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How Interwar Collaborations
between the CBOT and the
State Created Modern
Futures Trading

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SALEUDDIN



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Rasheed Saleuddin

The Government of Markets

How Interwar Collaborations between the CBOT
and the State Created Modern Futures Trading

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To Ammon.

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ABBREVIATIONS

1921 Act	The Futures Trading Act of 1921. 42 Stat. 187
1922 Act	The Grain Futures Act of 1922. 42 Stat. 998, 7 U.S.C. § 1
AAA	Agricultural Adjustment Act
ADM	Archer Daniels Midland
AFBF	American Farm Board Federation
AMA	Agricultural Marketing Act
BAE	Bureau of Agricultural Economics
BCC	Business Conduct Committee
CBOE	Chicago Board Options Exchange
CBOT	Chicago Board of Trade or Board of Trade at Chicago
CEA	Commodity Exchange Act of 1936. 49 Stat. 1491
CFTC	Commodity Futures Trading Commission
CME	Chicago Mercantile Exchange
FFB	Federal Farm Board
FINRA	Financial Industry Regulatory Authority
FNG	Farmers' National Grain Corporation
FTC	Federal Trade Commission
GCNA	Grain Committee on National Affairs
GFA	Grain Futures Administration
GFC	Grain Futures Commission
ICC	Interstate Commerce Clause
KBOT	Kansas City Board of Trade
NIRA	National Industrial Recovery Act. 48 Stat. 195
USDA	United States Department of Agriculture

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THE CAST OF CHARACTERS

The main participants in the governance and government of the CBOT are listed below in alphabetical order, with the exception of the CBOT presidents and secretaries in the chart immediately following.

Until very recently, the Chicago Board of Trade was run by a volunteer president and a paid secretary and supervised by an unpaid Board of Directors.

	<i>CBOT President</i>	<i>CBOT Secretary</i>
1920	Leslie Freeman Gates	John R. Mauff
1921	Joseph P. Griffin	
1922	Robert McDougal	
1923	John J. Stream	James J. Fones
1924	Frank Leighton Carey	
1925		
1926	John A. Fones	
1927		
1928	Sam P. Arnot	
1929		Fred H. Clutton
1930	John A. Bunnell	
1931	James C. Murray	
1932	Peter B. Carey	
1933		
1934		
1935	Robert P. Boylan	
1936		

There were a few other CBOT board members, lobbyists and legal representation. Other exchanges often appear in the archives, especially relating to lobbying and market policing efforts. Additionally, the Grain Futures Administration (after 1936, the Commodity Exchange Administration) had a staff that was remarkably consistent through the interwar years.

Julius Barnes—Grain trader from age thirteen until the age of 56.

President (beginning in 1922) and the Chairman of the United States Chamber of Commerce.

James E. Bennett—President of James Bennett & Co., and an influential CBOT member.

L. C. Brosseau—Member of the CBOT and, for a time, Chairman of legal advice and rules committee.

George Burmeister—Investigator under contract to the CBOT.

Arthur Capper—Newspaperman, Governor of Kansas (1915–1919) and long-serving (1919–1949) US Senator from Topeka, Kansas.

Frank Leighton Carey—CBOT President, 1924–1925. A partner at Minnesota grain trader Hallet & Carey Co. with offices in Minneapolis and Duluth.

Arthur Cutten—Canadian-born speculator, believed responsible for the 1925 rise in wheat prices sometimes known as the ‘Cutten Corner’.

Joseph William Tell Duvel—Grain Exchange Supervisor for Chicago (1922–1925), then Chief, Grain Futures Administration (GFA).

L. A. Fitz—Specialist at the GFA.

Leslie Freeman Gates—CBOT President, 1920, but involved in lobby and other affairs throughout the interwar years.

Chester Gray—President, American Farm Board Federation.

B. L. Hargis—President, Kansas City Board of Trade.

George Wright Hoffman—Assistant professor, University of Pennsylvania who also consulted for the GFA and the CEA.

Harold S. Irwin—Specialist, GFA.

Alexander Legge—President of the International Harvester Company (1922–1933) and Chairman of the Federal Farm Bureau (1929–1931).

Mrs. P. W. Macmillan—Lobbyist in Washington for various exchange groups.

Joseph Martin Mehl—Specialist, GFA.

- Chester Morrill—USDA lawyer from 1914. Assistant to the Secretary, 1921 and 1925. Secretary, general counsel Federal Farm Loan Board, 1927–1931.
- Henry S. Robbins—Lead counsel to the CBOT with Robbins Townley, Wild, Campbell and Clark, a Chicago law firm.
- Rollin Smith—Floor trader who wrote a long study *Hedging in the Futures Market*, published by the Board around 1919. Specialist, Grain Futures Administration, after 1923.
- Jasper N. Tincher—Representative for Kansas in Congress, 1919–1927.
- Morris Townley—Counsel to the CBOT with Robbins Townley, Wild, Campbell and Clark, a Chicago law firm.
- Fred B. Wells—Chamber of Commerce, Minneapolis, Chairman, General Committee.
- A Clement Wild—Counsel to CBOT with Robbins Townley, Wild, Campbell and Clark, a Chicago law firm.
- Holbrook Working—Academic at Stanford University’s Food Research Institute (from 1925).



CHAPTER 1

Introduction: The Interwar Coming of Age of Modern Futures Markets, Institutions and Governance

Modern futures markets are generally assumed to have originated and developed on their own with the sole aim of providing a more efficient and effective marketing venue and risk management tool for buyers and sellers of commodities. It has been observed that

[I]t is not too much to say that free commodity markets [...] are symbols of free societies [...] State Socialism, whether Communist, Fascist, or Socialist, means the destruction of free markets and their replacement by governmental buying and selling monopolies [...] Commodities exchanges are vital to the economic stability of a free society.¹

The idea of the futures market as the epitome of financial capitalism carries over into the study of the history of the development and governance of modern exchanges. Governments, in the accepted history, attempted, mostly unsuccessfully, to interfere with the *laissez-faire* Chicago Board of Trade (CBOT), along with its major competitor in Chicago the dominant exchange of the twentieth century. However, futures markets, today ubiquitous in modern finance, were in fact co-constructed during the interwar years by users, individuals and, crucially, the US Federal Government. Early on, the CBOT controlled the

¹Julius Baer and Olin Saxon, *Commodity Exchanges and Futures Trading* (New York: Harper and Brothers, 1949), p. xi.

process and, often, the outcome, yet government had very important roles to play in what became co-regulation. By the end of the interwar era the government cooperated closely with futures users to refine the regulatory and governance regimes that mostly survive into the present day. This book tells the story of the development of the many modern institutions for trading and governance that were developed in the USA during the interwar years, offering lessons for future regulation and governance debates, especially those following the global financial crisis of 2008–2009 (GFC). Government, then, had both critical and positive roles to play in the development of early financial markets and their governance.

Futures trading truly came of age in the middle of the nineteenth century in many commercial hubs of the USA, particularly the Midwestern city of Chicago.² The exchange trading of contracts of specified quantities and qualities of a commodity, to be delivered at some future date, has since expanded to include most globally traded commodities and, more importantly, currency, stock, bond and money markets. Such contracts are now ubiquitous in modern finance. In 2014, 21.87 billion futures and options contracts were traded on exchanges globally, for a dollar-equivalent volume of \$50,000,000,000,000 (\$50 trillion). In 1910, as in 1940, the CBOT was dominant, executing 80 to 85% of all futures contracts traded in the USA.³ Chicago futures exchanges—with the CBOT now merged into its ex-rival, the Chicago Mercantile Exchange (CME) and the Chicago Board Options Exchange (CBOE)

²There were earlier futures markets. But none of these were anywhere near as important as wheat and corn in Chicago, and none survived into the twentieth century. For Dutch markets in the sixteenth century, see Milja Van Tielhof, *The 'Mother of All Trades': The Baltic Grain Trade in Amsterdam from the Late Sixteenth to the Early Nineteenth Century* (Leiden: Brill, 2002); Oskar Gelderblom and Joost Jonker, "Amsterdam as the Cradle of Modern Futures and Options Trading, 1550–1650," in *The Origins of Value: The Financial Innovations That Created Modern Capital Markets*, ed. William N. Goetzmann and Geert Rouwenhorst (New York and Oxford: Oxford University Press, 2005), pp. 189–205. For Japan in the eighteenth century, see Shigeru Wakita, "Efficiency of the Dojima Rice Futures Market in Tokugawa-period Japan," *Journal of Banking and Finance* 25 (2001): 535–554.

³Other commodity futures markets existed in other centres in the US. For example, wheat and most other grain futures were traded in other Midwestern cities such as Kansas City, and New York handled the cotton futures market. See Anne E. Peck, "The Economic Role of Traditional Commodity Futures Markets," in *Futures Markets: Their Economic Role*, ed. Anne E. Peck (Washington, DC: AEI Press, 1985), p. 9.

spun off into its own entity—continue to lead derivatives trading into the twenty-first century.

The CBOT—as one of the preeminent markets for the trading of futures—has remained synonymous with innovative and successful financial market capitalism, and its institutions and modes of governance have been adopted far and wide, including in the 2010 ‘Dodd-Frank’ Act meant to cure the excesses of the 2008–2009 GFC.⁴ In fact, the GFC has directly impacted the academic study of financial regulation, and regulation in general, while further driving a wedge between those who believe that crises are caused by too little regulation and those who believe there is too much.⁵ Free market economists tend to argue that the laws and regulations of the land led directly to too much risk in the financial system.⁶ Even if government regulation was a main cause of the crisis, the solution is still debatable. Barth, Caprio and Levine want to set up an ‘overseer’ regulator on top of the already overwhelming and often conflicting extant regulatory regime.⁷ Others advocate for significantly fewer rules. Indeed, industry pushback on the new post-crisis regime has been quite successful, arguing that over-regulation inhibits economic growth by restraining financial markets.⁸ Many commentators, especially from the Chicago school, lament that any collaboration between the state and industry must inevitably lead to the capture of the regulations and the regulators by the industry, enabling the latter to extract concessions or powers from those with political power.⁹ That is,

⁴The Dodd-Frank Wall Street Reform and Consumer Protection Act (2010).

⁵For a description of the troubles facing the academic study of regulation, see Martin Lodge and Kai Wegrich, “The Regulatory State in Crisis: A Public Administration Moment?” *Public Administration Review* 70 (2010): 336–341.

