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Forward Contracting of COTTON

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Forward Contracting of Cotton*

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INTRODUCTION

FOR MANY YEARS cotton was the primary cash crop of Alabama's agriculture. Cash receipts derived from the sale of cotton and cottonseed amounted to approximately three-fifths of total cash farm receipts in Alabama in the 1930's. Cotton was grown throughout the State on farms with relatively small acreages. A cotton enterprise required a relatively large amount of labor, which was supplied primarily by members of the family. Little thought was given to marketing, which usually took place at harvest time and at the place where cotton was ginned.

During the 25-year period between 1940 and 1965 there were many developments that affected cotton production. Government programs that provided funds for price support and for loans were in effect. Provisions of programs were carried out through operations of the Commodity Credit Corporation (CCC). A range in the level of supports and loans was determined by Congress, which then gave the Secretary of Agriculture authority to set the effective support prices and loan rates within the range. Except during war years, when demand for cotton was unusually great, the effective level set for the CCC was near or above open market prices. This

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relationship applied to both domestic and world markets. The proportion of annual production that went to the CCC varied between 33 and 68 percent.[1] The volume of cotton owned by the CCC increased between 1962 and 1965, and in 1965 exceeded a year's production. Because of huge expense to the government, including storage costs, public pressure was put on Congress and the U.S. Department of Agriculture to change the program. Important changes were made through the passage of The Food and Agricultural Act of 1965. As initially passed, the Act extended through 1969, but it was later amended and extended through 1973.

Provisions of The Food and Agricultural Act of 1965 affected all segments of the cotton industry. Producers were asked to set aside a percentage of allotted acres to lower production. For compliance, growers received a direct payment. Support price level was set near the world price, and the loan rate was set below the world price.

Implementation of this program resulted in reduced production and movement of cotton out of CCC storage. New crops of cotton moved into domestic use and world trade channels rather than into government storage. Grower incomes were supplemented by direct payments, but marketing practices were markedly different.

Cotton production was affected by a number of developments both on and beyond the farm. Increased use of capital in the form of machinery and equipment greatly reduced the labor required to grow cotton. Individual growers cultivated more acres to make ownership and operation of equipment profitable, and to pay generally rising production costs. Many growers leased or sold allotments, which resulted in fewer growers and concentrated production areas. Local buyers became relatively few in number, as many changed to other businesses during the years when a substantial volume of cotton went to the Government.

Depletion of Government-held stocks caused domestic mill buyers to seek supplies in the open market. There the buyers found strong competition from foreign buyers whose activities were intensified as a result of two currency devaluations in the United States. The combination of these developments contributed to a volatile market and pricing situation. Representatives of all segments of the cotton industry sought ways for

[1] U.S. DEPARTMENT OF AGRICULTURE. Agricultural Statistics, various years.

adjustment to conditions that were radically different from the relatively stable situations that had existed for longer than two decades. Several techniques were tried by growers and merchants to solve new and different problems. This study was made to assess advantages and disadvantages of one technique, forward contracting.

THE SITUATION

Cotton production in Alabama had become concentrated in the Tennessee Valley and Sand Mountain areas by the early 1970's. For example, 12 counties in these areas accounted for 61 percent of the cotton produced in Alabama. In 1951 these counties had produced only 37.5 percent of the State's cotton.[2] This concentration of production was due to several factors, but an important one was the decline of cotton production in the Wiregrass Area. Production in that area decreased from 128,250 bales in 1951 to only 7,605 bales in 1971.[3]

Concentration of cotton production enhances forward contracting since buyers and mill representatives can consolidate buying activities in a relatively small area. This concentration reduces the number of central delivery points, and the increased volume facilitates efficient use of transportation and labor involved in moving cotton from gins to mills.

A primary reason for the increased interest in forward contracting of cotton was the changes made in Government programs in recent years. During the period 1953-65, loan rates for middling inch (M-1″) cotton at average locations ranged from 29.00¢ to 35.08¢ per pound. The annual average loan rate in this period was 32.75¢ per pound. Comparable spot prices for M-1″ cotton in designated markets averaged 33.14¢ per pound annually, or only 39 points[4] above the average loan rate. Variations in average monthly spot prices were usually less than 1.00¢ per pound from the low to the high within indi-

[2] ALABAMA CROP AND LIVESTOCK REPORTING SERVICE. 1972. Alabama Cotton Statistics, 1972. Alabama Department of Agriculture and Industries, Montgomery, Ala.

[3] Production of cotton in Alabama decreased 30 percent (from 909,000 to 640,000 bales) during the 20 years between 1951 and 1971. The downtrend in production continued at a rapid rate in the next 5 years, with production in 1976 being 47 percent less than in 1971. Although a decrease occurred in all areas of the State, the 12 counties in the Tennessee Valley and Sand Mountain areas produced only 53 percent of the State's 1976 crop. Counties in the Wiregrass reduced production by 55 percent between 1971 and 1976.

[4] A point is 1/100 of a cent.

