.

Feedgrains. The impact of the drought on the livestock and poultry sectors depends, to a large extent, on the level of feedgrain and soybean prices. Currently, 10 of the 17 major corn-producing states have a fourth or more of the corn crop rated poor or worse, compared with none last year. Corn prices are currently around \$3 per bushel compared with about \$2 in April. However, projected stocks of 4.1 billion bushels carried into the 1988/89 marketing year starting September 1, 1988--the second largest carryin stocks ever--are expected to temper further price increases.

- 4 -

The key to avoiding runaway price increases in the corn market will be access to CCC-owned and FOR stocks. Catalogs listing CCC stocks available to the trade are periodically being issued. Stocks pledged as collateral for FOR loans are available through the use of commodity certificates at or before loan maturity. If CCC and FOR stocks continue to be made available to the market, then the damage to the livestock feeding and poultry sectors can be contained.

On June 27, corn prices rose to the level needed to allow farmer-owned reserve loans to be repaid before maturity. Over 1.2 billion bushels of reserve corn loans can profitably be redeemed and brought onto the market. Wheat. The winter wheat harvest is well underway. As of last Sunday 65 percent of the winter wheat crop had been harvested. Normally 44 percent of the crop is harvested by this time. Winter wheat usually accounts for three-fourths of all wheat produced in the United States and the combination of an earlier than normal harvest and carry-over stocks from last year of 1.27 billion bushels on June 1 is an assurance of sufficient supplies to meet domestic and export needs.

The spring wheat crop, which normally accounts for one-fourth of U.S. production, has been damaged, and durum wheat and oats grown in the Northern Plains have been especially hard hit.

The prospect of reduced wheat yields has driven up Kansas City wheat prices by more than a third since early May. Prices of durum wheat and oats have increased much more than this. Substantial increases in wheat prices were expected during the 1988 crop year, even prior to the onset of the drought. The Department's early-season estimates indicated demand would

exceed production by 450 million bushels, leading to a 10- to 25-percent rise in season-average farm prices of wheat. With the drought, the drawdown in stocks could be even greater than this.

If the drought persists and wheat prices go even higher, there will be some additional pressure on retail prices of bakery products and cereals. However, farm-level prices account for only 8 percent of the retail value of cereal and bakery products. If wheat prices for the entire season average 30 percent above last year, this alone would translate into a 2.4-percent rise in the retail price of cereal and bakery products. Actual price increases would also depend on changes in other processing and marketing charges.

Soybeans. The soybean crop is generally rated fair to poor. Eleven of 19 major soybean-producing states have a crop condition rating of poor to very poor for 25 percent or more of the crop. A year ago, no major-producing state had more than 15 percent of the crop rated poor or worse. Soybean prices had already been rising for several months in anticipation of very low carryover stocks for the 1988/89 season. However, the drought greatly accelerated the soybean price rise. Since early May, soybean and meal prices in southern Iowa have jumped about 50 percent and soybean oil is up 25 percent.

The soybean meal price increase will push up protein costs in animal feed rations. The soybean oil price increase will affect the entire fats and oils price complex. However, world oilseed production is expected to be record large in 1988 and competition from corn, palm, coconut, and cottonseed oil and animal fats will moderate the impact at the retail level.

#### Food Price Increases to be Moderate

Prior to the onset of dry weather, food prices were forecast by the USDA to rise 2 to 4 percent in 1988. If the drought continues, food prices will

- 6 -

increase at a slightly higher rate during the second half of 1988 and the first half of 1989. Even so, the outlook is for moderate rather than sharp increases in the Consumer Price Index (CPI) for food.

USDA will release an official food price projection on July 20, but based on preliminary analysis, it appears that the new forecast will place overall food-price increases for 1988 in the 3 to 5 percent range. In other words, it appears that the drought will add about 1 percentage point to 1988 food price inflation. We could see price runups in certain foods, for example, pasta products made from durum wheat and oat-based cereals, but overall food price inflation in 1988 will be held to moderate levels.

#### Inflation Largely Unaffected

The upward adjustment of our food price estimate will have a negligible impact on the overall rate of inflation in the United States.