⁶See, for example, the free market view of Robert Litan, “The Political Economy of Financial Regulation After the Crisis,” in *Rethinking the Financial Crisis*, ed. Robert Solow, A. Blinder, and A. Loh (New York: Russell Sage Foundation, 2012).

⁷James Barth, Gerard Caprio, Jr., and Ross Levine, *Guardians of Finance* (Cambridge: MIT Press, 2012).

⁸Just before the GFC, Treasury Secretary and ex-Goldman Sachs Hank Paulson argued that ‘too much’ financial regulation would impact growth, hence the need to favour a *laissez faire* approach. See D. Lawder, “Paulson says strongly committed to strong dollar”, *Reuters*, 30 October 2007.

⁹For the original arguments, see George Stigler, “The Theory of Economic Regulation,” *Bell Journal of Economics and Management* 2 (1971): 3–21. For a more recent accusation of state capture by the financial industry, see Simon Johnson and James Kwak, *Thirteen Bankers* (New York: Pantheon Books, 2010).

state interference is always bad, either allowing the regulated to extract monopoly (and other) rents or inhibiting growth through unnecessary and throttling regulation and enforcement.

There is an almost endless debate among practitioners, academics and interest groups over whether markets, their users and, indeed, all affected by the markets, are better served by *laissez-faire* or government control. This book robustly argues that this is a false dichotomy: the Chicago futures markets were demonstrably improved and nurtured by both industry governance and governmental interventions during the interwar years. As is becoming increasingly clear, the state and markets can and do work together effectively to create and nurture new markets.¹⁰ This work, with clear substantiated historical evidence that governments and industry can work together to build better governance systems and solid, enduring institutions, should remind our lawmakers and regulators, as well as those in the financial markets, that *laissez-faire* on its own cannot be relied on to create efficient markets.

Current futures markets share many institutions and governance systems with the markets of 1923–1936. All markets are defined by (i) what is now known as central clearing of all trades, (ii) the reporting and dissemination of large positions in the market, (iii) a requirement for daily margining based on daily closing prices. Further, all exchanges (iv) possess Business Conduct Committees (BCC) and have (v) enacted rules regarding self-dealing, and (vi) segregating clients' monies from brokers' capital. Additionally, market data of all types are provided willingly by all futures exchanges, rather than distributed grudgingly, or even entirely withheld, as they were before 1923. Central clearing is perhaps the most important of all of these innovations, but each and every institution and control listed above is present in modern futures markets all over the world, in products ranging from cotton to crude oil to euro/dollar to stock indices.¹¹ Importantly, all of these innovations were established between 1923 and 1936. Many commentators view the development of

¹⁰See, for example, the Food and Drug Administration's approval mechanism as market transformative in Daniel Carpenter, "Confidence Games: How Does Regulation Constitute Markets?" in *Government and Markets: Toward a New Theory of Regulation*, ed. Edward Balleisen and David Moss (Cambridge: Cambridge University Press, 2009). For the argument that the state can foster markets, see Mariana Mazzucato, *The Entrepreneurial State* (New York: Public Affairs, 2013).

¹¹For an explanation of the importance of central clearing, see Chapter 4.

central clearing as the most significant. Yet before 1922, elements of the CBOT resisted any such changes. It is my contention that it was specifically government involvement that facilitated, if not always instigated, the institutional and governance changes necessary to ensure reasonably efficient markets for all users by 1936.

For all of Chicago's symbolic power and actual dominance of many financial and commodity markets for a century or more, there are very few studies of the origins of modern futures trading. Of those, none can rely, as this one can, on the inside story, told via the formerly private papers of the key actors. This book is intended to fill a major gap in our knowledge of the evolution of these key markets during the interwar years, documenting the role of a newly empowered US Federal Government in co-constructing these financial markets with, rather than in opposition to, the Chicago-dominated grain futures industry. One key conclusion from this study is that governments play crucial roles in developing and maintaining the efficient functioning of markets, since the CBOT may not have been capable of acting in its own best interests, let alone in the interests of society. This finding is still relevant to this day.¹² The finding also contradicts the accepted accounts, which are unfortunately based on ideological biases, (shallow) readings of press reports and public government documents.

1.1 RHETORIC OVER POLICY SUBSTANCE, IN 1922

On the Senate floor on 9 August 1921, Senator Arthur Capper, self-described populist newspaperman and sponsor of a bill on the floor at the time, announced that 'the grain gamblers have made the exchange building in Chicago the world's greatest gambling house. Monte Carlo or the Casino at Habana are not to be compared with it'.¹³ This moment was the culmination of almost a year of lobbying and work that ended

¹²For the co-construction argument, see, generally, Edward Balleisen and David Moss, eds., *Government and Markets: Toward a New Theory of Regulation* (New York: Cambridge University Press, 2009). For the government failure argument, see James Barth, Gerard Caprio, and Ross Levine, *Guardians of Finance: Making Regulators Work for Us* (Cambridge: MIT Press, 2012). For an analysis of the risks of interactions between government and markets, see Rasheed Saleuddin, *Regulating Securitized Products: A Post-crisis Guide* (London: Palgrave Macmillan, 2015), pp. 103–127.

¹³61 Cong. Rec. 4761, 4763 (9 August 1921) (remarks of Sen. Capper).

with his Bill's passage in the House a mere two weeks later on 24 August 1921. Earlier in the process he had bragged,

\$909,000,000 [is the] loss the Chicago wheat gamblers have caused American wheat raisers in the last two months by gambling in futures [...] in the *biggest gambling hell* in the world [...] operated at the Chicago Board of Trade [...] Several weeks ago I began work on measure to *abolish* this injurious form of *robbery* and shall press this bill on the first day of the next Congress and will undertake to *put this den of thieves out of business*.¹⁴

His strong words—'abolition' and 'out of business'—suggest Capper was out to ban futures trading. And the press was willing to fuel the fires of rhetoric. In September 1920, an article in the *Mississippi Valley Magazine* carried the byline 'the Chicago Wheat Pit denounced as a den of thieves by a United States Senator'.¹⁵ Later, one of the senator's newspapers, *Capper's Weekly*, had stated that the Capper-Tincher Bill would put the exchanges out of business.

The above public 'facts' have played important roles in justifying the state versus market conflict that is claimed by financial historians to have existed in the interwar years. However, private and previously confidential documents reveal this story to be false. Indeed, the executive of the CBOT, the organisation that was supposedly to be put 'out of business', was far from worried. Soon after Capper's remarks on the Senate floor, CBOT President JP Griffin wrote a letter, exhorting Mauff to calm panicked traders in Chicago and at other exchanges. This letter was likely never seen by more than a few close colleagues of the Secretary and the President of the most powerful commodity exchange. Confidentially, Griffin reminded Mauff that there were compelling reasons for the CBOT and the other exchanges to accept the new Bill as law. He began,

[Capper's 'gambling hell'] tirade [...] in no respect had reference to legislation enacted by the adoption of his bill [...] no good end was to be achieved by a long dissertation in denial of his charge.¹⁶

¹⁴Capper quoted in *Commercial and Financial Chronicle*, 16 October 1920.

¹⁵Letter, J.W. Barkdull, New Orleans, to Arthur F. Lindley, CBOT member, 22 September 1920. CME III.ss1.6.

¹⁶CME III.ss2.653.2 Letter from the President to J. Mauff, 16 August 1921.

Griffin wanted his membership to understand that it was the CBOT's version of the Bill, except for one minor annoying clause, that had entered the floors for the final votes, even if previous versions were less friendly to exchanges. The Bill was not going to shut the markets down at all; far from it. He continued,

The plain and simple facts are [...] the bill is *drafted substantially as we wished* [...] As they *yielded substantially to us* on the substance [...] I do not see how we could have acted differently [... There is] a sentiment in Washington that some legislation should pass, so the Act 'removes the popular clamor [and will] very likely prevent onslaught against us in the different State legislatures.'¹⁷

That is, the Bill was toothless in substance if not in rhetoric. In fact, it bestowed many enduring positive benefits on the exchanges, such as ending highly damaging State interference in the markets with finality, while eliminating certain competitive forces such as both real and faked exchanges.

1.2 THE CBOT EXPERIENCE AS A CASE OF MARKET REGULATION

The study of regulation requires society to focus the mind on what should be 'the optimal relationship between market and state, economy and polity, individual and society'.¹⁸ New regulatory institutions shape subsequent economic, political and cultural developments.¹⁹ John Stassen believes that 'to the serious student of the legal system [...] the

¹⁷CME III.ss2.653.2 Letter from the President to J. Mauff, 16 August 1921. Italics added by author.

¹⁸Mary Furner, "From 'State Interference' to the 'Return to the Market': The Rhetoric of Economic Regulation from the Old Gilded Age to the New," in *Government and Markets: Toward a New Theory of Regulation*, ed. Edward Balleisen and David Moss (Cambridge: Cambridge University Press, 2009), p. 92. See also James Farr, "Understanding Conceptual Change Politically," in *Political Innovation and Conceptual Change*, ed. Terence Ball, James Farr, and Russell Hanson (Cambridge: Cambridge University Press, 1989).

¹⁹Neil Fligstein, "Markets as Politics: A Political-Cultural Approach to Market Institutions," *American Sociological Review* 61 (1996).

legislative history of futures regulation is obviously of great value'.²⁰ Commodity markets are not natural endowments of an economy but are politically constructed social realities. Understanding how these markets develop and become controlled by the state is extremely important.²¹

Peter Pashigian inspired this study by observing that: 'while futures markets have been regulated in one sort of a way or another over many years, little is known about the sources of support for regulation and precious little is known about the underlying reasons for the regulations'.²² The interwar futures market provides not only an example of the growing Federal Government involvement in the economic affairs of American citizens and businesses, but also a study of how political institutions and cultural norms can come to influence the adoption, and evolution, of what is now known as 'economic regulation'. Until now, a detailed 'inside' history did not exist.²³

The above Griffin letter is but one direct and compelling example, of how the rhetoric in the press and in the public record of hearings and debates provides a highly misleading—and in this case, opposing—interpretation of *actual* events. It's also a prime example of the success industries often have in lobbying: what Gabriel Kolko identified as clientele politics of the era, earlier labelled by economist George Stigler as capture. In many cases throughout history, and into the current era, interest groups with the most at stake are often able to obtain concessions from the government. In some cases, it was the 'monied interests' who were able to wrest 'rents' from the state.²⁴ For those biased towards the more 'progressive' explanations, regulation was defined by an unequal struggle

²⁰John H. Stassen, "The Commodity Exchange Act in Perspective—A Short and Not-So-Reverent History of Futures Trading Legislation in the United States," *Washington & Lee Law Review* 39 (1982), p. 825.