TABLE 1. UPLAND COTTON: PRODUCTION, PRICE, LOAN RATE, AND PRICE SUPPORT OPERATIONS, UNITED STATES, 1963-77[1]

Year	Production	Av. price/lb. received by farmers	CCC loan rate/lb.[2]	Proportion of production put under support	Proportion acquired by CCC
	1,000 bales	*Cents*	*Cents*	*Percent*	*Percent*
1963	15,130	32.02	32.47	52.5	38.3
1964	15,025	29.62	30.00	48.5	32.1
1965	14,850	28.03	29.00	46.7	35.7
1966	9,484	20.64	21.20	32.6	14.9
1967	7,374	25.39	20.25	20.1	.4
1968	10,847	22.02	20.60	40.7	25.6
1969	9,913	20.94	20.70	37.2	10.8
1970	10,135	21.86	20.70	23.7	.1
1971	10,379	28.07	19.50	11.9	*
1972	13,608	27.20	20.75	14.2	*
1973	12,896	44.40	20.65	13.5	*
1974	11,450	42.70	27.06	21.4	*
1975	8,247	51.10	36.12	8.4	*
1976	10,517	63.80	38.92	NA	*
1977	14,400	56.20	44.63	NA	*

[1] Abridged from Agricultural Statistics, 1975, pp. 59-61.
[2] Weekly Cotton Market Review, Vol. 57, No. 7.

* Less than 0.1 percent.

vidual years. The relatively high loan rates, huge storage stocks, and large crops tended to have a stabilizing effect on spot prices. Buyers were assured adequate supplies of cotton at prices established largely by the Government program for cotton. Loan rates held a floor under prices, while the large stocks and resale policy of the CCC negated any large price increase.

Government legislation reduced the loan rate to 21.20¢ per pound in 1966 and this had a significant effect on cotton marketing, table 1. The loan rate continued at or near this level through 1973, resulting in a reduction of the percent of cotton acquired by CCC to less than 0.1 percent. The spot market price received by farmers increased by 115 percent, and stocks acquired by the CCC were reduced to less than 500 bales yearly after 1971, table 2. Since 1966, production has averaged 10.9 million bales annually and mill consumption and exports have averaged 11.7 million bales per year.[5] The carryover dropped 6.0 million bales in the 1967-68 marketing year. This resulted because of the new program established by the CCC, and a disastrous crop year when only 7.4 million bales were produced.

[5] U.S. DEPARTMENT OF AGRICULTURE. 1978. Statistical Bulletin No. 535. March 1978.

TABLE 2. UPLAND COTTON: CARRYOVER AND AMOUNT ACQUIRED BY CCC UNDER SUPPORT PROGRAM, UNITED STATES, 1963-77[1]

Year	Carryover at beginning of season	Acquired by CCC under support program
	1,000 bales	*1,000 bales*
1963	11,005	5,799
1964	12,110	4,824
1965	14,018	5,306
1966	16,565	1,415
1967	12,270	32
1968	6,246	2,775
1969	6,347	1,066
1970	5,635	10
1971	4,183	*
1972	3,150	*
1973	3,863	*
1974	3,687	*
1975	5,414	*
1976	3,513	*
1977	2,867	*

[1] Abridged from Agricultural Statistics, 1975, pp. 59-61, Cotton: Supply and Distribution.

* Less than 500 bales.

With the carryover supply at 3.1 million bales in 1972 and annual production averaging only about 10 million bales, buyers and mill operators began attempting to guarantee themselves a supply of cotton by contracting with growers. Contracting usually began in the winter months prior to the planting season. The Cotton Division, USDA Agricultural Marketing Service, reported that 43 percent of the 1971 crop was contracted prior to harvest, at prices ranging from 22.00¢ to 28.50¢ per pound. The terms in contracts were reported to vary widely among producers using this method of marketing.

Variations in contract provisions led to much confusion on the part of farmers and buyers alike. Apparently many farmers hastily signed contracts to deliver cotton basing their decision only on the base price involved. When delivery time came growers realized that contract provisions pertaining to premiums and discounts based on lint quality, which seemed unimportant when the contract was signed, had an enormous effect on the price actually received. Lack of communication led to distrust among cotton growers, ginners, buyers, and merchants. An urgent need existed in the cotton industry for a clear understanding and rectification of the problems brought about by contracting.

OBJECTIVES AND METHODS OF STUDY

The general objective of this study, carried out in 1973, was to determine the types of contracts used by cotton buyers and the effect of these contracts on growers' returns.

Specific objectives were:

(1) To determine the different types of contracts used by marketing agencies in contracting for producers' cotton.

(2) To determine the effects of selected cotton marketing contracts on producer returns and on their responsibilities as entrepreneurs.

(3) To determine the effects of contract marketing on cotton merchandising firms and on the structure of the cotton market.

(4) To analyze the risks of growers and buyers in forward contracting.

