

THE NEW IDAHO POTATO FUTURE CONTRACT
WHAT IT MAY DO FOR WASHINGTON GROWERS

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Last June the Chicago Mercantile Exchange resumed future trading in Idaho potatoes after a lapse of some 12 or 13 years. We do not know whether enough speculative, trade, and grower interest will develop to provide the volume of trading that will make this a useful futures market in the years ahead. However, experience so far in this first season is encouraging.

Some growers feel that futures trading in Russet potatoes will be detrimental to their interests. I can see why one would feel this way if he has speculated in the futures market. On the basis of my own observations I would guess that at least 90 percent of the growers and college professors who have speculated on the futures markets have lost more money there than they made. I can think of no other way that futures trading in Russet potatoes is likely to injure a grower.

In general, the greater the number of people that are interested in your product, the better off you are. Adding commodity speculators to the groups that bid on Russet potatoes will, I am convinced, be of benefit to most growers. Speculators are notorious for their optimism. Most of them go long, thereby creating a good market for hedging by dealers, processors, and growers if there are enough speculators active in the potato market.

Although the new futures contract on the Chicago Mercantile Exchange provides for trading in Idaho potatoes only, nearly all the benefits it provides for Idaho growers will also accrue to Washington growers. That's because Washington and Idaho potatoes are so near alike that prices for the two nearly always go up and down together and by about the same amount (see Chart 1, also Charts 4 through 8).

If the futures market in Russet potatoes attracts enough hedging and speculative trading it is likely to be of greatest benefit to growers of Russet potatoes in two ways: (1) By bringing higher prices for Russet potatoes at digging time in most years. (2) By enabling growers to "hedge," that is, to guarantee themselves a specific price at digging time or at any time during the storage season even though they store their potatoes for sale in the winter or the following spring.

Higher Prices at Digging Time

Harvest-time is usually a period of abundant supplies of whatever is being harvested. Some very perishable products must be sold and consumed at time of harvest. Others, such as fall potatoes can be stored for a while and consumed later. When this is done, someone must bear the cost of storage and someone must assume the risk that prices might drop before the product is finally bought by the consumer. If there is no futures market on which the product can be hedged, the risk of price change must usually be assumed by the person who does the storing.

If a dealer or processor buys potatoes at digging time and stores them for later sale or use, he must operate on a margin large enough to cover the risk of loss due to price change. If he contracts to buy potatoes at a given price for a period of time before he takes delivery he must also operate on a margin wide enough to cover the price risk unless he can in turn pass that risk on to someone else in the marketing channel by contracting to sell the potatoes to them at a specific price. This other buyer then assumes the price risk, takes a larger margin and passes the risk cost back to the local dealer and eventually the grower in the form of a lower price.

If dealers and processors can hedge on an adequate futures market purchases of potatoes they plan to store and hold, they bear little risk of loss due to changing prices. Thus, they can operate on a smaller margin and pay the producer more. Competition will usually force them to do this.

So far as I know, no research has been done on this point for potatoes. However, two very good research jobs have been done on it for onions. Onions, of course, are like potatoes in that they are a perishable product that can be stored for a few months.

Workers at both the University of Minnesota and at Stanford University have shown that onion prices averaged substantially higher at harvest time in relation to the season average price when there was an active futures market as compared with periods when there was no active futures market. Chart 2 shows this clearly. It was taken from the Minnesota study.

The Stanford study showed almost identically the same thing. In addition to studying the U. S. average farm price of onions, the Stanford study, which was conducted by Dr. Holbrook Working, made a comparison of seasonal price variation of Michigan onions for the different periods. The results were similar to those shown by the U. S. average farm price. However, seasonal variation was leveled out even more for Michigan. This is logical because Michigan grows mostly yellow globe onions - the kind that were deliverable on the futures contracts.

Charts 4 through 8 show the seasonal variation in Washington and Idaho Russet f. o. b. shipping point potato prices. It is obvious that in most years digging-time prices are much lower than the seasonal average. Although the disparity must continue in order to compensate for storage costs, there is plenty of room for narrowing the gap.

Chart 3 shows the current marketing season, as does Chart 4. However it also shows the cash wholesale price at Chicago and the price of May futures. Trading on the Idaho futures started in June. The May contract moved above \$6.00 in August. The speculators were there putting money on the line to show that they thought that Russets would bring a good price long before you started digging. Local growers and dealers obviously had lower price ideas until after the October crop report confirmed the optimism of the speculators. It is my opinion that cash prices would not have moved up as soon nor as fast as they did if the speculators had not been in there leading the way on the futures market.

Hedging by Growers

Some potato growers will be able to make more money if there is a good futures market where they can hedge.

Hedging is a form of price insurance. By hedging on the futures market, a grower can insure himself a given price sometime in the future. At the same time he gives up his chance to gain from a rise in price. He is shifting the price risk to a risk-taker -- the speculator. If the market goes up, the speculator profits from the price rise. The grower who hedged fails to gain from the price rise. If the market goes down, the speculator loses, but the grower does not.

