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**Statement
Of
Neal P. Gillen
Executive Vice President & General Counsel
American Cotton Shippers Association
To
Agricultural Advisory Committee
Commodity Futures Trading Commission
July 19, 2000**

Commissioner Spears and members of the Advisory Committee. I thank you for the opportunity to present these views as the Congress and the Commission move in unison in the final stages of the process of deregulating the commodity markets. While I am of the view that it is the proper direction to take, I share the observation and concerns of many that what is happening may not be fully understood by important participants in the process. Underlying these concerns is the future role of the Commission, and the fact that agriculture is not participating in the deregulatory process.

Establishment of CFTC

In 1974, the American Cotton Shippers Association was among a handful of advocates, including the National Grain & Feed Association and the National Farmers Union, who urged the Congress to remove the regulation of the agricultural futures contracts from the Department of Agriculture (USDA) through the establishment of an independent regulatory agency with authority to regulate all commodity contract markets.[1]

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[1] In October 1973, the House Agriculture Committee began consideration of reforming the regulation of commodity futures trading following the completion of extensive hearings conducted by the Small Business Subcommittee chaired by Representative Neal Smith (D-IA). The USDA, speaking through the CEA Administrator, Alex Caldwell, recommended to the Committee that all futures trading be subject to federal regulation. In November, Committee Chairman W.R. Poage (D-TX) appointed a Special Subcommittee to consider changes in the Commodity Exchange Act. In short order, the Special Subcommittee recommended that the CEA be replaced by a 5 person Commission, the CFTC, consisting of the Secretary of Agriculture and 4 public members required to be knowledgeable in the intricacies of futures transactions. Considered, and rejected, were proposals to create what Congress ultimately established, an independent regulatory agency, combining the CEA functions with the SEC, and the status quo of continuing the CEA in USDA. Included in the recommendations were the regulation of all exchange traded contracts and the requirement that all contract markets submit contracts for prior approval along with the Bylaws pertaining to trading in the contract market.

In February 1974, the House Agriculture Committee reported its CEA reform legislation, H.R. 13113, and on April 11th, the legislation passed the House by a record vote of 281 to 43 after rejecting, by a vote of 158 to 179, an amendment to replace the 4 public members with 4 full-time government employees. In May, the General Accounting Office issued a report recommending that commodity regulation be removed from USDA since it lacked the resources to adequately police the markets. The GAO also focused on the Department's inherent conflicting interests given its Congressional mandate to "influence and maintain" commodity prices. The GAO opined that "to remove any appearance of a conflict of interest and to instill full public confidence, the Congress should establish an independent agency, separate from the Department of Agriculture, to regulate all trading in commodities futures." Further, the GAO noted that the futures

Until that time, the regulatory authority over commodity futures trading was vested in a USDA agency, the Commodity Exchange Administration (CEA), and limited to the contract markets trading agricultural commodities. The unregulated commodities, gold, silver and other precious metals were self-regulated by the contract markets on which they were traded. In 1973[2], Senator Robert J. Dole (R-KS) recommended that the regulatory jurisdiction of the CEA be extended to include trading in all contracts for future delivery, noting that the public desired and required this protection. Further, he observed that should a problem occur in a non-regulated futures market that it would reflect badly on all other futures markets.

America had just ended a regretful period of government price controls, inflationary pressures were unleashed on the market place, and commodity prices were rising to new plateaus driven by significant increases in the price of oil and other energy products vital to maintaining our productive resources. Further, financial, stock indexes, options or other derivative instruments did not exist. It was around this time that the world's financial powers, the signatories to the Bretton-Woods Agreement, abandoned the concept of fixed currency rates in effect since 1945 and agreed to let market forces determine the value of the various world currencies. Overnight, a significant opportunity emerged for the development of contract markets and off-exchange markets for the trading of the various currencies. By the early 1980's, trading in stock index futures began, and soon after the Congress lifted the ban on the trade of agricultural options. The success of these markets is well documented. Trading volume has expanded well beyond expectations and the contract markets and this agency have kept pace with this exponential expansion through effective self-regulation and prudential oversight.

This important fact is overlooked. The regulation of these markets has been effective, not overly intrusive, and accomplished with minimal resources. Simply stated, the CFTC's regulatory role has provided the trading public the necessary confidence to utilize the markets and has materially assisted in the phenomenal expansion of the U.S. futures industry. As the Congress and the Commission move from an era of effective regulation to a new era of deregulation the question comes to mind, are the appropriate safeguards in place to maintain the public's confidence in the financial and futures markets?

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markets were "vital to the country's economic well-being" and should be regulated by a "strong, independent agency."

In May, the Senate Agriculture Committee conducted hearings, and in August, a Bill was reported establishing an independent regulatory commissions, the CFTC, with 5 full time commissioners. On September 9th, following a half hour of debate with only 3 Senators present and voting, H.R. 13113 was enacted, establishing regulatory authority over all exchange traded commodities. On October 23rd, President Gerald Ford signed the Commodity Futures Trading Commission Act of 1974.