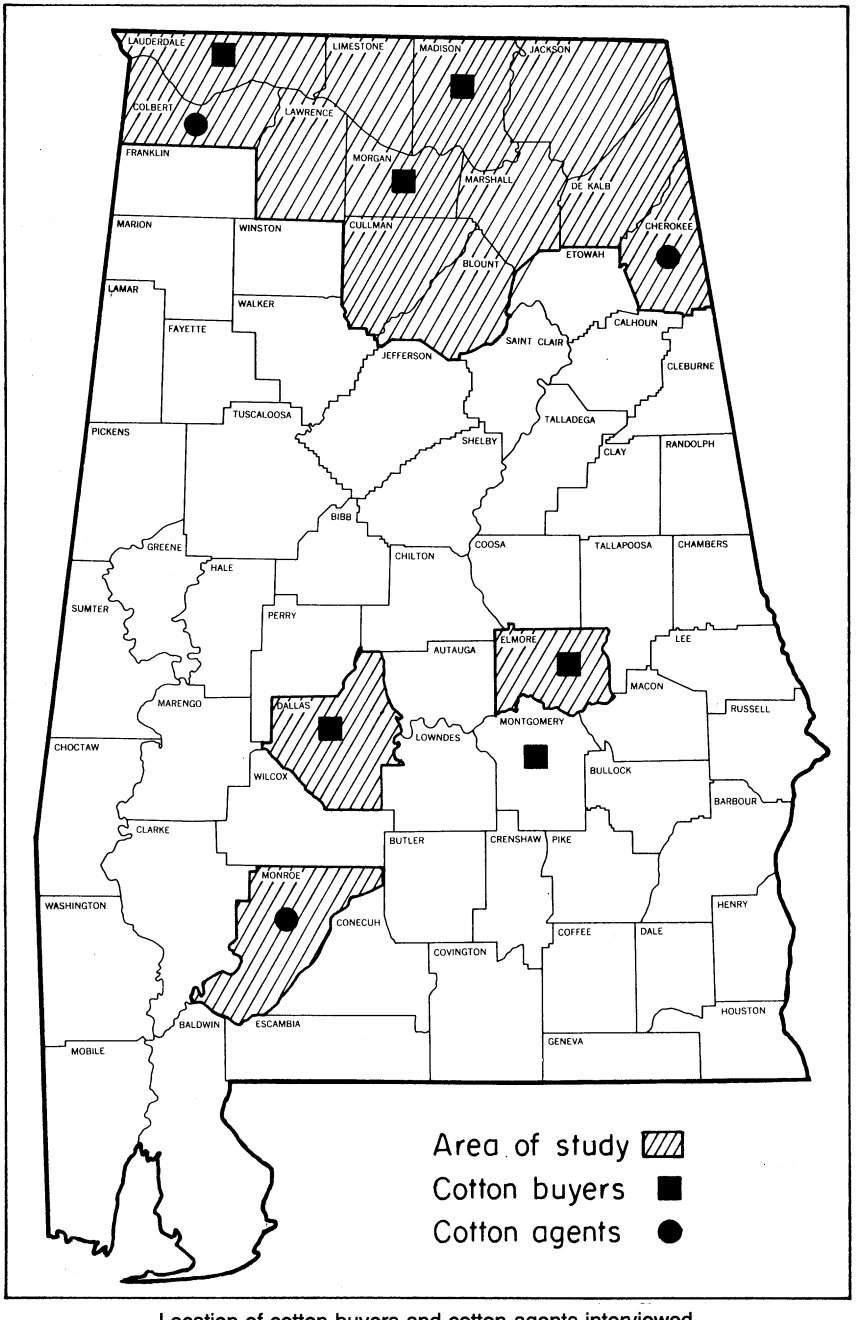
Data concerning grower contracts were obtained by personal interview with farmers in selected counties (identified by map). Counties were chosen on a production basis for the 1971 crop year with only those counties having 10,500 acres or more of cotton included in the survey.[6] This resulted in 15 counties comprising 60.3 percent of the State's production being included.

The counties selected and their acreages and production of cotton were:

County	*Acres planted, 1971*	*Total bales produced, 1971*
Blount	11,000	11,800
Cherokee	22,700	34,300
Colbert	22,700	34,300
Cullman	17,500	15,000
Dallas	19,700	22,500
DeKalb	22,100	22,800
Elmore	13,100	16,600
Jackson	15,500	15,400
Lauderdale	19,500	23,800
Lawrence	37,900	49,900
Limestone	46,100	65,800
Madison	55,300	84,000
Marshall	19,100	18,800
Monroe	11,400	12,900
Morgan	16,900	16,850

The names of 44 farmers were randomly selected from lists of known contractees, and these were personally interviewed using a prepared questionnaire.

[6] In addition to the 15 counties listed, contracts were made in one other county where production reached this level. However, the majority of cotton marketed in that county was through a marketing cooperative.



Location of cotton buyers and cotton agents interviewed.

An attempt was made to interview all central market buyers who had contracted with farmers in the counties selected. In addition, local buyers were interviewed along with persons or firms that acted as agents only (location shown on map, page 9).