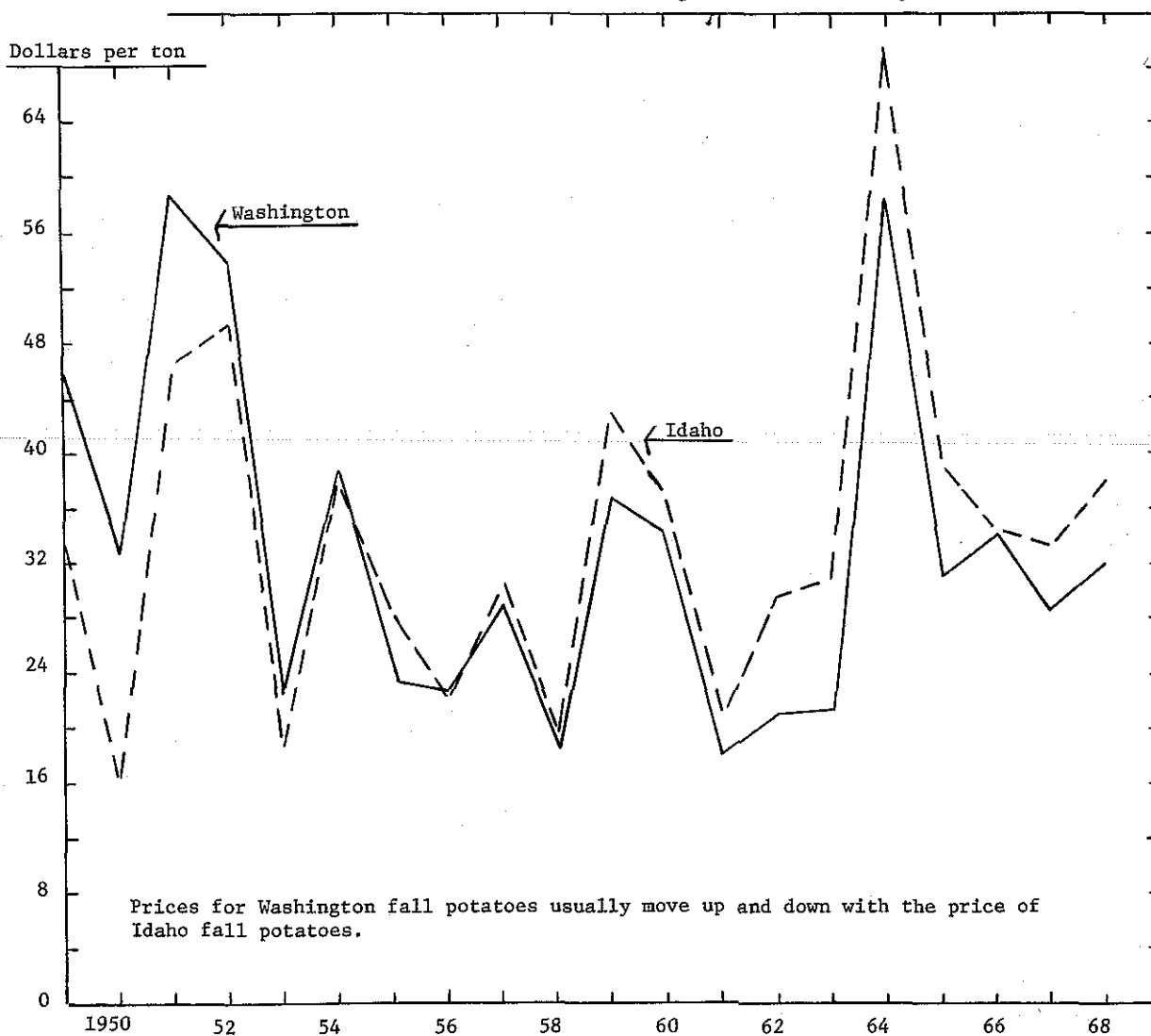
Last fall provided a good example of one way some growers can profit by hedging. At digging time in early October Washington growers were being offered \$40 bulk per ton, less sorting for U. S. No. 1 Russets. That's equivalent to a price of around \$4.00 per 100 pounds on the Chicago wholesale market. In fact, the cash price at Chicago was a little below \$4.00 in early October. But the May future on Russets was trading at around \$6 in early October (from \$5.80 to \$6.25 in the first half of October). \$6.00 per 100 pounds in Chicago is equivalent to about \$80 per ton in Washington, double the cash price that growers were being offered. It doesn't cost \$40 per ton to carry potatoes from October to May. Around \$10 per ton probably would be closer including both storage and shrinkage. The cost of a futures transaction is about \$1.50 per ton. Thus, a grower who could sell for \$40 in October would have about \$51.50 per ton in his potatoes by May. By storing and hedging in the May future in October he would be ahead \$28.50 per ton as compared with selling for cash in October. For more detail on how this works, see my article in Spud Topics, September 25, 1968, or talk with a commodity broker.