²¹Richard F. Bense, *The Political Economy of American Industrialization, 1877–1900* (Cambridge: Cambridge University Press, 2000), pp. xvii–xxii.

²²B. Peter Pashigian, "The Political Economy of Futures Market Regulation," *The Journal of Business* 59 (1986), p. S55.

²³Ferris admitted as much in William G. Ferris, *The Grain Traders* (East Lansing: Michigan State University Press, 1988), p. ix.

²⁴Gabriel Kolko, *The Triumph of Conservatism: A Reinterpretation of American History, 1900–1916* (New York: The Free Press, 1963). For a more general case, see Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review* 64 (1974).

of the people against the monied interests who frequently dominated politics.²⁵

Yet the exchanges and their lobbyists were not always successful legislatively. Indeed, as should be expected, the story of early market regulation is far more complex than can be defined by either a government versus markets dichotomy or a strict capture explanation. Accordingly, this book, with its inside view of both industry and government efforts to create modern futures trading, reveals that the relationships between industry, market users, policy-makers and regulators varied over time, in response to several highly specific contexts. Governance and institutional development in this nascent market did not follow any simple or absolute model.

This book argues that the CBOT as the ‘rent seeker’ was able to dominate Congress, the US Department of Agriculture (USDA) and then the Grain Futures Administration (GFA), as a product of shared ideology in industry and in government. Capture was a driver in the early 1920s, yet even then the regulation was not fully supportive of industry (transparency was the *quid pro quo* for state support of futures markets). An environment biased against state interference in the mid- to late 1920s meant that government had to operate informally, at the same time that progressive forces within the futures industry realised that the assistance of the state was essential to overcome collective action problems. Later, in 1926, there was a co-construction of markets by both government and industry even as the CBOT remained influential in Washington. Finally, in the 1930s, special interests cooperated with the government to install consumer protection laws. By 1936, however, a powerful lobby driven not by rent-seeking but rather by revenge was able to impose important changes on the exchanges that ended up being in the interests of all of society.

Did the state always get it right? Of course not. There were suboptimal decisions over the interwar years on all sides. But policy creation is a messy enterprise, and muddling through the issues and compromising between interests involves time-consuming processes even as it requires trial and error. The sheet in 1921 was blank. Market regulation did not

²⁵Mary Furner, “From ‘State Interference’ to the ‘Return to the Market’: The Rhetoric of Economic Regulation from the Old Gilded Age to the New,” in *Government and Markets: Toward a New Theory of Regulation*, ed. Edward Balleisen and David Moss (Cambridge: Cambridge University Press, 2009), p. 92.

exist, and neither did many key characteristics of modern futures markets. Neither *laissez-faire* nor state policy alone could create a successful modern market in such a vacuum. The fact that the futures market exited the interwar era with most modern institutions and governance mechanisms well entrenched is a huge success story for government *and* markets.

1.3 THE THEMES OF THIS BOOK

This book has four key themes. First, I believe that the true history of any new market and its regulation must rely on ‘inside’ evidence to be credible, as the private and public records are often highly divergent (as shown in Sect. 1.1). The second is that coordination problems within any industry—especially those with highly heterogeneous participants—might result in the suboptimal formation, evolution and function of new financial markets, and that, therefore, the state has a role in helping set the institutions required for successful and efficient markets. The third theme is that transparency and the study of markets by all interests, especially government but also special and often less-powerful interest groups, can result in market design and policing that protects all market participants, and not simply the most powerful at the time. The fourth and final theme—related to the third—is that any history of radical policy and regulatory change, as well as innovative institutional design, must necessarily be about the actual individuals involved. The formerly private and confidential CBOT internal and external documents reveal that there were strong personalities involved in the wholesale evolution of the markets and their governance, while strong personal ties between many individuals with differing agendas, often operating at great distance, were crucial to the success of the interwar actions and reforms.

1.3.1 *Private Versus Public Evidence*

The award-winning musical, *Hamilton*, has arguably made financial history, perhaps for the first and last time, cool. As the biography of American founding father Alexander Hamilton by Ron Chernow (2004) explains, Hamilton must have met with rivals Thomas Jefferson and James Madison to hash out the financial future of a nascent USA. Yet there is no record of the negotiations, even if the clear result was that Madison lobbied on behalf of Hamilton’s financial plan while Hamilton supported moving the Federal Capital to Virginia. As the musical

emphasises, it is very difficult to know how and why specific laws and policy come into being, as many key laws and their wording are determined through compromises resulting from back-room negotiations. Yet historians must generally rely solely on public documents, or even private documents where the authors had a reasonable expectation that they would be released to the public. Such documents cannot be said to represent what went on ‘in the room where it happens’.²⁶ In fact, private attitudes, negotiations and responses are often completely hidden from media and government reports, and inferring intent and actions from either policy consequences or public hearings likely cannot reveal the true legislative history.²⁷ We cannot learn from history if we are unable to obtain the true story.

According to regulation scholar Daniel Carpenter, ‘with rare exceptions, analyses of state building [... historians] study bureaucracy only through the legislation that created agencies, the presidents who govern them, or the court decisions that check or enable their decision making’.²⁸ This is necessary because while ‘Congressional debates, roll-call votes, presidential biographies, and court decision are readily available [...], administrative documents are not’.²⁹ The private record needs to be considered due to ‘the incorrigible willingness of American public officials to seek the public good through private negotiations’.³⁰ Any analysis of witnesses’ testimonies at hearings cannot determine how influential said speakers are on the legislative process. In fact, hearings could be held for reasons other than to actually accumulate information on which to base policy.³¹ At the very least, activities within the committee

²⁶Lin-Manuel Miranda, *Hamilton: The Musical* (Milwaukee: Hal Leonard Corporation, 2014).

²⁷John Mark Hansen, *Gaining Access: Congress and the Farm Lobby 1919–1981* (Chicago: University of Chicago Press, 1991), pp. 22–23.

²⁸Daniel Carpenter, *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862–1928* (Princeton: Princeton University Press, 2001), p. 11.

²⁹Daniel Carpenter, *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862–1928* (Princeton: Princeton University Press, 2001), p. 11.

³⁰Robert Lively, “The American System: A Review Article,” *Business History Review* 29 (1955): 81–96, p. 93.

³¹Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406, p. 290.

rooms should be considered.³² Powerful committee members could veto bills for their own personal reasons, regardless of support from outside—or even inside—the committee. The CBOT executive in one instance was appalled that a bill that the committee had agreed should go forward was being held up because Chairman Norris wanted to table his own ‘pet’ bill.³³ But private conversation occurred well before any bill entered into committee. Senate and House officials and politicians, the White House, government agency employees, industry leaders and interests of all types had the ability to influence each other far away from the House and Senate. As a result, most historians can never know the real story that occurred behind the scenes. And a history of legislation that does not account for back-room discussions and horse-trading is unedifying, though that has not deterred historians of futures regulation.³⁴

Leon Kendall, for example, called the Federal Government, the Board’s ‘chief critic’.³⁵ But he also focused almost solely on the public record, concerned ‘with the reaction of the general public, government officials, and Board members to speculative trading activity’.³⁶ Kendall readily accepted, however, that:

To the degree that the actual attitude and beliefs of the respective parties differed from their official pronouncements, the dissertation is delimited. The activities of lobbyists and resolutions adopted in the oft-mentioned smoke-filled rooms, for example, were rarely brought to public attention except under duress.³⁷

³²Gary Cox and Matthew McCubbins, *Agenda Power in the US House of Representatives, 1877 to 1986* (Stanford: Stanford University Press, 2002). As Woodrow Wilson stated in 1885, ‘it is not far from the truth to say that Congress in session is Congress on public exhibition, whilst Congress in its committee rooms is Congress at work’. As quoted in George B. Galloway, “Development of the Committee System in the House of Representatives,” *American Historical Review* 65 (1959): 17–30, p. 25.

³³Letter, L.F. Gates to Carey, 13 May 1924. CME III.11.10.

³⁴Two examples are Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406; Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956).

³⁵Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 1.

³⁶*Ibid.*, p. 3.

³⁷*Ibid.*, p. 4.

The popular press, corporate public relations releases and publications of public hearings during the interwar years were full of colourful rhetorical flourishes aimed at establishing and defending extreme positions. The CBOT, large traders such as Cargill and Armour Grain and politicians acted like early modern pamphleteers to sway the American public.³⁸ For each defender of free market capitalism, several railed against the monopolistic interests of the grain trade and its choke-hold on the food supply chain.³⁹ The chair of an earlier set of hearings in Washington stated bluntly, ‘These Chicago speculators control the price of wheat. The Chicago speculators control the market not only of Chicago and Minneapolis but New York and Liverpool and in fact the whole world’.⁴⁰

In one of the few important treatises on the subject—the *History of Commodity Futures Trading and Its Regulation*—Markham bases his conclusions on the words, but crucially not the actions, of Senator Arthur Capper.⁴¹ Another scholar who relies on public record falsely concludes that Capper was very much ‘anti-futures’ rather than simply ‘anti-manipulation’.⁴² Indeed, Capper’s public pronouncements in the press and in Congressional hearings run contrary to his private words and, indeed, his actions as demonstrated by his dealings in private with the USDA, other government agencies and the exchanges.⁴³

Such studies of the public record by many academics and practitioners suggest that it would be fairly straightforward to interpret the struggle for the regulation of futures markets as pitting the people’s interests against those of the grain trade.⁴⁴ For example, driven by a shallow

³⁸For example, see Edward J. Grimes, *The Farmer and Legislation*, Address given before the 26th annual convention of the Farmers Elevator Association of South Dakota. Grimes worked for Cargill.

³⁹Representative Chase, member of the House Agricultural Committee, as quoted in *Bradford Evening Star*, 15 May 1934, p. 9.

⁴⁰*Chicago Tribune*, “Anti-option Bills in Congress. Hearing to Be Given Wednesday,” 2 February 1892.

⁴¹Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987), p. 13.