FORWARD CONTRACTING

Although relatively new to cotton growers, forward contracting has been practiced for many years by growers and buyers of other agricultural commodities. Under this practice, a contract between a grower and buyer is signed prior to the commodity being harvested. In some situations and with some commodities, contracts are signed before production is started. Most cotton contracts were between growers and cotton merchants. However, in some localities local ginners contracted with growers. Buyers added processing and handling

TABLE 3. PROPORTION OF UPLAND COTTON CONTRACTED BY FARMERS, BY STATE AND REGION, U.S., 1970-77

State and geographic area	Cotton crops						Contracted Sept. 30	
	1970	1971	1972	1973	1974	1975	1976	1977
	Pct.	*Pct.*	*Pct.*	*Pct.*	*Pct.*	*Pct.*	*Pct.*	*Pct.*
Southeastern:								
North Carolina	3	4	8	66	8	4	38	16
South Carolina	5	20	30	75	17	16	42	18
Georgia	4	6	6	64	4	1	33	1
Alabama	15	48	33	83	11	4	68	9
AREA AVERAGE	8	28	23	73	10	5	50	9
South Central:								
Missouri	22	75	63	89	36	12	84	24
Mississippi	25	69	72	87	37	17	68	27
Arkansas	17	73	74	90	30	17	81	17
Louisiana	8	26	47	84	21	2	75	7
Tennessee	2	20	44	84	17	1	65	2
AREA AVERAGE	17	59	66	87	30	15	74	19
Southwestern:								
Oklahoma	*	7	7	35	*	*	25	19
Texas	7	39	13	69	7	1	22	19
AREA AVERAGE	7	37	13	68	6	1	22	19
Far Western:								
New Mexico	*	8	2	69	13	*	45	18
Arizona	6	19	29	75	40	23	61	49
California	8	28	25	80	55	34	73	30
AREA AVERAGE	6	23	24	75	48	30	69	34
United States	11	43	36	75	21	10	49	21

SOURCE: U.S. Department of Agriculture, Agricultural Marketing Service, Cotton Division.

* Less than 0.5 percent.

charges to grower contract price and either sold the cotton forward to mill buyers or hedged on the futures market. This sale by buyers was made immediately after contracts with growers were signed.

Activity in forward contracting cotton varied widely in the United States between 1970 and 1976. Variation in the proportion contracted was even greater in Alabama than in the United States, ranging from a high of 83 percent in 1973 to a low of 4 percent in 1975, table 3. Apparently, forward contracting has been accepted as a method of marketing by cotton growers in Alabama.

Types of Forward Contracts[7]

Of the 16 different contracts collected from growers, all but one involved the sale of cotton to be produced on a specified number of acres. The remaining contract called for delivery of a specified number of pounds of cotton. In acre type contracts, the base price stipulated applied to all grades and all staple lengths within micronaire measurements of 3.5 to 4.9. Discounts were calculated for other micronaires and for cotton delivered after cut-off dates. Discounts were based on different criteria. Some were based on the current futures market price and others on the spot market price. Some contracts specified that below grade cotton was to be delivered at a "negotiable" price. Discounts were expressed in points (usually 100 to 150 points) "off" or below the base price for failing to meet standards. A typical contract is reproduced in the Appendix.

Bale contracts specified that a certain number of bales were to be delivered to the buyer. Usually, this type contract was used late in the growing season when volume of production could be closely estimated. This enabled the buyer to sell forward more accurately to mills or on the futures market, which protected him against a price decrease. Bale contracts, unlike acre contracts, removed volume of production risks from the buyer and placed them on the grower.

Grower Participation

Half of the 44 growers interviewed contracted for the first time in 1973. Only 18 percent had contracted cotton in 3 or

[7] Members of the National Cotton Council together with representatives of growers, cooperatives, merchants, and mills developed a sample contract, given in the Appendix, which could be used as a guide.

more years. One in four growers contracted both in 1971 and 1973, years following those when contracted prices were substantially higher than the spot market price during harvest time. Only 9 percent of the contracting growers had contracted cotton for future delivery before 1970. Therefore, contracting is a relatively new cotton marketing tool in Alabama.

Of the producers who contracted to sell cotton produced from a specified number of acres, acres per grower averaged 320 and ranged from 11 to 962. Fifty-nine percent of the growers contracted all of their planted acreage. Approximately half contracted 260 acres or less and about 11 percent contracted 700 or more acres.

Contract Prices

The base contract price was the most important contract provision in determining returns to growers. This price applied to about 85 percent of the cotton delivered by growers. Prices for the remaining cotton were discounted because of the following discrepancies: (1) high or low micronaire measurements; (2) cotton reduced in grade because of grass or other reasons; and (3) cotton delivered after the cut-off dates of the contracts.

Futures market quotations reflect what traders on futures markets, in general, feel the spot market price will be at a future date. Because December is considered to be the end of harvest season for cotton, changes in the December quotation are observed closely by those who merchandise cotton. Most forward contracts with growers specified delivery of cotton in or near December. Contract prices were compared to December futures quotations on the day contracts were signed, table 4. The difference between contract prices and December futures quotations ranged from 4.92¢ to 20.72¢ per pound and averaged 7.64¢. Both the contract and futures prices rose during the growing season. Average contract prices in acreage contracts signed after March 30 were 7.60¢ higher than prices in contracts signed before March 30. The average of futures quotations after March 30 was a fraction over 12¢ per pound higher than before March 30. Prices in contracts signed by farmers ranged from 28¢ to 74¢ per pound. However, 70 percent of all contracts were for 32¢ or less. There were indications that contract prices did not change in proportion to