A grower who has sufficient resources of his own can usually afford to store and take a chance on the price going up during the storage season, if he doesn't like the price offered at digging time. But a grower who isn't that well heeled may have to sell at digging time and take whatever cash price is being paid. Most any banker or credit agency will loan money on a product that is hedged on the futures market.

If the Chicago potato futures attracts enough speculative interest, we will see futures trading on a potato crop in the spring before it is planted. This will enable a grower to hedge his crop before planting time. He can then borrow money for his operations more easily.

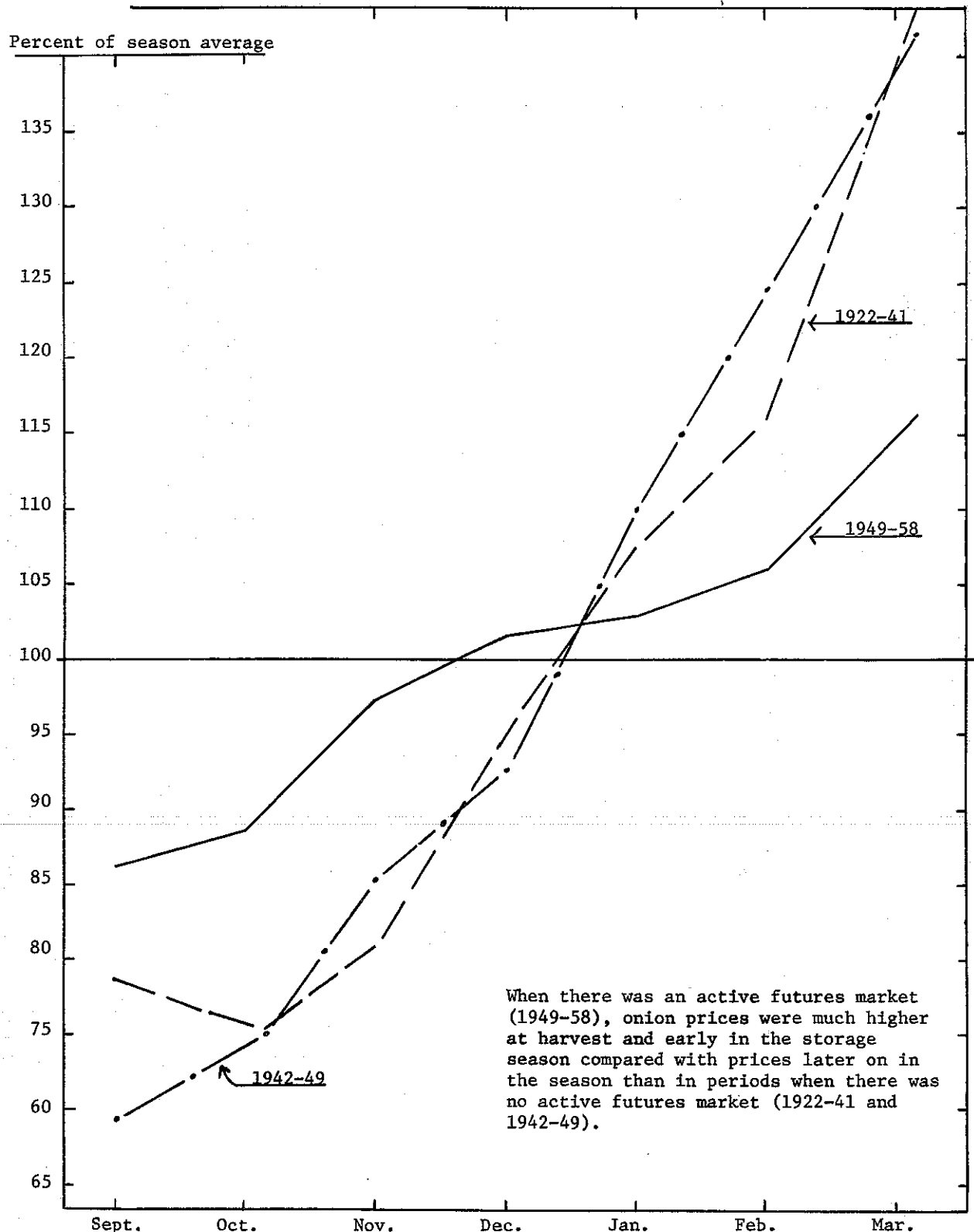
There are several other ways that a good futures market can benefit potato growers. However, I believe that the two I have discussed are the most important.

Chart No. 1. Fall Potatoes - Season Average Price Received by Farmers



Source: Crop Reporting Board, U.S. Department of Agriculture.