⁴²Cedric R. Cowing, *Populists, Plungers and Progressives* (Princeton, NJ: Princeton University Press, 1965), pp. 90–91.

⁴³*Chicago Tribune*, “Wheat Declines on the Threat of Legal Changes,” 26 February 1926.

⁴⁴For example, see Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987); Geoffrey Poitras, “From Antwerp to Chicago:

reading of public—rather than private—documents, the academic record sees the 1921 Futures Trading Act as a failed populist attempt by farmers to control the otherwise ‘free’ commodity markets of Chicago. But this story is completely wrong, as this book will show.

The identification of the actual motives and actions of those key actors who created the formal and informal grain futures regulatory regime is only really possible through an examination of thousands of private papers, many of which were ‘internal’ and so were intended to remain confidential. Conveniently, just such an archive did exist, though is no longer publically available. I believe that the insights such documents provide are almost as good as being in the ‘room where it happened’. Through such previously—and currently—unavailable archives, I show that the markets of Chicago evolved into their modern form over the interwar years (beginning with the 1921 Act) precisely due to cooperation between the CBOT and the US Federal Government.

The public justification for legislative action does not always match the substance of the law. Even the names of bills were often misrepresentative, being directly opposed to their intent. Public statements either legitimise the back-room dealings or seek to cover them up. While ‘specific experts are [...] whispering [to] specific policy makers, leaders still need to justify their actions [...] with a decent regard for what makes sense as well as what non-partisan experts embrace’.⁴⁵ Ironically, even the Board’s own history, supported by an archivist and written by a derivatives (futures) expert, does not dig deeply into the archival record, relying instead primarily on hearings, FTC testimonies, newspaper articles and secondary sources for much of the interwar history.⁴⁶

In summary, the private record of regulatory changes in the futures markets between 1920 and 1935 diverges from the public record. Contrary to the public record, and studies based on it, markets, as

The History of Exchange Traded Derivative Security Contracts,” *Revue d’Histoire des Sciences Humaines* 1 (2009): 11–50.

⁴⁵Mary Furner, “From ‘State Interference’ to the ‘Return to the Market’: The Rhetoric of Economic Regulation from the Old Gilded Age to the New,” in *Government and Markets: Toward a New Theory of Regulation*, ed. Edward Balleisen and David Moss (Cambridge: Cambridge University Press, 2009), p. 93.

⁴⁶William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998).

represented by the futures exchanges, and the state, as represented by legislators and bureaucrats, can clearly be seen to have worked collaboratively in both the legislative developments and their administration.

1.3.2 *Public and Private Sectors in Partnership*

The greatest obstacle to a clear understanding of history of the regulation and evolution of financial markets is the confusion between normative models of market policy-making and regulation and positive observations throughout history. Commentators often justify their conclusions using selective evidence that is anecdotal at best, and at worst requires highly biased interpretations. To some, interwar futures regulation remains ‘an orgy of populist rhetorical excess’ aimed at removing the grain trade from the sphere of free market capitalism.⁴⁷ A previous vice-chair of the CFTC described the then-current state of regulation as ‘a chain letter, first penned in 1921’ and concluded that ‘many of the provisions in today’s law are legacies both of Senator Capper’s [interwar] attack on speculators and of the system envisioned for their control’.⁴⁸

From a normative perspective, many of us would like to believe that policies and regulations are formed in the public interest. Yet, those on the right deny any usefulness in government interference, preferring that markets are left to their own devices, and not hampered by anti-growth ‘red tape’. To these observers, a regime of pure self-regulation would result in the best outcomes. Industry, of course, generally is in favour of being left to its own devices. The CBOT itself, as early as 1920, was strongly in favour of self-regulation.⁴⁹ As President L. F. Gates boldly stated in January 1921, ‘It has been said by someone - I think it was Congressman Hoch - that no change, no reform is ever made within the trade; it must be forced from without. I wish to state for the record

⁴⁷John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, p. 636. See also Roberta Romanlo, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997), p. 640.

⁴⁸John V. Rainbolt, “Regulating the Grain Gambler and His Successors,” *Hofstra Law Review* 6 (1977), p. 8.

⁴⁹Statement of L.F. Gates, President of the Chicago Board of Trade during 1919 and 1920, before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

that while it has been occasionally true that the suggestion of some change has come from without, as general practice every reform that has been made in the trade... has been worked out by the members of the exchanges themselves'.⁵⁰

How optimal government regulation is depends upon which end of the political spectrum one sits. Positive scholarship often takes as its point of departure the norms of its authors, and there is a strong bias against any assumption of state effectiveness by mainstream economists and political scientists who worked on this subject in the last century. Chicago-school economists, from Stigler to Becker to Peltzman, saw government failure in each and every regulatory framework. Such authors label the public interest theory of regulation as 'normative analysis as positive theory'.⁵¹ Curiously, scholars of both the 'private interest' (also known as the public choice or capture) approach and the public interest approach generally view market regulation as a struggle between the state and so-called free markets.

In such a paradigm, the market, in the form of the self-regulatory authority at the CBOT, either won or lost the interwar political struggle against a newly emergent Federal Government, backed by the 'populist' agrarian movements that began in the late nineteenth century. Nowhere is this more evident than in Stassen's comment: 'in fact, the history of futures legislation in the United States is largely the saga of a single institution – the Chicago Board of Trade – fending off countless politicians on both the state and national level, all of whom seemed intent on shutting the Board down'.⁵² Pashigian sees the failures of many bills that were tabled after the original 1921–1922 legislation as a victory of the free marketers over irrational legislators and regulators.⁵³ Charles Geisst also relies entirely on the public record and secondary sources to

⁵⁰CME VII.ss3.65.2, Statement of L.F. Gates, President of the Chicago Board of Trade during 1919 and 1920, before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921 [Note: 60 pages of testimony].

⁵¹Sam Peltzman, Michael E. Levine, and Roger G. Noll, "The Economic Theory of Regulation After a Decade of Deregulation," *Brookings Papers on Economic Activity, Microeconomics* (1989): 1–59.

⁵²John H. Stassen, "The Commodity Exchange Act in Perspective—A Short and Not-So-Reverent History of Futures Trading Legislation in the United States," *Washington & Lee Law Review* 39 (1982): 825–843, p. 826.

⁵³B. Peter Pashigian, "The Political Economy of Futures Market Regulation," *The Journal of Business* 59 (1986).

conclude that ‘the [1922] law was nevertheless the first salvo in the war, initiated unsuccessfully many times in the past, to gain some modicum of control over the futures and (indirectly) stock markets’.⁵⁴ He cites the *New York Times* as reporting: ‘the farmers are seeking to “hog tie” the exchanges because they do not understand them’.⁵⁵

This study provides evidence that the history of modern futures markets cannot in any way be described as the result of a confrontation between ‘grain men’ and populist farmers, and their Washington representatives, intent on shutting the exchanges down. Indeed, throughout the interwar period, the various interested parties worked very closely with one another, even if they did not always agree on the optimal outcome. Although in 1921–2, most of the regulation can be explained by capture through collusion, by the mid-1920s the political climate had changed to allow for a more benign form of public–private partnership: cooperation rather than the more ominous-sounding collusion. It is argued here that, early on, capture was not only inevitable but led to the release of the data needed to make good decisions by all parties later in the interwar years. The state can be—and in this case was—essential in overcoming coordination problems such as those outlined by Mancur Olson.⁵⁶ This concept is reasonably recent and is well explored in Balleisen and Moss (as well as this book), providing further evidence of the need for state regulation of markets of all types.⁵⁷ Equally, though, the industry, its knowledge and the relevant data are crucially important to help government design the appropriate policies, regulation and informal and networks. Indeed, certain elements of the CBOT were far-sighted, pragmatic and altruistic, but other reactionary forces often sabotaged efforts to reform and to create the best possible market for all. I conclude that there is a crucial role for government officials to act as coordinating agents in facilitating collective action of private agents by collecting and disseminating information to all concerned

⁵⁴Charles R. Geisst, *Wheels of Fortune: The History of Speculation from Scandal to Respectability* (Hoboken: Wiley, 2002), p. 74.

⁵⁵Charles R. Geisst, *Wheels of Fortune: The History of Speculation from Scandal to Respectability* (Hoboken: Wiley, 2002), citing *New York Times*, 21 September 1922.

⁵⁶Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965).

⁵⁷Edward Balleisen and David Moss, eds., *Government and Markets: Toward a New Theory of Regulation* (New York: Cambridge University Press, 2009).

parties (creating a public good), without actually exercising the implicit threat of forceful punitive action. The archival material robustly supports the assertion that even weak government authority can facilitate publicly useful changes in financial practices—marketing of financial derivatives in this case. The evidence supports the general assertion that the industry and the government (and its agents) often cooperated and collaborated during the interwar years. I argue further, however, that these arrangements were critically important for the development of modern futures. Chapter 5 tells the story of how the partnership evolved. By the 1930s, many special interests were frustrated by their treatment by the CBOT. Though many more restrictive measures failed, some interests were able to work with the government to make the markets safer for all. This ‘enforced self-regulation’, where industry has certain powers to enforce rules set by the government and themselves, has been shown to be effective in many market governance cases. Government and industry once again needed to work together, though not in the same manner as in 1926 and 1922. This work reveals the state versus markets dichotomy to be a trope, overused by those ideologically inclined to believe that *laissez-faire* results in efficient markets.

1.3.3 *The Role of Transparency and Intellectual Study in Optimal Markets Design*

An increasing scholarship involving, especially, environmental and market regulations focuses on the positive role of informational transparency on better public outcomes.⁵⁸ This work argues that the US Federal Government obtained high degrees of market transparency in return for the favours the industry received in the 1922 Act. On its own, the information may have languished, unexamined. Yet the 1922 Act eventually resulted, in 1923, in the establishment of a highly competent technocracy of experts, including some ex-industry specialists, the so-called poachers turned gamekeepers. The bureaucrats of the era not only learned rapidly, but were experts in negotiating and obtaining concessions from politicians and industry, alike. Additionally, the administrators of the 1922 and 1936 Acts were able to bring on experts from outside,

⁵⁸See, for example, Archon Fung, Mary Graham, and David Weil, *Full Disclosure: The Perils and Promise of Transparency* (New York: Cambridge University Press, 2007).

including those who would go on to make their name in markets analysis, such as Holbrook Working.