Food accounts for approximately 16 percent of the Consumer Price Index for urban consumers--the most widely used measure of inflation. Food prepared at home accounts for about 10 percent of the overall CPI while the remaining 6 percent reflects food purchased or consumed away from home, mainly restaurant meals (see attached table). Meat, poultry, and fish consumed at home account for almost 3 percent of the index and fruits and vegetables, 2 percent. Dairy products and cereals and bakery products each represent a little over 1 percent, and fats and oils less than one-third of 1 percent of the index.

Since food accounts for 16 percent of the overall CPI, a 1-percent boost in food prices translates into an increase of less than two-tenths of 1 percent in the overall CPI. However, inflation is a monetary phenomenon dependent upon monetary policy. There is no reason to believe that a

- 7 -

one-time, drought-induced boost in farm commodity prices will lead to higher overall inflation.

Many Factors to Restrain Food Prices

Higher farm commodity prices this year will bring about a production response next year. More than 78 million acres of U.S. farm land have been removed from production this year under federal programs, 24 million acres of which are in the long-term Conservation Reserve Program. Some idled land will be released for planting under the 1989 wheat program, and the remainder serves as a buffer against serious crop shortfalls in this country. This country has an enormous capacity to increase food and fiber supplies by returning idled acreage to production.

It is still too early in the crop production cycle to assess the full extent of the drought damage. The Department will issue a crop report on July 12 that will reflect the impact of the drought on production based on July 1 conditions. If drought conditions persist, yields on this year's spring-planted crops will be further affected. However, the impact on 1988 food prices and supplies will be modest for a number of reasons.

- o Accelerated marketings of livestock will add to already record supplies of meat and poultry.
- o Large feedgrain stocks can help mitigate the damage to livestock and poultry feeding operations.
- o Diverse production areas and irrigation mean fruits and vegetable prices will be largely unaffected, even though production in certain Lake States will be down.

- 8 -

- o Soybeans and wheat will be affected, but the farm price of these commodities accounts for a relatively small share of the retail value of their products.
- o Record-large global supplies of vegetable oils will moderate the price impact on cooking and salad oils.
- o The most seriously affected crops, such as oats and durum wheat, will have a retail impact, but products made from these crops represent only a very small component of the CPI.

The immediate problem is not one of food shortage or food price inflation, except in certain specific instances, but rather the problem is one of responding in a compassionate way to the losses faced by American farmers.

Madam Chairman, that concludes my testimony. I would be pleased to respond to any questions you or other Members of the Subcommittee might have.

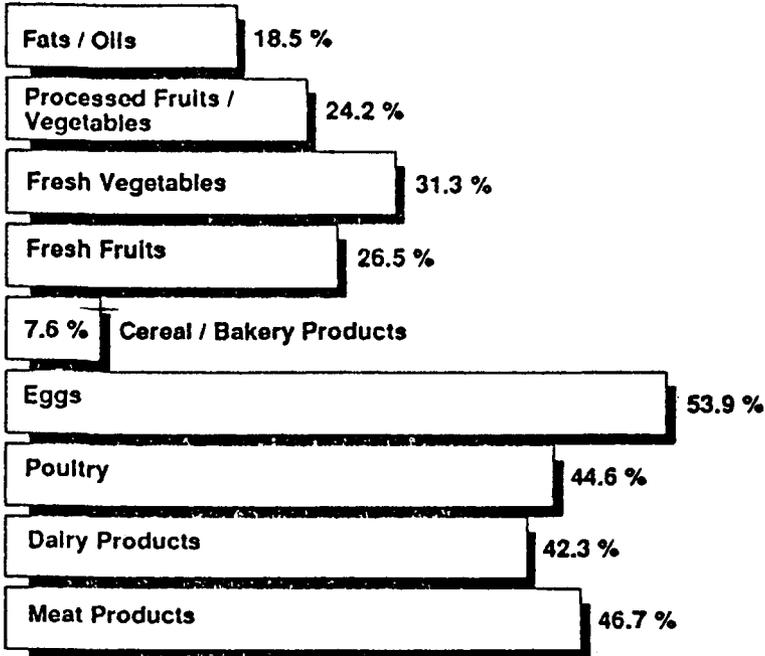
SUBMITTED BY EWEN M. WILSON

Relative importance of food groups in consumer price index for urban consumers, December 1987