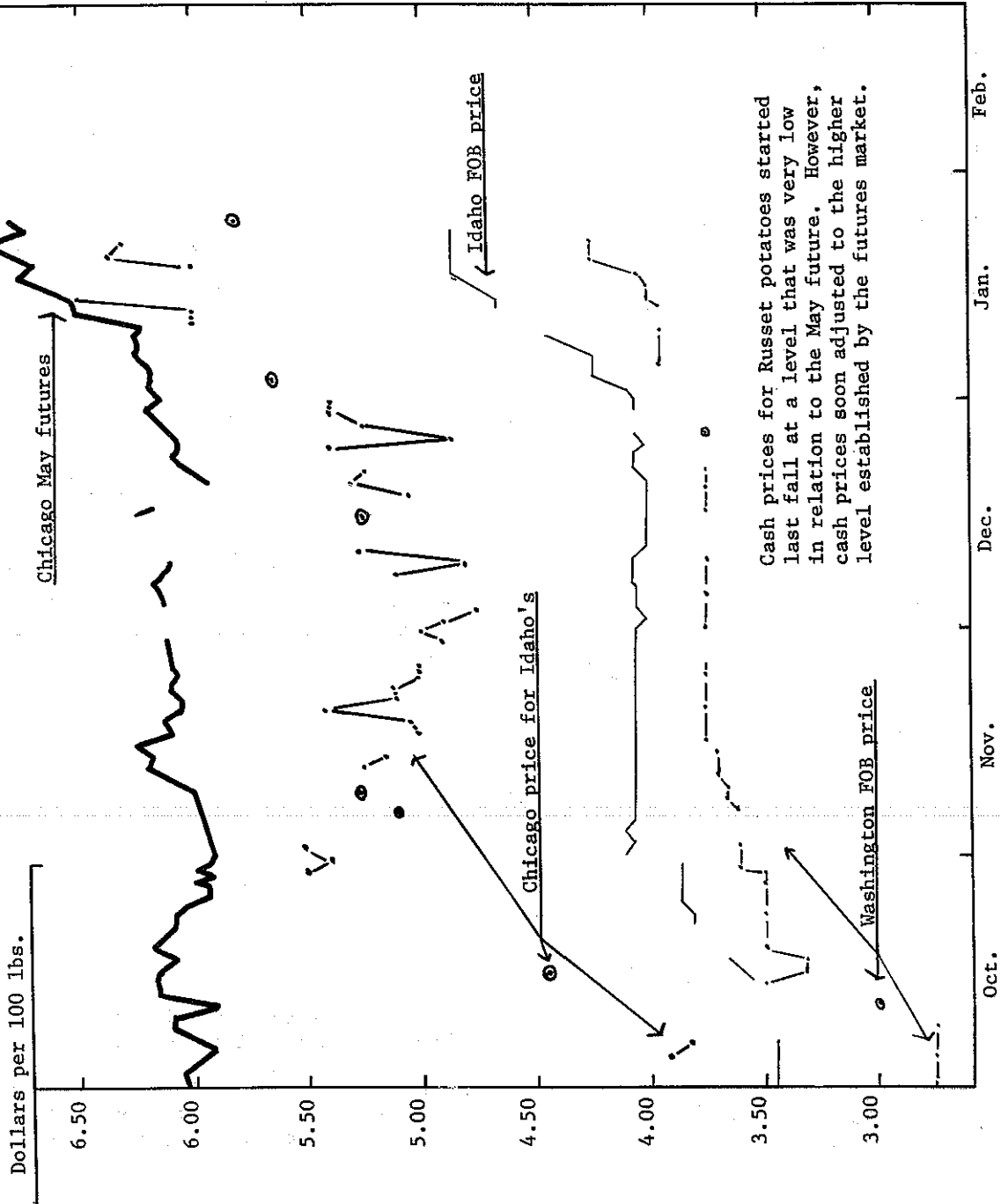
Chart No. 2. U.S. Farm Price of Onions Seasonal Variation



When there was an active futures market (1949-58), onion prices were much higher at harvest and early in the storage season compared with prices later on in the season than in periods when there was no active futures market (1922-41 and 1942-49).