Backed by the 1922 Act and sheer willpower, the government made ever-increasing demands for more-specific information, begrudgingly provided by grain exchange members. This data was used to improve governance and futures institutions, thereby helping to legitimise futures trading as a whole, in the governments' and even the publics' eyes. The interwar futures market investigations, which will be examined in Chapters 4 and 5, are far from the only examples of the value of information for business, academia, government and the general public.⁵⁹ Such investigations conducted by the regulatory body formed the basis of political and intellectual justifications for the usefulness of futures markets, while influencing the innovative actions of 1926 as well as the making of the Commodity Exchange Act (CEA) in 1936. Indeed, the governmental responses to the three crises of confidence in the futures markets during the interwar years are interrelated. For example, the 1936 Act's development, construction and implementation were heavily dependent on the government's information-gathering experiences, while the 1926 changes in the regulatory regime were enacted specifically because the 1922 Act was deliberately designed to be weak. Industry lobbying, together with the prevailing political ideology in Washington, combined to entrench the monopoly of the CBOT, but—more importantly for the history of these markets—to make the earliest futures regulatory bureaucracy first and foremost an information gatherer, analyser and provider.

As even New Deal policy could not attach any shackles to the futures markets, the lack of power at the USDA's GFA meant that information disclosure and coercion/compromise were the only weapons of government between 1923 and at least 1936. Nonetheless, one prominent business school, EDHEC, recently identified that the key lesson learned from a history of commodity futures trading controversies was 'the ability to carry out objective, empirical studies, dating back to at least the release of the Hoffman and Duvel (1941) report'.⁶⁰ The history of the 1921

⁵⁹Daniel Carpenter, "Confidence Games: How Does Regulation Constitute Markets?" in *Government and Markets: Toward a New Theory of Regulation*, ed. Edward Balleisen and David Moss (Cambridge: Cambridge University Press, 2009).

⁶⁰http://www.edhec-risk.com/latest_news/featured_analysis/RISKArticle.2012-03-15.1016:newsletter=yes.

and 1936 regulations shows that the 1922 Act allowed for the gathering of information that legitimised and justified futures markets, while informing the improvements and developments that have made them the financial market of choice for millions of investors, commercial hedgers and, of course, speculators, for better or for worse. The most important outcomes of the interwar regulations—and partly their cause—were the practitioner and academic studies that continue to be cited to this day. On the government side, well-educated bureaucrats cross-fertilised with top academics, some of whom trained at the USDA's own school of statistics, to produce landmark studies of the futures markets by the newly empowered USDA, the GFA, the Federal Trade Commission (FTC) and the new Bureau of Agricultural Economics.

1.3.4 *Policy and Industry Entrepreneurs*

This study documents the parallel development of both the leadership of the CBOT and the technocratic bureaucracy of the governmental agency set up to monitor the CBOT. There is an argument to be made that technological change requires changes in financial arrangements as well as institutional systems before technology can function optimally. Such change needs agents and windows of opportunity. Financial innovations such as the futures markets followed directly from improvements in the transportation and grading of wheat. The Chicago region's eventual importance in global agricultural trade was the result of technological and biological improvements.⁶¹ Transportation improvements, mainly the railways but also canals, benefited the Midwest in general and port cities such as Chicago in particular.⁶² But early markets in Chicago, on their own, were ill-equipped to handle trading in an efficient manner. Market leaders, such as those at the CBOT after 1920, were well placed

⁶¹Alan Olmstead and Paul W. Rhode, "Adapting North American Wheat Production to Climatic Challenges, 1839–2009," *Proceedings of the National Academy of Sciences* 108 (2011); Alan Olmstead and Paul W. Rhode, "The Red Queen and the Hard Reds: Productivity Growth in American Wheat, 1800–1940," *Journal of American History* 62 (2002).

⁶²Sukkoo Kim, "Expansion of Markets and the Geographic Distribution of Economic Activities: The Trends in US Regional Manufacturing Structure, 1860–1987," *The Quarterly Journal of Economics* 110 (1995); Giovanni Federico and Paul Sharp, "The Cost of Railroad Regulation: The Disintegration of American Agricultural Markets in the Interwar Period," *Economic History Review* 66 (2013).

and sufficiently prescient to understand that many changes in the institutional arrangements as well as market governance were needed before the markets would be accepted by all the relevant interests. When a policy window opened up, policy entrepreneurs in government and industry were able to drive change in the Chicago markets.

This study argues that the Federal Government was able to effect real change, even in the face of chaos within the ranks of the grain futures industry itself. Industry leaders were often unable to forge any consensus on the critical issues relating to the modernising of their markets. Policy entrepreneurship, where key individuals took initiatives to make policy rather than relying on institutional pressures, was central to decisions made behind closed doors between government officials and the CBOT.⁶³ A lack of political entrepreneurs (to drive legal and regulatory changes) can negatively impact financial innovation, which can limit the effectiveness of earlier technological innovation.

Policy advocacy and policy-making by powerful, knowledgeable and driven industry leaders, bureaucrats, lobbyists and politicians—through negotiation, joint problem-solving and threats—was at least partly responsible for the essential changes that assured the dominance of futures markets with Chicago as their hub. Though there was some coercion and control, the institutional and regulatory changes were more often a result of back-room collaborations between elements of the United States Department of Agriculture (USDA) and futures market executives to *serve* the industry rather than controlling or fighting it, at least until 1933. After 1933, it was an ‘advocacy’ *coalition* of farmers’ organisations and government—again through policy entrepreneurship—that provided new ‘market facilitating’ regulation.⁶⁴ Some ‘poachers turned gamekeepers’ were more than adequate defenders of the public interest; Rollin Smith led the way and Sam Arnot followed. Also, certain board executives and directors were in favour of better markets. And, although they had limited enforcing power, GFA bureaucrats, led by Dr. J.W.T. Duvel, regularly pushed the exchanges and

⁶³For an overview of the research on policy entrepreneurship, see Michael Mintrom and Phillipa Norman, “Policy Entrepreneurship and Policy Change,” *Policy Studies Journal* 37 (2009): 649–667.

⁶⁴Paul A. Sabatier, “An Advocacy Coalition Framework of Policy Change and the Role of Policy-Oriented Learning Therein,” *Policy Sciences* 21 (1988): 129–168.

their members to comply with suggestions and proposals. Pragmatic coalitions developed, if sometimes only temporarily. Early on in the history of futures markets bureaucrats needed information to govern scientifically, and the CBOT wanted regulation to further its own interests.

The Board of Trade membership was far from homogenous. There were reactionaries who preferred the pre-1920 status quo, and there were progressives who realised that the markets needed wholesale change to become what they are today. There were even elements of the Board who preferred to operate outside of the law. Luckily, the progressive forces at the Board were regularly in power and were able to counter the reactionaries, often with the help of the Federal Government. For instance, CBOT Presidents Griffin and Arnot were firm believers in well-controlled markets, even if their rules benefited the protected monopoly interest of their entire memberships. Such executives of the Chicago exchange were well aware of both the usefulness and willingness of the Federal Government to support futures markets and used this information to compel their members and the competing exchanges to comply with 'best practices'. Often, the greatest challenge for the CBOT executive was to prevent its members from rebelling against the beneficial legislation that was often incorrectly supposed to have been 'imposed' on them.

Just as there was no homogeneous group of industry activists, government officials rarely shared a full common agenda. Many had quite complex and differing views on the subject of regulation and free market capitalism. As mentioned earlier, Senator Capper was not an enemy of futures markets. Although he acted as a pompous uncle at times, he did the best he could during the pro-business anti-intervention government of the 1920s and early 1930s. Julius Barnes of the powerful US Chamber of Commerce, though defending 'free markets', was also on the side of the cooperative movement, which could veer towards pure socialism. Such leaders permanently improved the markets over the interwar years. People and relationships mattered.

That key institutions and regulatory ideas were developed behind closed doors, mainly by unelected officials, may call into the question of the democratic legitimacy of the process and therefore the resulting futures market supervision and control by the Federal Government and independent private institutions such as the CBOT, the Futures Industry Association and clearing houses. Self-regulation as often exercised in financial markets, even if supervised by the state, takes decisions that would otherwise be made by the state and places them further away from the democratic process,

especially as regards on-the-ground enforcement of the rules.⁶⁵ Worse still for those who favour transparency and legitimacy in government, it would appear that the contemporary public story of the regulatory changes was entirely different from the substance of the resulting regime. Technocracy as described in this history has, indeed, both good and bad normative elements. Recent literature bemoans the decent to undemocratic actions of financial market regulators.⁶⁶ Yet regulating by the technocracy has much support, due to the benefits of, for example, operating and negotiating rules with those who share the required knowledge. In fact, technocracy can counter attempts at the over-politicisation of regulatory issues.⁶⁷ Of course, creating public spaces for deliberation among all actors is also a possibility, yet this is quite rare in policy-making circles.⁶⁸ In the case of modern futures market regulation, the main actors, operating in secret, appear to have created markets that generally work well for all users, and therefore, indirectly, the wider public.

1.4 WHEAT, FUTURES AND THE CHICAGO BOARD OF TRADE

The CBOT began as a businessmen's club in 1848 and ended the nineteenth century as an Illinois State-chartered self-regulatory body with powers to make its own trading rules and enforce them over its membership through arbitration hearings and rulings.⁶⁹ In effect, it was a loose association of disparate interests, where many of its members were in competition with each other in buying and selling cash wheat as well as futures contracts. During the nineteenth century, the Board's rules and norms for cash trading developed, even as its disparate business groups could hardly ever agree regarding what rules were in the best interests

⁶⁵Tanina Rostain, "Self-Regulatory Authority, Markets, and the Ideology of Professionalism," in *The Oxford Handbook of Regulation*, ed. Robert Baldwin, Martin Cave, and Martin Lodge (Oxford: Oxford University Press, 2010).

⁶⁶See, for example, Paul Tucker, *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State* (Princeton: Princeton University Press, 2018).

⁶⁷Johan Eriksson, Mikael Karlsson, and Marta Reuter, "Technocracy, Politicization, and Noninvolvement: Politics of Expertise in the European Regulation of Chemicals," *Review of Policy Research* 27 (2010): 167–185.

⁶⁸Leigh Hancher and Michael Moran, *Capitalism, Culture, and Economic Regulation* (Oxford: Oxford University Press, 1989).