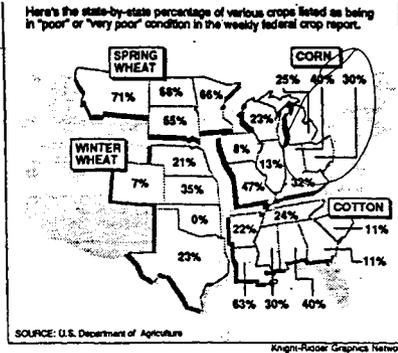
Food group	Weight in CPI	Weight in food CPI
-----Percent-----		
ALL FOOD	16.06	100.0
FOOD AWAY FROM HOME	6.19	38.6
FOOD AT HOME	9.87	61.4
Meat, poultry, and fish	2.89	18.0
Meats	2.07	12.9
Beef and veal	1.03	6.4
Pork	.62	3.8
Other meats	.42	2.6
Poultry	.43	2.7
Fish and seafood	.39	2.4
Eggs	.15	.9
Dairy products	1.23	7.7
Fats and oils	.26	1.6
Fresh fruits and vegetables	1.15	7.2
Fresh fruits	.55	3.4
Fresh vegetables	.60	3.8
Processed fruits and vegetables	.64	4.0
Processed fruits	.37	2.3
Processed vegetables	.27	1.7
Sugar and sweets	.35	2.1
Cereal and bakery products	1.35	8.4
Nonalcoholic beverages	.82	5.1
Other prepared foods	1.03	6.4

Sources: Bureau of Labor Statistics, U.S. Department of Labor  
Economic Research Service, U.S. Department of Agriculture

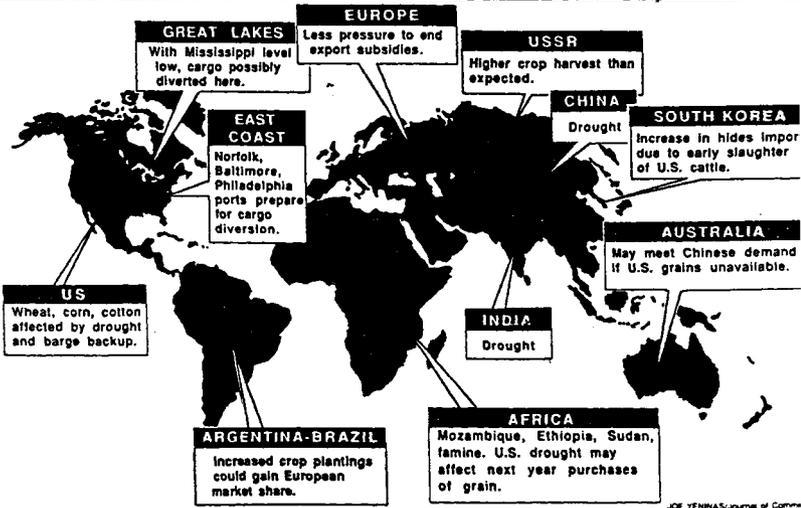
## What the Farmer Gets From Food Sales In Grocery Stores



Source: Department of Agriculture



## Drought's Worldwide Trade Impact



STATEMENT OF THE HONORABLE NORMAN D. SHUMWAY  
Economic Stabilization Subcommittee  
Hearing on the Drought  
July 6, 1988

Thank you, Madam Chair.

As we are all too aware, the drought currently plaguing our agricultural belt is one of the most severe in modern history. The stories of crop losses are growing larger as each new week without precipitation passes. As a member representing an agricultural region of California, I am very sensitive to such circumstances, and am deeply interested in how this will affect the lives not only of the farmers in my district, but all farmers and all consumers across the country.

As a member of the Banking Committee, I am also familiar with the financial markets. We have seen all too clearly in recent months how disruptive market fluctuations can be -- particularly with respect to the commodities futures markets. As speculation on crop production fuels speculation in the marketplace, prudence dictates that Congress stay well abreast of negative trends which may begin to manifest themselves.