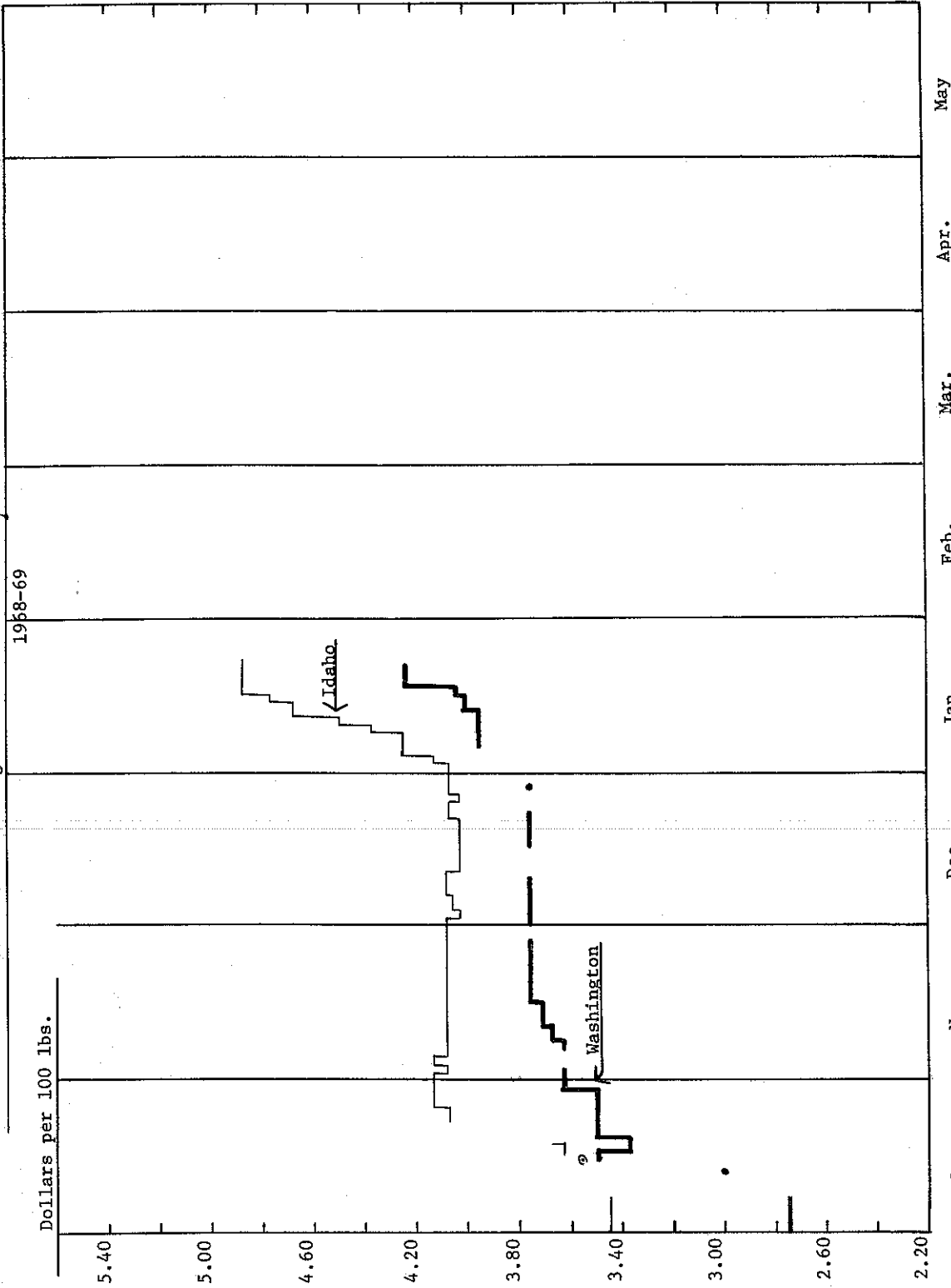
Source: March-April 1959 issue of Minnesota Farm Business Notes, Institute of Agriculture, University of Minnesota.