TABLE 4. FORWARD CONTRACT AND NEW YORK FUTURES MARKET PRICES, 12 CONTRACTS, ALABAMA, 1973

Type of contract	Dates of contracts	Base contract price/lb.	December 1973 futures price/lb.[1]	Difference between contract prices and Dec. futures quotation
		Cents	*Cents*	*Cents*
Acreage basis				
LM & better	2- 2-73	28.00	32.92	- 4.92
All grades	3- 1-73	30.00	35.70	- 5.70
All grades	3- 3-73	28.00	35.75	- 7.75
All grades	3- 5-73	30.50	35.75	- 5.25
All grades	3-15-73	32.00	37.06	- 5.06
All grades	3-21-73	33.00	38.74	- 5.74
All grades	3-30-73	32.50	37.82	- 5.32
All grades	4- 1-73	32.00	38.26	- 6.26
All grades	5- 9-73	40.00	46.55	- 6.55
All grades	7-12-73	32.73	53.45	-20.72
All grades	7-17-73	48.00	55.48	- 7.48
Bale basis	8-24-73	74.00	80.35	- 6.35
AVERAGE				- 7.64

[1] New York futures market closing price for the day preceding the date of the contract.

changes in December quotations. This was reflected in growers' response to the question: "How do you determine if the contract price offered is satisfactory?" Only 2 out of 44 indicated that the futures market was used as a guide.

The highest contract price reported was in the contract that provided for delivery of a specified number of bales. Such contracts should pay higher prices than contracts providing for delivery of cotton grown on a specified acreage because farmers bear the risk arising from the possibility of a poor production year. In 1973, however, the price of cotton was rising throughout the year, and most of the difference in contract prices was due to the time when contracts were signed.

Grower Evaluation of Forward Contracting

At the time of the interviews, most growers felt that forward contracting was a satisfactory method of marketing cotton. Six in 10 growers planned to continue selling cotton on forward contracts.

Price was named by 68 percent as the primary factor considered in deciding to accept or reject contracts offered by buyers. Date of delivery, grade stipulations in the contract, and reputation of the buyer were listed by approximately 10 percent of the growers. Other factors cited were market outlook, legality

of the contract offered, variety specifications, and the spread between the futures market quotation and the contract price for the specified delivery date.

In determining if the contract price offered was satisfactory, growers considered the margin between the cost of producing cotton and the contract price. Popular farm magazines and agricultural reporting services were the main sources of information about market outlook that growers used. More than half the growers felt the available information was inadequate for making decisions to accept or reject forward sales contracts. Most growers saw a need for information presented in a form more easily understood by farmers.

The major advantage of contracting cited by growers was protection against price declines. About half the growers felt that contracting, by fixing price early in the growing season, aided in planning production. Sixteen percent felt that lint quality was less important to buyers who contracted for cotton than to those who bought spot cotton. Only 7 percent thought that contracting increased competition among buyers. However, the proportion of cotton sold on forward contracts in 1973 could make that belief questionable.

Growers were asked what they considered to be disadvantages associated with contracting cotton for sale prior to harvesting. Replies varied, but inability of growers to capitalize on an increase in price was reported to be the most important disadvantage by 82 percent.[8] Forty-one percent said buyers were in a better position to evaluate market factors and to anticipate future demand and prices than were growers. Sixteen percent thought growers had insufficient market information early in the growing season when most contracts were signed. A like number believed buyers were in a better position than farmers to use the futures market for hedging cotton. This was because farmers had too little volume of cotton and were inexperienced in the use of futures as a hedging tool. Two growers believed buyers would try to find loopholes in the contract if the market went against them, leaving the farmer with cheap cotton, whereas the farmer could not reciprocate when prices rose as in the then current year.

Growers were asked how contracting affected the availability of production financing. Surprisingly, 39 percent of those

[8] At the time of the interviews, this condition was indeed the major disadvantage.

interviewed did not borrow money to finance production costs. Of the 61 percent who did borrow, two in three growers found that contracting the sale of cotton was helpful in obtaining loans.

Information also was sought on buyer acceptance of the cotton for which they had contracted. Only one grower experienced any problem with buyer acceptance of contracted cotton. In the previous year (1972) cotton was contracted at a price higher than the spot market price at harvest time. This could have resulted in buyers attempting to reject the cotton on a false pretext of low quality. However, growers indicated that this was not a problem.

Since contracts are legal documents, growers were asked if they had consulted a lawyer or sought any legal advice regarding the sales contract. Only 5 percent had consulted on the legality of terms of the agreement.

Buyer Evaluation

Forward contracting with growers created problems for cotton buyers. In an attempt to delineate some of these, efforts were made to contact buyers in major cotton producing areas and buyers who had contracted with the growers previously interviewed.

Eight buyers were interviewed: five central market buyers, two ginner-buyers, and one local buyer. Combined cotton purchases of the eight firms represented 80 percent of the cotton produced in Alabama in 1972. Seven of the buyers bought cotton for their own firm only, while the other purchased cotton for himself and acted as an agent for another buyer.

Six of the eight merchants had begun contracting cotton after 1971, and seven had contracted for more than 1 year. All buyers indicated they had begun contracting because of competition from other buyers who were contracting. This forced all cotton merchants to begin contracting to maintain their position in the marketing chain. One buyer indicated that mill representatives began buying cotton in his area in the late 1960's, thereby forcing cotton merchants into contract marketing.