Additionally, since rising prices of commodities are often used as excuses for price gouging by manufacturers, it also behooves us to keep a close eye on how market prices will affect consumer prices. We must assure that financial futures continue to reflect actual

- 2 -

commodities values, and we must also take precautions to see that actual pricing reflects the cost of commodities obtained, and nothing else.

I would like to extend my welcome to today's witnesses, and look forward to their testimony.

UNITED STATES OF AMERICA  
**COMMODITY FUTURES TRADING COMMISSION**

2033 K Street, N.W.  
 Washington, D.C. 20581



July 22, 1988

The Honorable Mary Rose Oakar  
 Chair, Subcommittee on Economic  
 Stabilization  
 Committee on Banking, Finance, and  
 Urban Affairs  
 2231 Rayburn House Office Bldg.  
 Washington, DC 20515-3520

Dear Ms. Oakar:

When Commissioner William Seale testified before your Subcommittee on July 16, 1988, representing the Commodity Futures Trading Commission, he stated that he would provide for the record a written response to a question that you raised. You requested that the Commission elaborate on its view, expressed in the written testimony submitted by Commissioner Seale, that wheat futures prices were not artificially high despite the substantial increases that occurred during June 1988 as the drought enveloped the Midwest.

The Commission's response to your question is attached. If you have any additional questions regarding the grain futures markets, please contact Mr. Gary Madson at 254-3596.

Sincerely,

*Jean A. Webb*  
 Jean A. Webb  
 Secretary

Attachment

In response to your question regarding whether wheat futures prices in late June 1988 reflected artificially high levels, we do not believe that such is the case. Our conclusion is based on an analysis of supply and demand conditions for wheat, large-trader activity in the wheat futures markets, cash wheat price movements, and historic experience with past droughts.

As Assistant Secretary Wilson pointed out in his testimony, the U.S. winter wheat crop, which accounts for about half of U.S. wheat production, was least affected by the drought. While the spring wheat crop was severely damaged, we have relatively large supplies of most classes of wheat carried over from prior harvests, and, as a result, cash wheat prices did not increase as much as oat, corn and soybean prices.

Futures prices also generally have reflected this situation. Between May 22 and June 23, 1988, for example, the prices of new crop futures contracts for winter wheat in Kansas City increased 43 percent. During that same period, new crop oat futures prices increased 108 percent-- reflecting the major damage to that crop-- while corn futures prices rose 53 percent and soybean futures rose 48 percent.

Futures markets are anticipatory by their nature. Through the collective actions of a large number of traders in a competitive arena, futures markets reflect prices today for a commodity at specific future time periods. At any given time, futures prices attempt to take into account all known supply and demand conditions affecting a commodity. When considerable

uncertainty exists regarding supply and/or demand conditions --as is the case now with the drought--futures prices become more volatile and react to each new piece of information that reaches the marketplace. As the true effect of the drought gradually becomes known, futures price volatility should diminish, and the cash and futures markets are expected to stabilize at a price level that rations reduced supplies among the various uses of each commodity. While no one currently knows what that price level will be for any of the commodities affected by the drought, our monitoring of futures trading provides no basis for concluding that the prices reflected by those markets are determined noncompetitively nor that they are subject to manipulative pressures.

The Commission's market surveillance economists review large-trader positions in wheat and all other futures markets on a daily basis for evidence of price manipulation. Surveillance economists are specialists in particular commodity areas and are familiar with the cash market conditions for their assigned commodities, as well as with the large participants in the futures markets. These surveillance efforts have not disclosed any evidence of price manipulation nor of any other disruptive trading activity that could have caused artificially high prices.

In particular, the largest position holders in the wheat futures markets during the periods when prices advanced the most were commercial grain merchants holding large short futures positions to hedge their inventories and purchases of grain.

Traders holding short futures positions, of course, did not profit on those positions during the significant price increase that occurred through late June. Large speculators as a group were net long during the period, but they held much smaller positions than did commercial traders.