Chart No. 3. Fall Potato Prices, 1968-69 Season, No. 1A Russets



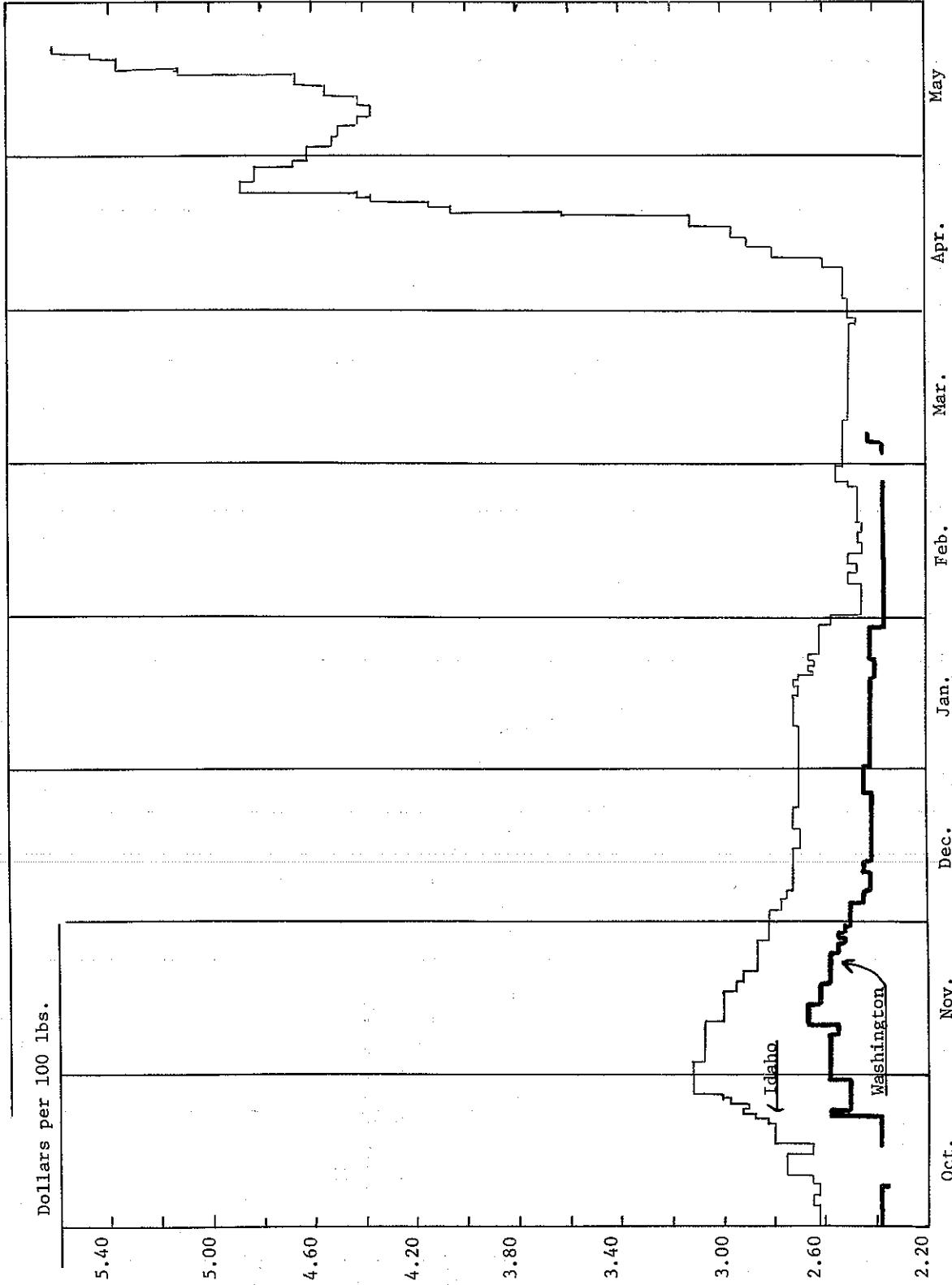
Source: U.S. Department of Agriculture market reports.

Chart No. 4 Washington and Idaho Russet Potato Prices, FOB, U.S. 1A



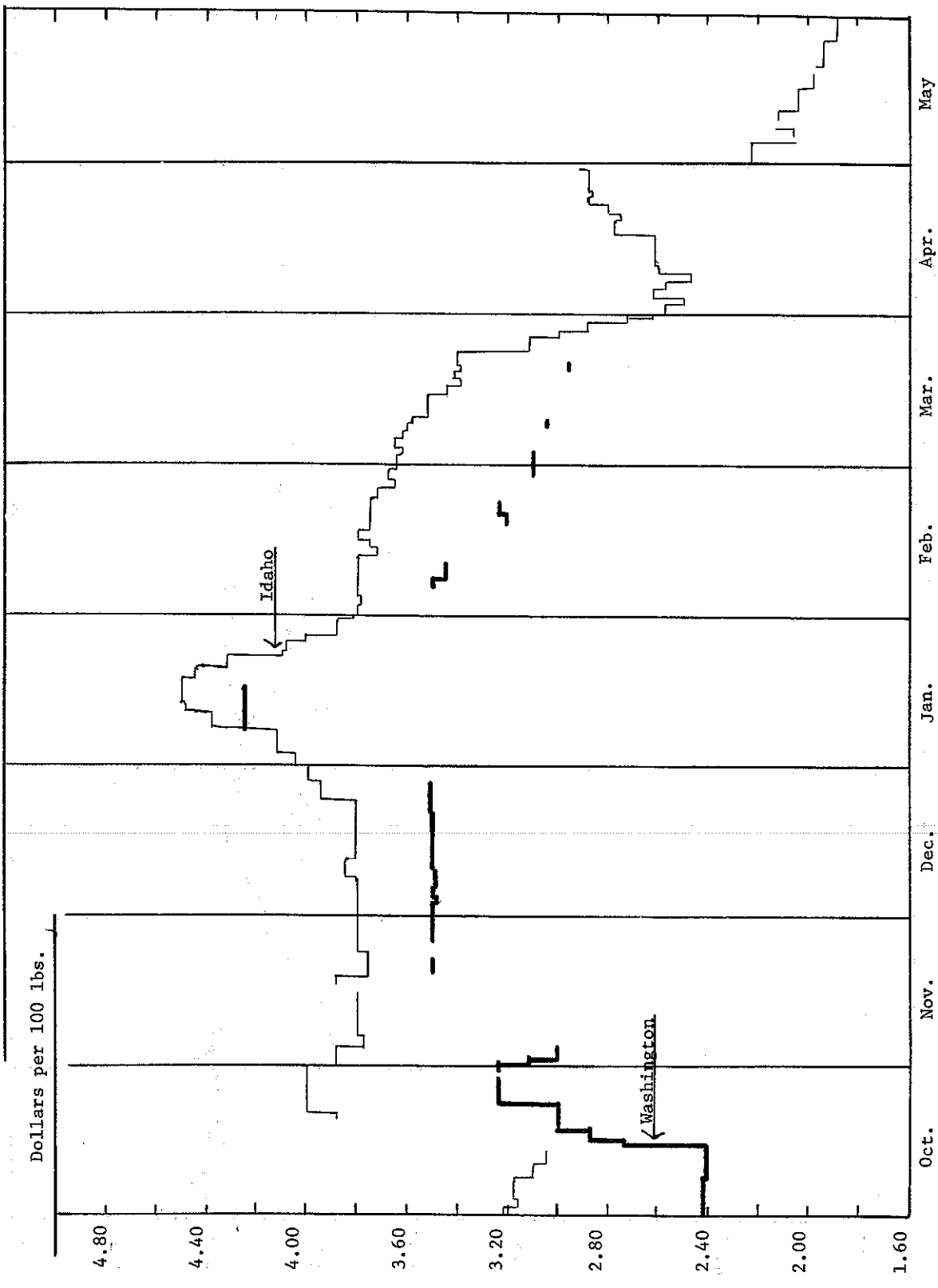
Source: U.S. Department of Agriculture market reports.