⁶⁹For an early history, see Charles H. Taylor, *History of the Board of Trade of the City of Chicago* (Chicago: Robert O. Law, 1917).

of the markets. In the nineteenth century, courts generally upheld the right of the Board to set its own trading rules and discipline its own membership for any violations, and the appeals committee of the Board acted as a court of last resort.⁷⁰ These rules covered important details of how brokerage should be charged, how fees should be divided, who paid for errors, and what constituted an adequate grain inspection report.⁷¹

Elevators, railroads and improved grading techniques and systems provided the basis for the futures exchange. In 1927, grain would leave a farm for one of 20,000 country ‘elevators’, where grain could be stored or quickly shipped on, generally by rail. Elevators or other intermediary agents would then on-sell the grain to (1) a local consumer, (2) an intermediate (railway) line elevator or (3) elevators at a terminal market, such as in Chicago. In Chicago, the grain could be stored speculatively or sold as far afield as Europe.⁷² Because wheat in particular is easy to store cheaply, it is unnecessary to clear an entire harvest immediately. Surpluses were held in country elevators on railway lines and at markets like Chicago for future use or for speculation.⁷³

It is not clear precisely when futures trading began to dominate the Chicago markets. An early Board historian observed that, by 1855, futures trading was ‘heavy and almost continuous’.⁷⁴ Before this, in the time between the grain arriving at Chicago and it reaching New York, middlemen were exposed to price fluctuations such that when prices collapsed many were forced out of business. As a solution, prices were set in advance of a shipment’s arrival and grading inspection standards were created on the principle that grain of a certain type and quality was ‘fungible’ (exchangeable) for any other; the way was paved for modern futures markets.

The defining characteristic of a futures contract, as compared to a ‘to arrive’ contract, was that its seller, who was said to be ‘short’ the

⁷⁰Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 63.

⁷¹CBOT all rulings index 1921–1927. CME Group Collections at the Richard J. Daley Library (hereafter CME) File III.2.641.6.

⁷²J.A. Pattern and Boyden Sparkes, “In the Wheat Pit,” *Saturday Evening Post* (Reprint Curtis Publishing Company, 1927).

⁷³*Ibid.*

⁷⁴Charles H. Taylor, *History of the Board of Trade of the City of Chicago* (Chicago: Robert O. Law, 1917), p. 207.

contract, was not required to deliver a pre-specified shipment of the commodity. A buyer who went ‘long’ might expect delivery, at any time during the contracted delivery month, of a pre-specified quantity with a certain range of product quality, but not any one specific shipment. One who agreed on 1 December 1924 to buy 10,000 bushels of wheat in May 1925 at \$2.00 per bushel would be required to pay 20,000 dollars to the seller in return for a warehouse certificate for 10,000 bushels on any day of their choosing in May 1925. While delivery was possible under such contracts if they were left open until May, a buyer would more likely offset the long position before the delivery month by a sale of 10,000 bushels for May delivery to any other counterparty. That is, the buyer and seller did not have to re-contract with each other in order to offset the original agreement: either or both could enter the futures market and transact a closing out of the original position with any third party as long as they were members of the exchange. This fungibility of individual contracts and the required standardisation of contract maturities, sizes, deliverable grades and eligible counterparties defined a futures contract, and this is true even today. Hence, any contract could be substituted for any other.

During the Civil War, the fixed price contract for future delivery developed out of a need for risk sharing of government procurement contracts.⁷⁵ As Edward Dies wrote in 1929, ‘One man did assume the enormous risk of the government contract, but he immediately [...] succeeded in spreading the responsibility among many [who...] agreed to deliver to him at certain future dates specific amounts of grain at stipulated prices’.⁷⁶ By 13 October 1865, soon after the end of the Civil War, Chicago grain contracts had achieved a high degree of standardisation.⁷⁷

By 1880, the telegraph was used to communicate futures prices to other centres, thus allowing non-local market participants to trade in Chicago, and to price their own products far from the main trading hubs

⁷⁵Statement of L.F. Gates, President of the Chicago Board of Trade during 1919 and 1920, before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

⁷⁶Edward J. Dies, *The Plunger: A Tale of the Wheat Pit* (New York: Covici-Friede, 1929), pp. 38–39.

⁷⁷See, for example, William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998), p. 58.

based on price discovery in the futures markets.⁷⁸ By the 1920s, when a world market in wheat had developed, it was usual for cash grain transactions in the Midwest to be based on Chicago's current futures prices; hence, markets in Liverpool, London and elsewhere looked to Chicago to set world prices.⁷⁹ After its revolution and during World War I, Russia exited the world wheat market and large swathes of wheat-growing lands in Europe became fallow, resulting in the Chicago market holding a near monopoly in Europe.⁸⁰

This study focuses on wheat futures trading, specifically at the CBOT. There were other futures markets extant in interwar times—e.g. cotton in New York—but none were as highly regulated, nor as heavily traded, as wheat futures on the CBOT. While other exchanges ended the interwar years with larger cash grain markets, Chicago remained by far the dominant grain futures exchange. Even while cash wheat flowing into Chicago declined rapidly to only 29 million bushels by 1910, futures trading had expanded to 1000 times that, with the CBOT trading 80% of all grain futures.⁸¹ Thus, CBOT membership had significant advantages, including being charged half the one cent per bushel commission charged to outsiders. In 1921, the CBOT had about 1600 'voluntary' members, most of whom lived in Chicago, all of whom agreed to abide by the Board's rules.⁸² During pre-specified hours, six days per week, wheat futures were traded in octagonal 'pits', with three sets of steps.⁸³ Pit traders were one or more of four types: (i) scalpers, (ii) speculative traders, (iii) brokers, representing hedgers or speculators, or (iv) hedgers as principals. Such floor traders 'shouldered' their way 'into the mass of yelling' to trade with each other.⁸⁴ The common justification for markets in the nineteenth century, and even today, is that speculators create markets for the hedgers to manage their exposures to farm commodity prices. That is, elevators who were holding cash grain could sell 'short'

⁷⁸Dan Morgan, *Merchants of Grain* (New York: Viking, 1979), p. 62.

⁷⁹Harold S. Irwin, *A Guide to Grain-trade Statistics* (US Department of Agriculture No. 141, 1932), pp. 33–37.

⁸⁰Dan Morgan, *Merchants of Grain* (New York: Viking, 1979), p. 67.

⁸¹*Ibid.*, p. 70.

⁸²*Ibid.*

⁸³*Ibid.*

⁸⁴J.A. Pattern and Boyden Sparkes, "In the Wheat Pit," *Saturday Evening Post* (Reprint Curtis Publishing Company, 1927).

futures and fix a price of wheat today, even if the cash grain was yet to be sold at a fixed price. Scalpers were called on to absorb trades on a minute-by-minute basis and in 1929 were compared to:

A school of small fish nibbling at one another's fins and tails [...] provid[ing] a service that is tremendously important in a commodity market. [...] It is possible for a merchant or a farmer to hedge at any moment he cares to, because [scalpers] are ready to buy or sell.⁸⁵

While scalpers attempted to profit from holding positions for a few hours or even a few seconds, a few outsized speculators could gamble in millions of bushels, holding positions overnight, or for weeks or months. However, far too many small speculators regularly lost their entire investment trying to anticipate market direction. Both speculators and scalpers were effectively gambling on the price of wheat, and, to this day, 'futures markets are often attacked on the grounds that they attract and facilitate "speculation" in the unfavourable sense of the word'.⁸⁶ The famous speculator, Arthur Cutten, described himself as 'once a scalper, a wheat-pit trader, a bull one minute, a bear the next, glad to make an eighth of a cent a bushel profit, making a living by showing such a profit on three trades out of four'.⁸⁷

On any day of the delivery month, a 'short' could deliver to a counterparty a State-approved warehouse receipt for the contracted amount of grain of one of eighteen pre-specified types.⁸⁸ In return, the short would expect the cash price contracted. May futures trades consummated in December implied a significant financial and/or delivery obligation in five months. To aid in the settlement of such pit trades, in 1881 the CBOT established a simple clearing house. However, the trades in such 'ring' clearing could be exposed to the risk that the other party defaulted before the expiry of the contract at final delivery,

⁸⁵Ibid.

⁸⁶US Chamber of Commerce, Washington Congress, 1931. "Trading in Futures, Its Aim, Functions and Legal Treatment, 1932." CME VII.ss2.57.12.

⁸⁷J.A. Pattern and Boyden Sparkes, "In the Wheat Pit," *Saturday Evening Post* (Reprint Curtis Publishing Company, 1927).

⁸⁸Author Unknown, "The Chicago Board of Trade, How to Speculate," Circa 1890. CME VII.ss2.57.2.

even if the contract had been previously offset⁸⁹ (Chapter 4). To mitigate the risk that a customer would renege on a trade by the settlement date, third parties that used CBOT members as agents on the exchange could be asked to put up a ‘margin’—i.e. a good faith deposit against their obligation to sell or purchase; however, this, even if called for—and at the turn of the century it was common to trade without margins—was rarely more than 10% of the full value of the grain.⁹⁰ Consequently, punters with a small amount of capital could take large speculative positions in the grain futures markets, while those with large amounts of capital could take overwhelming positions, which is what they often did, to dramatic effect. Therefore, a common justification for regulation is to limit price manipulation so as to ensure a market clearing price representative of true supply and demand.

Attempts at manipulating markets are as old as markets themselves. Joseph de la Vega in 1688 dramatically described the sorts of underhanded tactics that remained ever-present in the nineteenth century and early twentieth century US grain and cotton markets. De la Vega decried speculators as ‘double dealers! [...] The labyrinth of Crete was no more complicated than the labyrinth of their plans’.⁹¹ On the largest of the grain and meat exchanges of Chicago and other Midwestern cities, Craig Pirrong counted 121 separate manipulations, while between 1868 and 1921, 28 such activities were identified in cotton.⁹² Speculative buyers of grains, or ‘bulls’, would fight with ‘bears’ who expected markets to fall and sold short contracts for future deliveries, where such short sellers

⁸⁹What is now known as modern clearing system was not used at the CBOT until 1926. An excellent description of early ring settlement procedures is in George Wright Hoffman, *Future Trading upon Organized Commodity Markets in the United States* (Philadelphia: University of Pennsylvania Press, 1932), Chapters 11 and 12.