[2] October 9, 1973, Agricultural Economics Conference, Kansas City, Kansas

The President's Working Group on Financial Markets

Market innovation keyed the phenomenal growth of the US economy and its related markets in the last decade, but tied to this growth is a combination of governance that kept it on track at a controlling rate of acceleration. The agencies participating in this effective governance, the Federal Reserve, Treasury, the SEC, and the CFTC have concluded the markets have come of age and it is time to relax the, albeit limited, restraints. The Report of the President's Working Group[3] could be the most influential document in the history of US financial markets. Given the leadership of the Working Group, its far-reaching recommendations are being followed with little dissension or dispute. I do not challenge the conclusions of the Report or its recommendations. I simply raise the question, why is there an inconsistency in the regulation of agricultural and non-agricultural commodities?

Agricultural Futures & Option Contracts

We understand the need for transparency, the essentiality of price discovery, and the concern that commodities with a finite supply could be manipulated. Every market participant shares these concerns - the producer, merchant, cooperative, processor, and the speculative interests. If the contract markets afford adequate participation to the representatives of all of these interests in the development of rules and regulations and the governance of that market, then the self-regulation of the futures and options trading in this agricultural market should be permitted. Simply stated, we understand the markets, we are entitled to a meaningful role in market development and governance, and we do not wish to be prohibited from benefiting from any innovative trade practices available to the non-agricultural commodities.

The Physical Agricultural Markets

The agricultural spot and forward markets are open networks ubiquitous with accurate price data and other information vital to all who function within them. This open network of producers, merchants, cooperatives, and processors utilizes transparent market information to serve one-another by producing a product, adding value to it, offsetting price risks, protecting the product's value, shipping it for processing or manufacturing, and then creating a product or products which stimulate additional production. The participants in these networks moving farm products from the field to the consumer adhere to the highest standards by sharing the norms or values of fairness, truth, and reciprocity beyond those necessary for ordinary market transactions. That is why the Congress in 1921 included the forward contract exemption[4] in the Commodity Exchange Act.

The Agricultural segment of American business is perhaps the most complex and yet the most efficient and productive in our economy. Americans spend approximately one fourth of their disposable personal income on food and fiber, the lowest percentage in the

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[3] *Over-the-Counter Derivatives Markets and the Commodity Exchange Act*. Report of The President's Working Group on Finacial Markets. November 1999.
[4] 7 USC 1a(11)

world because of the productivity of our nation's farmers and the efficiency of our processing and distribution system. Our efficient and self-sustaining system equals the efficiency of the financial markets, yet it is trapped within a legislative and regulatory framework that precludes its use of the product innovation allowed the non-agricultural commodities. Why do the Commission and the Congress trust the financial markets to move towards self-regulation, yet deny the same privilege to agriculture? The answer lies in the recent failure of the implementation of the Pilot Program for Agricultural Trade Options. It is assumed that innovation is either too risky for agriculture or that agriculture lacks the sophistication to innovate. These assumptions are not only unfounded, but they are prejudicial to the interests of agriculture.

Limitations on Innovations in Agricultural Marketing Practices

Since 1985, when the Commission's Office of General Counsel issued an Interpretative Statement[5] on the forward contract exemption, the trading of agricultural products has been constrained from innovation and limited to merchandizing transactions in a physical commodity in which delivery is delayed or deferred for commercial convenience or necessity. In the fifteen years since the issuance of this opinion, production, harvesting, and distribution practices have undergone considerable improvement through technological change. Except for the advent and significant use of exchanged traded options contracts there has been little change in the risk management instruments made available to the producers of agricultural commodities. It is patently unfair and unreasonable to continue a policy that denies agricultural producers the innovations in risk management instruments made available to other industrial producers.

Much has transpired in the 79 years since Congress enacted the forward contract exemption. The law of contracts and the court interpretations are uniform throughout the various states, the reputable agricultural buyers are known to the producers, trade rules and practices are well established, arbitration and other legal remedies are readily available to resolve disputes, and accurate spot and futures price information is available on a continuing basis. Therefore, if ready buyers and sellers agree to terms they are financially capable of undertaking, they should not be restrained from entering into such contracts. Denying producers and merchants the flexibility to enter into such contracts is denying them the right to maximize their opportunities to minimize their risks and maximize the price potential of the market.

Consider New Marketing Opportunities for Agriculture

By labeling transactions as non-sanctioned trading instruments we are denying agricultural producers the right to innovative risk management alternatives. In doing so, we are failing to consider, in the words of the Commission's 1985 Interpretative Statement, "the economic reality of the transaction." The reality is that delivery will be required or not required depending upon the specifics of the contract to which the parties, possessing the legal and financial capacity to engage in such transactions, have entered into of their own volition solely for purposes related to their business.

[5] Federal Register, Vol. 50, No. 189, p.39657-61.

This is the standard utilized by the Commission for all commodities other than agricultural commodities.

In its desire to protect agricultural producers, the Commission is instead penalizing producers in denying them the potential of beneficial marketing innovations. Before the Commission and the Congress finish their work on the deregulation of the markets they should reconsider the decision to continue treating agriculture as a market meriting constrictive regulations and instead provide US agriculture the same opportunities it allows the other segments of our thriving economy.