Chart No. 5 Washington and Idaho Russet Potato Prices, FOB, U.S. 1A, 1967-68



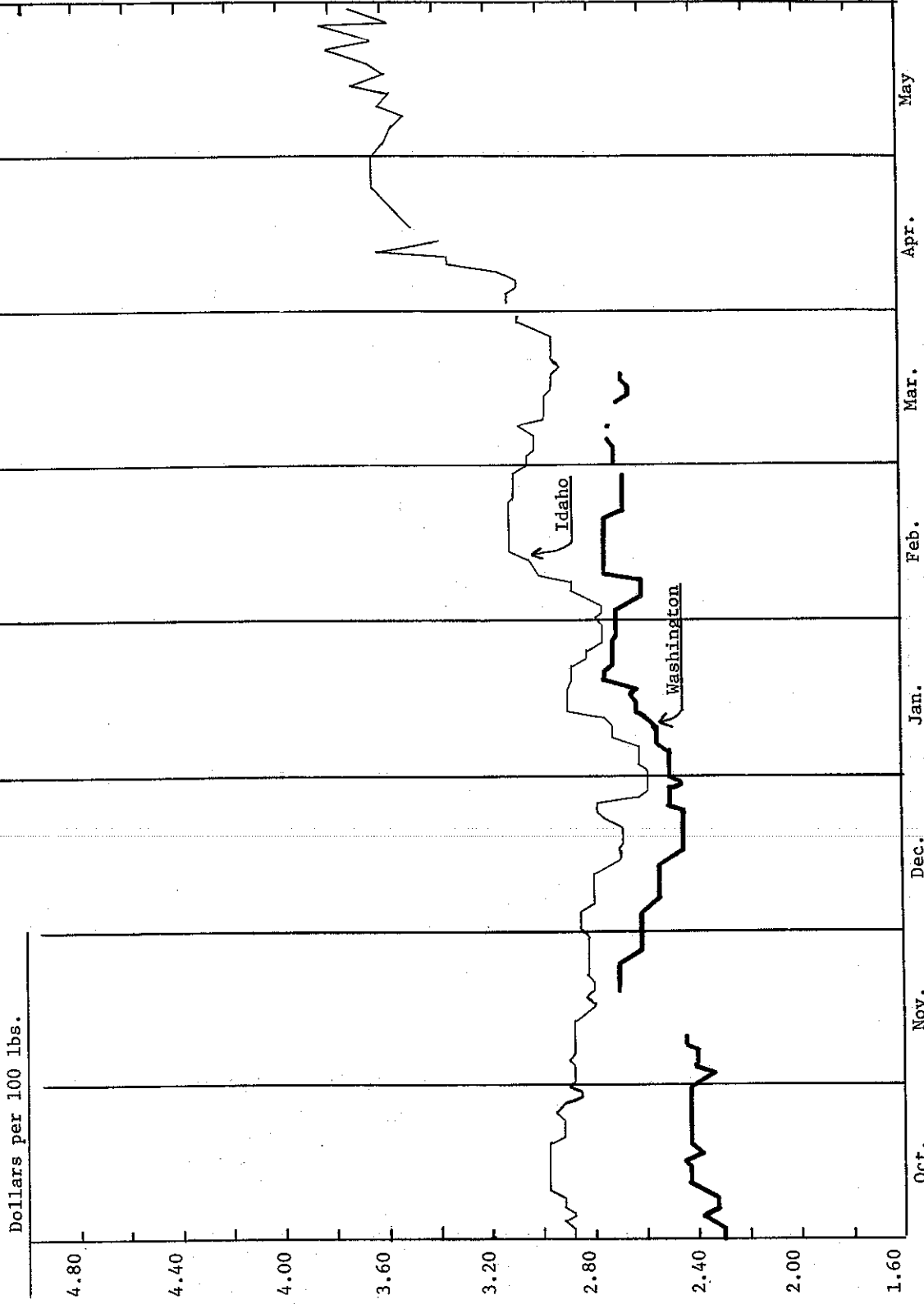
Source: U.S. Department of Agriculture market reports.