⁹⁰Author Unknown, “The Chicago Board of Trade, How to Speculate,” Circa 1890. CME VII.ss2.57.2; U.S. Federal Trade Commission, *Report of the Federal Trade Commission on the Grain Trade, Vol. 5, Futures Trading Operations in Grain* (Washington, DC: Government Printing Office, 1920), pp. 27–28.

⁹¹Jose De La Vega, *Confusion de Confusions* (New York: Wiley, 1996 [1688]). See also Edwin Lefevre, *Reminiscences of a Stock Operator* (New York: Wiley, 2006 [1923]).

⁹²Stephen Craig Pirrong, “Self-Regulation of Commodity Exchanges: The Case of Market Manipulation,” *Journal of Law & Economics* 38 (1995): 141–206, pp. 165, 201. See also Charles H. Taylor, *History of the Board of Trade of the City of Chicago* (Chicago: Robert O. Law, 1917).

were obliged to deliver wheat that they did not possess. If the price went up, the bulls could close out their contracts at a profit before delivery. If prices fell, the bears who sold short could ‘buy in’ or ‘cover’ their short position for a profit, again before they were obliged to deliver the grain they had sold forward.

Traders could sometimes ‘encourage’ markets in the direction they had positioned for. Because delivery eventually needed to be made, the most popular manipulations were the ‘corner’ and the ‘squeeze’. A speculator attempting a corner would purchase all of the deliverable underlying cash crop and buy up (go ‘long’) as many futures contracts as possible such that, at delivery time, the shorts would not be able to secure supplies to deliver, and could be held hostage by the cornerer. This is not the easiest strategy to pursue in the long run, but in the short term, it can force shorts to pay a very high price to be let out of their contracts to deliver. A squeeze is similar, but here it is unnecessary to control the entire crop to push prices temporarily higher.⁹³

Grain traders were often seen by the farmers and their representatives as parasites who made outsized profits by standing between the producer and the consumer. Some middlemen were indeed very profitable. A government study in 1921 estimated that the return on capital of many Chicago middlemen was in the triple digits.⁹⁴ The grain merchants were regularly considered a scourge to farmers and consumers alike.⁹⁵ Yet, regarding grain ‘interests’, it is crucial to note that there was no unified set of ‘grain men’, and they rarely shared consistent interests. Grain users, such as flour millers, had completely different needs from farmers, elevator men (who profited from storing and buying and selling wheat as principal) and brokers. Elevators and millers, especially, were often near-monopolies. At the turn of the century, four companies owned almost all the milling capacity in Minneapolis.⁹⁶ At the same time, the FTC found that three grain buyers controlled 30% of the wheat that moved through New York City.

⁹³Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014), pp. 3–5.

⁹⁴Dan Morgan, *Merchants of Grain* (New York: Viking, 1979), p. 67.

⁹⁵See Frank Norris, *The Pit* (New York: Penguin, 1994 [1903]). US Congress, Hearings Before the Committee on Rules on HR 424. House of Representatives, 63rd Cong. 2nd Sess., 5–7 March 1914.

⁹⁶Dan Morgan, *Merchants of Grain* (New York: Viking, 1979), p. 57.

Once futures markets were well-established, one of the primary roles of the Board leadership was to maintain and improve the Board's monopoly. By the late nineteenth century, the CBOT, whose directorate was tasked with appointing the memberships of the various committees that adjudicated on the key issues of the day, enforced a long period of fixed commissions as well as the 'call rule' which forbade members to underbid each other for cash grain after closing hours. Fixed commissions were seen as a way of enforcing monopoly profits. A departure from this rule from 1890 to 1901 'resulted in ruinous competition of rates and impairment of service, and utterly destroyed all profit in the commission business. The lack of profit led to practices which were [...] in many cases dishonest'.⁹⁷

The CBOT was seen as 'a gentlemen's club with few true gentlemen'. Rules were developed to stop the 'non-gentlemen' from taking advantage of each other.⁹⁸ The most relevant regulation was the 'anti-corner' rule of 1910, whereby a Board committee could intervene in the markets and set a 'fair price plus liquidated damages not over 10% per cent, etc.'.⁹⁹ However, such rules were rarely enforced, consequently most participants saw manipulation as normal.¹⁰⁰

Many commentators view the self-regulating board as a panacea of norms and rules that facilitated efficient transactions in the cash and future grain markets.¹⁰¹ However, the Board's rules were not sufficient to prevent regular occurrences of manipulation and fraud, even before 1921. That is, self-regulation solved certain initial coordination and standardisation problems in order to facilitate market transactions, yet voluntary organisations could not address more complex yet still crucial issues. For example, while it is true that the Board began grading wheat and forming rules for its delivery and storage, it was State government inspectors that actually performed the task, while federal inspection

⁹⁷Letter, J. Griffen to J. Barnes, 7 July 1921. CME III.ss1.7.

⁹⁸Ibid.

⁹⁹Ibid.

¹⁰⁰Statement of L.F. Gates, President of the Chicago Board of Trade During 1919 and 1920, Before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

¹⁰¹See, for example, Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979).

standards were enforced by those State-licensed inspectors in 1916 due to failings in the self-regulatory system.¹⁰²

It has been observed that:

A natural disaster, an assassination, or even a war can send the futures markets into a frenzy while the general public looks on in stunned disbelief. The vision of trading floors crowded with profit seekers while the nation grieves is not a scene likely to endear futures markets to the public.¹⁰³

In general, in most markets and for time immemorial, high prices upset consumers and processors (or other users of the underlying commodity) while low prices upset farmers (or miners or other producers) and those who depend on them. While public outrage was predominantly focused on high food prices at the beginning of the twentieth century, it was the short sellers who came under public scrutiny after the great grain price collapse of 1920–1921 and again after 1929.¹⁰⁴ Determining what grain price is in the public interest is problematic. Moreover, high volatility impacts decision-makers in periods of uncertainty and also causes crises in that market prices may not reflect market fundamentals. On the other hand, volatility may benefit futures brokers by attracting new gamblers, who pay commission on every trade, win or lose. Dissatisfaction with unstable prices occasionally attracted State and federal attention before 1921. While Congress considered introducing about two hundred control bills between 1880 and 1920, the only Acts passed dealt with the quality of cash commodities suitable for delivery into futures contracts—government intervention that even free market academics would deem appropriate to facilitate proper market function.¹⁰⁵ For instance, because

¹⁰²Report by Special Committee on Cash Grain to President Stream. August 1923. CME III.11.7.

¹⁰³Philip McBride Johnson, “Federal Regulation in Securities and Futures Markets,” in *Futures Markets: Their Economic Role*, ed. Anne Peck (Washington, DC: AEI Press, 1985), p. 301.

¹⁰⁴Julius Baer and Olin Saxon, *Commodity Exchanges and Futures Trading* (New York: Harper and Brothers, 1949), p. x.

¹⁰⁵Jerry W. Markham, *The History of Commodity Futures Trading and its Regulation* (Westport, CT: Praeger, 1987).

For a discussion of achievable regulatory goals, see Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation* (Oxford: Oxford University Press, 2011).

of frauds perpetrated by short sellers of the New York Cotton Exchange on each other by delivering poor grade goods, traders asked for and received federal intervention in the form of the Cotton Futures Act of 1914 that set grading controls.¹⁰⁶

The agrarian unrest common in the mid- to late nineteenth century cooled during the run-up in farm product prices from the end of the Long Depression until the end of World War I. While grain prices were fixed at historically high levels by Herbert Hoover's US Food Administration created under the wartime Lever Food Control Act, by 1920 trading on grain futures exchanges had resumed. Between 1920 and 1927, following its investigation of the grain markets, the FTC published seven volumes of the seminal *Report on the Grain Trade* and, in 1922, the Capper-Volstead Act was passed exempting the commodity markets from certain Sherman Act antitrust provisions. After key parts of the Futures Trading Act had been overturned by the Supreme Court in 1921, the Grain Futures Act (1922 Act) was passed by large majorities in both legislative Houses. The 1922 Act was administered by a new GFA, reporting to a three-person Grain Futures Commission, headed by the US Secretary of Agriculture. In 1923 large traders were made subject to reporting requirements and, in the same year, the GFA began publishing annual reports and frequent detailed market studies in response to requests from the USDA and Congress.

1.5 MARKETS TODAY

For over one hundred years, futures markets have been seen to offer a more complete market than simple cash crop trading in the spot markets. From 1897 to the present, the existence of futures markets has been justified by the fact that they provide 'a special class of speculator who carry the price risks of merchants and manufacturers' who provide a facility for risk shifting or hedging, on grounds that speculators are motivated by the profit through effective forecasting.¹⁰⁷ Futures markets can be used

¹⁰⁶Bruce Baker and Barbara Hahn, *The Cotton Kings: Capitalism and Corruption in Turn-of-the-Century, New York and New Orleans* (Oxford: Oxford University Press, 2015).

¹⁰⁷George Wright Hoffman, "Past and Present Theory Regarding Futures Trading," *Journal of Farm Economics* 19, no. 1 (1937): 301; Thomas A. Hieronymus, *Economics of Futures Trading for Commercial and Personal Profit* (Washington, DC: Commodity Research Bureau, 1977), p. 70.

to insure against lower prices on unsold or anticipated inventory.¹⁰⁸ Others rather stress the role of continuously traded futures markets in price discovery for market participants.¹⁰⁹ Indeed, auction markets such as those at the CBOT, where buyers and sellers enter simultaneous competitive bids and offers, are generally agreed to be an efficient means of price discovery and, therefore, bargaining.¹¹⁰ Scholars further generally agree that self-regulation on such exchanges produces efficient markets.¹¹¹ Participants act in the market according to their own view of the future and their tolerance for risk. Justice Holmes in the famous *Christie* case wrote ‘Speculation of this kind by competent men is the self-adjustment of society to the probable’.¹¹² A 1927 commentator added:

When the competent man speculates regarding the probabilities of the future, he tries to know all that he can about the certainties of the present. He may buy wheat or corn or cotton, but the real raw material of the speculator is information.¹¹³

The markets provide a central location for the distribution of fundamental market information, both real and imagined.¹¹⁴ The pit is a place of gossip and rumour, but it is also a place where minds focused on what the true price of a commodity should be. A study of modern futures traders observed: ‘Rumours represent opportunities, manna for the

¹⁰⁸Lester G. Telser, “Why There Are Organized Futures Markets,” *Journal of Law and Economics* 24 (1981), p. 3.