Buyers were asked about the effect grower contracts had on the volume of cotton they handled. Only one of the eight

reported a change in the volume of cotton he handled, a 15 percent increase.

Forward contracting with growers had led to numerous changes in the operating procedures of cotton merchandising firms, buyers reported, the most notable being in sales procedures. Seven of the buyers had to change their practices of selling cotton. Most either had to sell cotton to mills earlier in the year or hedge their contract purchases on the futures market at a much earlier date than with spot market buying. This led to increased marketing costs in the form of interest on margin requirements. Seventy-five percent of the buyers indicated that contract marketing increased their use of the futures market.

The proportion of contracted cotton hedged on the futures market ranged from none to 50 percent. All buyers sold at least half their contracted cotton forward to spinning mills at or shortly after contracting. These two practices eliminated the possibility of buyers taking advantage of rising market prices, contrary to the popular belief held by most growers interviewed. No buyers carried any portion of their purchased cotton in an open position (neither hedged nor sold to mills).

Half the buyers said that contracting with growers led to a change in buying procedures. For example, ginner-buyers had to actively seek growers as contractees to secure enough cotton to operate their gins. Twenty-five percent of the buyers had changed their procedure for pricing lint cotton. They contended that contracting cotton with "all grades" contracts resulted in a lower grade of cotton, and that they had to alter the price paid accordingly.

Contract marketing of cotton brought little increase in the buying activity of country buyers, or in personal contracts among growers and buyers. Only two of eight said an increase in these areas of buying occurred as a result of contract marketing.

Buyers were asked if grower contracts influenced the loans they made. Only one of the two buyers who made production loans to growers gave an affirmative reply.

Grower Practices Required

All buyers indicated that they specified some cultural and other grower practices. These specifications ranged from the

very general to the very specific. For example, 25 percent of the buyers named the varieties to be planted by growers. Buyers reported that mills preferred certain varieties because of quality.

Seven of the eight buyers included statements in contracts regarding harvesting practices. Each specified that all cotton was to be hand or spindle picked. The main concern of buyers regarding harvesting was that cotton strippers not be used. This practice results in a much lower grade of cotton due to trash content. As another safeguard against low quality cotton, 75 percent of the buyers required that cotton under forward contracts be defoliated prior to picking. These requirements were used in an attempt to assure buyers of clean cotton. Neither required practice represented new procedures for growers since a great majority of upland cotton was already defoliated and machine harvested.

Five buyers had some statement in their contracts dealing with ginning practices, mainly concerning amount of heat to be used. Half specified the warehouse where cotton was to be stored. This was an attempt to minimize handling by the broker and to facilitate marketing.

All buyers considered the "locking in" of a price to be the main advantage of contract marketing to growers. Inability of growers to take advantage of price increases was cited by buyers as the main contracting problem for growers.

Buyers saw no advantage of contract marketing to themselves. They recognized the buying of acres of cotton and selling bales as the largest disadvantage of contract marketing to themselves. This problem placed production risks on the buyer instead of the grower, forcing the buyer to cover sales of known quantity and quality of cotton with unknown quantity and quality of cotton. Eighty-seven percent of the buyers felt that contracting of cotton would increase.

A majority of buyers had experienced problems with contract compliance by growers. The main problem was with growers who had some of the cotton grown on contracted acres ginned at other than stipulated gins, and then sold this cotton on the spot market. Another problem reported was with growers purposely reducing the grade of cotton when contracts specified that below grade cotton would be delivered at a negotiated price. This problem arose when prices of all cotton

rose tremendously between the date of contracting and harvest time. By delivery date, the price of below grade cotton was substantially higher than the contract price. Buyers felt that growers attempted to get unusual portions of their cotton into the lower grade to increase returns.

Contract marketing resulted in an increase in the costs of merchandising by buyers, 62 percent of the buyers reported. Each buyer indicated that entering the market earlier had caused higher interest costs for margin monies for the futures market. One buyer said that he employed an additional person to actively seek out contracts, thereby increasing his costs of operation.

Marketing Agent Response

Marketing agents were interviewed to determine the effect that contract marketing of cotton by agents had on the structure of the cotton market. Marketing agents were defined in this study as parties who negotiated contracts with growers for buyers, but did not actually take title to any cotton. They operated as brokers only at fees mutually agreeable to cotton buyers and themselves. Three agents were contacted in different cotton producing areas (shown on the map, page 9).

The three agents operated gins, with two owning the gins they operated. The third agent operated a cooperative gin. This agent also sold cotton on the spot market for patrons of the cooperative gin. Two of the agents had contracted cotton prior to 1973, while the other began in 1973. Forward contracting by these agents comprised between 48 and 95 percent of their total transactions in 1972.

The marketing agents used only the acre-type contract to forward contract cotton. Grower contracting resulted in no change in the method of operation for the agents, but one of the agent-ginners reported an increase of 10 percent in the amount of cotton handled as a result of forward contracting.

Two of the agents said they began contracting to keep ginning customers. The operator of the cooperative gin began contracting because of pressures by the grower members of the cooperative.