Chart No. 6 Washington and Idaho Russet Potato Prices, FOB, U.S. IA, 1966-67



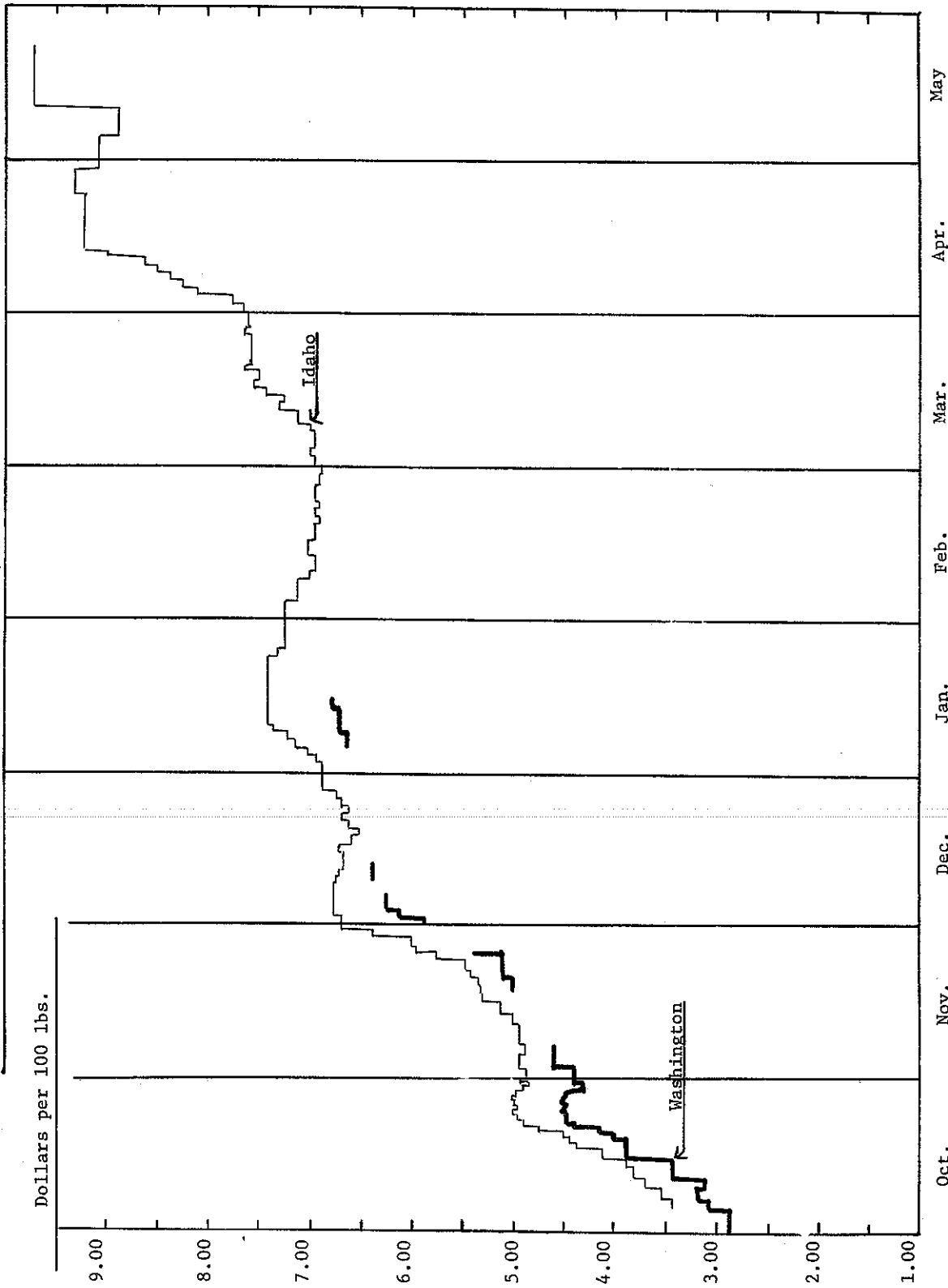
Source: U.S. Department of Agriculture market reports.

Chart No. 7 Washington and Idaho Russet Potato Prices, FOB, U.S. IA, 1965-66



Source: U.S. Department of Agriculture market reports.

Chart No. 8 Washington and Idaho Russet Potato Prices, FOB, U.S. 1A 1964-65



Source: U.S. Department of Agriculture market reports.