

of marketing and thereby permit the farmer to obtain a better price for his produce and enable the consumer to obtain products at lower cost.

Among those who use a futures exchange for hedging, citing cotton as an example, are growers, shippers, merchants and manufacturers. Since there are not an equal number of hedgers taking long and short positions on the exchange, speculators are necessary to a futures market and, for an expected profit, they act as insurers for those who deal with the actual commodity.

The hedger who purchases, sells, or holds, a commodity obtains protection against a change in price by taking an opposite position on a futures exchange. If he is a farmer or a merchant who holds cotton he hedges by selling a futures contract. If the price of his cotton goes down he liquidates his futures contract and what he loses on his cotton he makes up on his futures transaction. It is the speculator who generally takes the position opposite to the hedger and performs the function of the insurer. Markets which enjoy higher levels of speculative participation provide more reliable price protection. A market with fewer speculators is less effective, less liquid and less useful to a hedger. If margins are increased to drive out the speculator the functioning of the futures market will be impaired and the benefits of hedging to the country's economy will be lost.

There is little similarity between the operation of a stock exchange and a commodity exchange. On a stock exchange when a person buys a security he receives it within a few days and must pay the seller the full price in cash. If he requires credit to finance his purchase he borrows from his broker. The margin is the amount of cash he puts up which is the difference between the purchase price and the amount borrowed. Lower margins mean higher buying power. Thus, when margins are low there is a greater demand for stock and this has a tendency to increase prices. When the Federal Reserve Board is of the opinion that excessive speculation on the stock exchanges is causing an excessive increase in prices, margins are increased and it is believed that the effect is to reduce the demand for stocks and thus stabilize the market.

Margin on a futures exchange is based on an entirely different concept. It has nothing to do with the amount of money made available to purchase commodities. It is not a downpayment on the price. A futures contract is a contract to purchase and sell a commodity for delivery in the future. Most contracts are liquidated by offsetting contracts before the delivery date. Delivery is the exception. In those cases where delivery is made, the purchaser pays cash and the margin put up on his futures trade is not related to the cash which he pays. The margin on a future exchange is merely security to guarantee to the clearing member the obligations of the trader when he buys or sells a futures contract.

What is that obligation? When a customer buys a futures contract he owes nothing. If the price changes in his favor he owes nothing. It is only when there is an adverse change in price that he incurs an obligation. When he offsets his contract by a contra-contract he must pay his loss. The margin is to guarantee to the clearing member that he can pay this loss. The amount of the margin is fixed in relation to the loss which he may sustain as a result of an adverse change in price. When the price changes so that the margin is partially used up additional margin is called for and this additional margin is also merely to guarantee to the clearing member that the customer will be able to pay the loss resulting from an adverse change in price. When the governing board of an exchange sees a likelihood of large price fluctuations, initial margins are increased by the exchange because it is anticipated that there will be a larger obligation to pay for an adverse variation in price.

We have discussed the margin applicable to the buyer. Every transaction on a futures exchange involves a seller and buyer. Generally both parties are required to put up margin. In a normal transaction on a stock exchange, margin is required only of the buyer because the seller's transaction is completed. On a futures exchange every single transaction involves a short sale and there are speculative shorts as well as speculative longs. The amount of the margin is and should be geared to the obligation of the trader which is to pay for the variation in price when he closes out his transaction whether he is long or short.

When the purpose of margin on a commodity exchange is understood, that it is not a downpayment on the price—it should be apparent that an increase or reduction in margins will not be effective to control prices. However, any increase in margins beyond the point necessary to guarantee the obligation of the trader may interfere with the operations of a futures exchange in facilitating the