Marketing agents were asked for an opinion as to the advantages and disadvantages of contract marketing of cotton to both the grower and themselves. Obligation of growers to gin cot-

ton at that location was cited as an advantage by the operator of the cooperative gin. Another marketing agent reported that, by acting as an agent, he was relieved of pressures of selling forward the cotton that normally would be bought by him on the spot market and then sold to spinning mills. The third broker said he had less trouble getting ginning business because all contracts written by him required ginning at his gin.

One agent observed that for growers, elimination of price risks at harvest was the main advantage of contract marketing. A second broker said the opportunity to sell all cotton that met grade specifications at one price was the single most important benefit. All agents agreed that the inability of growers to share in spot market price increases during the production period was the main disadvantage of contract marketing to growers.

Two of the three agents stated that acreage contracts created problems for them as agent-ginners. One thought that a single price for all grades of cotton resulted in growers delivering lower quality cotton to the gin. Another agent voiced the opinion that acre-type contracts did not reward ginners who had modern equipment and delivered a higher quality processed product. However, all marketing agents believed that the use of contracts would increase as a method of marketing cotton.

SUMMARY AND CONCLUSION

The general objective of this study was to examine the various contracts being used and provide information about contract marketing of cotton that would be helpful to all parties of the industry.

The advantages of forward contracting reported most often by growers were (1) provides protection against price declines, and (2) aids in planning production. The major disadvantages were (1) growers did not share in price increases, and (2) growers were at a disadvantage in evaluating the cotton market outlook.

All cotton buyers indicated that they started contracting only after competition forced them to begin. Only one of eight said contracting of cotton had changed the volume of cotton handled. Seven buyers changed their method of selling cotton. Most indicated that they had to buy cotton earlier and, consequently, sell earlier to mills or hedge contract purchases

on the futures market. This resulted in more marketing costs for buyers in the form of interest on margin requirements. Seventy-five percent of the buyers reported contract marketing had increased their use of the futures market.

All buyers considered the "locking in" of a price early in the growing season as protection against a price decrease to be the main advantage of contracting to growers. None of the buyers saw any advantage to themselves from contract marketing. Inability of growers to take advantage of price increases was cited by buyers as the main problem for contracting growers.

A majority of buyers experienced problems with grower compliance. The principal problem was with growers ginning portions of their cotton at unspecified gins and not delivering as agreed in contracts. This cotton was subsequently sold on the spot market at a price considerably above contract prices. Only one grower said that he experienced problems in getting buyers to accept contracted cotton.

Unanimously, buyers recognized that buying acres of cotton and selling bales, which are the units of trade on the futures market as well as with mills, was the most serious disadvantage to them of contracting cotton. This problem placed production risks on the buyer instead of the grower by forcing buyers to cover purchases of potentially variable quantities with sales of specified quantities and qualities of cotton.

Two of the three marketing agents stated that they began contracting to keep their ginning customers. All agents agreed that the inability of growers to share in price increases was the main disadvantage of contract marketing to growers.

Forward contracting as a method of marketing cotton in Alabama was used extensively in 1973, when 83 percent of the State's production was contracted. Changes in government agricultural policy, abnormal weather conditions both early and late in the growing season, and the entrance of foreign mill buyers into the domestic market combined to drastically affect forward contracting. As a result, the final analysis by growers and buyers of this method of marketing cotton was one of general disappointment.

With the high investment in machinery and the high costs of production prevalent today, farmers need protection against financial risks. One such method for cotton farmers is forward contracting, which allows growers to protect themselves against price declines.

APPENDIX

CONTRACT FOR PURCHASE AND SALE OF COTTON

THIS CONTRACT made and entered into as of this _____ day of _____, 197____, at _____ between _____ of _____, called "Seller", and _____ of _____, called "Buyer", WITNESSETH:

IN CONSIDERATION of the mutual promises and obligations contained herein, sufficiency of which is acknowledged, the parties agree as follows:

1. Description of Acreage Contracted: On the terms and conditions and at the prices set forth below, Seller hereby sells and agrees to deliver and Buyer hereby purchases and agrees to take delivery of _____ of the acceptable cotton produced during the crop year 197____-197____ on _____ acres situated in the State of _____ more fully described below:

ASCS Farm No. Or Other Description	LOCATION County	NO. ACRES Contracted	

IF LANDLORD'S BALE SHARE IS NOT INCLUDED IN THIS CONTRACT, ONLY TENANT'S SHARE SHOULD BE SHOWN ABOVE.

If ASCS farm numbers are not available at the time of execution of this contract by Seller, or if farm numbers are changed, Seller agrees to furnish farm numbers and other related information immediately upon farm numbers being determined.

2. Acceptable Seed Varieties to be planted are: _____

3. Price and Other Terms: The prices to be paid for acceptable cotton shall be as follows: _____

(Note: Prices for various qualities, delivery dates, etc., to be negotiated and written in here may include, in addition to grade, staple and micronaire, the following: below grade; cotton reduced for grass, bark, etc.; deliveries after certain dates; cotton harvested by certain methods, such as picked up off the ground; cotton planted in certain patterns, such as narrow rows; etc.)

4. Ginning and Warehousing: The cotton to be ginned at _____ (name(s) and location(s) of gin(s))

and is to be warehoused at _____ (name(s) and location(s) of warehouse(s)) by Seller unless Buyer approves a change in writing, and all rebates given by the compress will be for the account of Seller.

5. Charges. All accrued charges (such as receiving and warehouse charges) to date of invoice are to be deducted from payment to Seller. Seller shall pay the Cotton Research and Promotion Fee. All rules of _____ (exchange or association) relevant to charges, freight, handling, billing and weights of cotton shall apply.

6. Invoicing. Seller agrees to invoice the cotton promptly as government class is received. Cotton is to be invoiced on warehouse receipts, net weights with official USDA class cards attached, and invoiced as follows:

7. Liens or Prior Interests. Seller acknowledges that the following, and only the following liens or prior interests (landlord's lien, landlord's crop share in bales, landlord's crop share in money, PCA, bank, prior crop contracts, etc.) are in effect against the production from the contracted areas, to wit: _____

_____

Name Address Nature of Lien or Prior Interest

(Unless filled in, Seller warrants there are NONE.) Seller warrants that he will satisfy all liens from Buyer's payment for the cotton. If Seller's contracted acres are subject to a crop share in bales lease with his landlord, Seller should have his landlord join in signing below for Seller's protection, or limit amount in paragraph 1 to tenant's share, inasmuch as Seller absolutely warrants delivery to Buyer of the entire production described in paragraph 1.

8. Jurisdiction. It is acknowledged that this contract is accepted by Buyer in the State of _____ _____, and shall be governed by and interpreted in accordance with the laws of said State. Should any litigation arise out of or occur because of the breach of this contract, both parties agree to submit to the jurisdiction of any State or Federal court in the State of _____, empowered to hear and determine such dispute, with any non-resident party hereby agreeing that service of process by a judicial officer or by the Secretary of State of said State through registered mail shall be sufficient to establish personal jurisdiction.

9. General Terms Incorporated. This contract includes all of the General Terms set out on the reverse of this page. BOTH PARTIES HAVE CAREFULLY READ AND FULLY UNDERSTAND THE TERMS AND PROVISIONS CONTAINED ON THE FRONT AND BACK OF THIS CONTRACT, WHICH REPRESENTS THE ENTIRE AGREEMENT BETWEEN THE PARTIES, AND FURTHER UNDERSTAND THAT THERE MAY BE NO MODIFICATION OF THIS CONTRACT EXCEPT IN WRITING. TIME IS DEEMED TO BE OF THE ESSENCE IN THE PERFORMANCE OF THIS CONTRACT.

Witness our signatures as of the day and year first above written.

Seller _____ Buyer _____

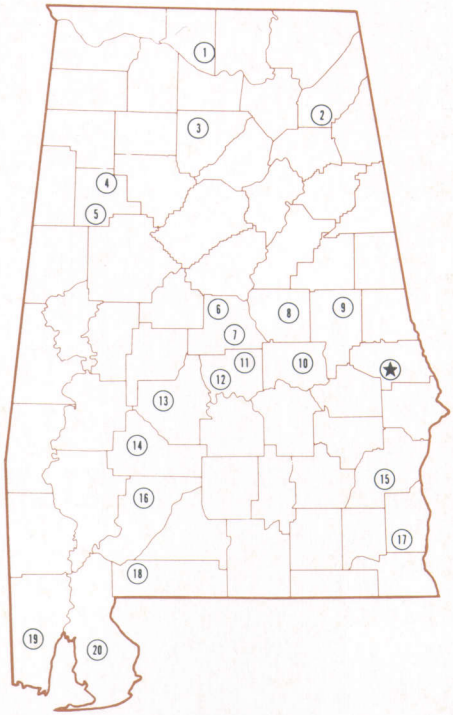
By _____ By _____

Witness: _____ Witness: _____

(Seller's Agent (if any)) (Buyer's Agent (if any))

Alabama's Agricultural Experiment Station System
AUBURN UNIVERSITY

With an agricultural research unit in every major soil area, Auburn University serves the needs of field crop, livestock, forestry, and horticultural producers in each region in Alabama. Every citizen of the State has a stake in this research program, since any advantage from new and more economical ways of producing and handling farm products directly benefits the consuming public.



Research Unit Identification

★ Main Agricultural Experiment Station, Auburn.

1. Tennessee Valley Substation, Belle Mina.
2. Sand Mountain Substation, Crossville.
3. North Alabama Horticulture Substation, Cullman.
4. Upper Coastal Plain Substation, Winfield.
5. Forestry Unit, Fayette County.
6. Thorsby Foundation Seed Stocks Farm, Thorsby.
7. Chilton Area Horticulture Substation, Clanton.
8. Forestry Unit, Coosa County.
9. Piedmont Substation, Camp Hill.
10. Plant Breeding Unit, Tallassee.
11. Forestry Unit, Autauga County.
12. Prattville Experiment Field, Prattville.
13. Black Belt Substation, Marion Junction.
14. Lower Coastal Plain Substation, Camden.
15. Forestry Unit, Barbour County.
16. Monroeville Experiment Field, Monroeville.
17. Wiregrass Substation, Headland.
18. Brewton Experiment Field, Brewton.
19. Ornamental Horticulture Field Station, Spring Hill.
20. Gulf Coast Substation, Fairhope.