¹⁰⁹Henry H. Bakken, *Futures Trading: Origin, Development and Present Economic Status* (Chicago: Mimir Publishers, 1966), p. 15.

¹¹⁰Fischer Black, “The Pricing of Commodity Contracts,” *Journal of Financial Economics* 3 (1976).

¹¹¹Stephen Craig Pirrong, “Self-Regulation of Commodity Exchanges: The Case of Market Manipulation,” *Journal of Law & Economics* 38 (1995): 149. See also Linda N. Edwards and Franklin R. Edwards, “A Legal and Economic Analysis of Manipulation in Futures Markets,” *Journal of Futures Markets* 4 (1984); Daniel Fischel and Stanford Grossman, “Customer Protection in Futures Markets,” *Journal of Futures Markets* 4 (1984).

¹¹²*Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 236 (1905).

¹¹³J.A. Pattern and Boyden Sparkes, “In the Wheat Pit,” *Saturday Evening Post* (Reprint Curtis Publishing Company, 1927).

¹¹⁴Statement of L.F. Gates, President of the Chicago Board of Trade During 1919 and 1920, Before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

speculator'.¹¹⁵ The spreading of false rumours was an everyday occurrence because it proved to be profitable.

Currently, futures markets include a wide variety of underlying assets such as stock market indices, US treasury bonds, currencies, other sovereign longer dated fixed income instruments, short-dated bank-determined interest rates—such as Eurodollars or 'Euroyen'—and most globally traded commodities, such as gold, crude oil, cotton and wheat. Additionally, there are over-the-counter, non-exchange traded, forward—not futures—markets in such products as above and more, such as credit indexes. Forwards are similar to futures without a central exchange, and where margin is not required by a central clearing counterparty—although this is changing post-2008. A forward contract is bilateral and so not fungible or easily assignable, while offset generally requires consent of the other party at the very least.

During the interwar period, the CBOT remained the dominant futures exchange, a position it would hold until well into the second half of the twentieth century. In 1937, it captured 87.9% of all futures trading, or 14,680,000,000 contracts, not far off its 1952 market share of 88.1%.¹¹⁶ In 1937, the US television network CBS marvelled at the combination of the tallest and most impressive building in Chicago, overwhelming technology, including '3,000 miles of wire beneath the floor', and a mass of '600 men in action'.¹¹⁷

The 1921 Futures Trading Act and the 1922 Grain Futures Act (the 1922 Act), which in 1936 became the CEA, was the futures markets' first federal regulation, the current version of which continues to shape these now gigantic markets. Modern futures markets and exchanges owe their success to the way the US Federal Government nurtured them in the 1920s and 1930s; indeed, if it had not, the important innovations associated with modern markets, the CBOT in particular, and futures markets in general, might not have been as dominant when financial, non-commodity futures appeared in the 1970s and 1980s. Government and industry collaboration created a near monopoly that survived for close to a

¹¹⁵Bob Tamarkin, *The New Gatsbys: Fortunes and Misfortunes of Commodity Traders* (New York: William Morrow, 1985), p. 125.

¹¹⁶Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014).

¹¹⁷Transcript, CBS News Report, 8 July 1937. CME III.23.3.

century.¹¹⁸ Indeed, Chicago futures exchanges, with the CBOT now merged into its rival the CME, continued to dominate futures trading until the turn of the twentieth century.¹¹⁹ Futures markets are of course now ubiquitous. In 2014, Chicago-based exchanges accounted for about 15% of all contracts (3.44 billion contracts), though China now dominates the trade in agricultural commodities.¹²⁰ Additionally, institutions adopted in the 1920s have been mandated by government regulators in other markets. The Dodd-Frank Act of 2010 requires many contracts not traded on futures exchanges to be cleared centrally, as Chicago contracts were first cleared in 1925.

1.6 THE CME GROUP ARCHIVE

The story of the interwar futures regulation begins with my discovery in 2014 of a newly reorganised archive at the Daley Library at the University of Illinois at Chicago. It was a three-year project that had just been completed thanks to funding and document provision by the CME Group, the CBOT's parent. Thanks to the generosity of the CME Group and its membership, I was able to parse records totalling 58.5 linear feet for CBOT secretary John R. Mauff, 44 linear feet for secretary James J. Fones, and 169.5 linear feet for Fred H. Clutton. This was an enormous resource, until the records were made unavailable some time in 2017. I wish that access to such accounts still existed. I can not overstate the usefulness of the records of, especially, the secretaries of the CBOT during the interwar years, in piecing together what I believe in the real story of the evolution of the institutions, governance and regulations of modern futures trading that came into existence between 1922 and 1936. This work is, of course, based on other sources, but none so valuable as the CME Group archive. I drew heavily on the GFA papers at

¹¹⁸While the CME (a merger of the CME and the CBOT) led in terms of volume in 2015, there are many large rivals in the developed markets and newer competitors in emerging markets. See Statista, *Largest Derivatives Exchanges Worldwide in 2015, by Number of Contracts Traded (in millions)*. <https://www.statista.com/statistics/272832/largest-international-futures-exchanges-by-number-of-contracts-traded/>. Accessed on 1 March 2017.

¹¹⁹Other commodity futures markets existed in other centres in the USA. For example, wheat and most other grain futures were traded in other Midwestern cities such as Kansas City, and New York handled the cotton futures market. From http://www.farmdoc.illinois.edu/irwin/archive/books/Futures-Economic/Futures-Economic_chapter1.pdf, p. 9.

¹²⁰2014 Futures Industry Association 2014 Annual Volume Survey.

NARA Kansas City and the USDA papers at NARA College Park and at the National Agricultural Library. Yet it was truly the CME Group documents that, combined with archival material from other sources, put us ‘in the room where it happened’ during an incredibly important period in the development of financial market and their regulation. Thus I owe such an incredible debt to the sponsors and organisers of the archive as well as the archivists of this incredible data source.

1.7 CONCLUSIONS

There has been very little focus on the early years of agricultural futures market regulation, even though the regulation of the period has had an important influence on current market rules, norms and ideas. Much of what has been written suffers either from over-simplistic explanation or is excessively ideologically driven.¹²¹ In analysing the nineteenth-century futures markets, Jonathan Lurie wrote:

It must be acknowledged that historians do not know enough about the development of regulations in American political-legal history to make [...] generalisations [...] Viewpoints owe more to the ideological convictions of their exponents than to the existing state of historical knowledge, [suffering] from a tendency to produce history that vindicates the deeply felt and previously formed convictions of those writing. Perhaps historical writing cannot be totally free of such bias. Historians, however, should be aware of its dangers, especially in fields that have not been adequately researched.¹²²

¹²¹Examples of over-simplifications include Julius Baer and Olin Saxon, *Commodity Exchanges and Futures Trading* (New York: Harper and Brothers, 1949); Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987); Stephen Craig Pirrong, “Self-Regulation of Commodity Exchanges: The Case of Market Manipulation,” *Journal of Law and Economics* 38 (1995): 141–206; and John V. Rainbolt, “Regulating the Grain Gambler and His Successors,” *Hofstra Law Review* 6 (1977): 1–27. Ideological biases can be evidenced by rhetorical flourishes in John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656; Anne E. Peck, “The Futures Trading Experience of the Federal Farm Board,” in *Futures Trading Seminar Proceedings*, Vol. IV (Chicago: Chicago Board of Trade, 1976).

¹²²Jonathan Lurie, “Commodities Exchanges as Self-Regulating Organizations in the Late 19th Century: Some Perimeters in the History of American Administrative Law,” *Rutgers Law Review* 28 (1974–1975), p. 1109.

Most academics who study the functioning and economic value of markets tend to come from the American finance tradition, which supports free markets. This bias tends to be evident in any historical examination of market regulation, although few so obviously resort to free market discourse to label the current CFTC Act anti-futures ‘propaganda’.¹²³ Other accounts simply lack nuance. An important example comes from one of the most respected specialists in futures markets, Hendrik Houthakker, who, in a 1982 address to the American Finance Association, began, ‘In the United States most of the pressure for [...] intervention [in the futures markets] came from farmers, who have traditionally viewed futures trading with suspicion, if not outright hostility’.¹²⁴ In a two-volume study of futures markets, both economic and regulatory, the American Enterprise Institute repeats the oversimplified case thus: ‘Futures regulation surfaced in an atmosphere of chronic distrust and suspicion toward those markets, hardened by decades of campaigns to outlaw futures trading entirely’.¹²⁵

Most of the research into the origins of futures regulation is ideologically biased. Jonathan Lurie’s commentaries on both pre-1905 and interwar futures markets suffer from a bias towards viewing all useful regulation as originating with the exchanges.¹²⁶ But neither Lurie nor Leon Kendall, in his 1956 thesis on futures regulation, engage with the private correspondence between the key actors including the USDA, the GFA, the CBOT, the exchange lobbyists and Congressmen such as Arthur Capper.¹²⁷

¹²³John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656.

¹²⁴Hendrik S. Houthakker, “The Regulation of Financial and Other Futures Markets,” *The Journal of Finance* 37 (1962): 481–491, p. 482.

¹²⁵Philip McBride Johnson, “Federal Regulation in Securities and Futures Markets,” in *Futures Markets: Their Economic Role*, ed. Anne Peck (Washington, DC: AEI Press, 1985), p. 30. See Senate Report no. 93-1131, 93rd Congress, 2nd Session, reprinted in U.S. Code Congressional and Administrative News (1974), pp. 5843, 5853–5855.

¹²⁶Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980).

¹²⁷For example, see Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979); Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956).

Depending on the commentator's ideological biases, the fact that the CBOT remained relatively unregulated during the interwar years—and, indeed, beyond them—either was a success story in protecting a nascent industry providing a critical service to consumers and producers, or was the result of the protection of a small group of middlemen with vested interests who preyed on farmers and consumers during this tumultuous period. This 'state versus markets' struggle is further confused by its parallels in the often ideologically based studies of the New Deal policies of the 1930s, particularly state interference in the cash grain markets that continues in the form of the Farm Bill to this day. Although some work hints that the state's granting of monopoly rights to the exchanges is anti-free market, very little is made of this and other industry-friendly outcomes in terms of explaining the phenomenon by using the regulation theory.¹²⁸ In both its populist and monopolistic explanations—not, of course, mutually exclusive—the strong ideological biases of commentators cloud the important discussion of why, how and with what consequences, new controls on free markets are implemented.

This study, especially, requires the disentanglement of futures regulation from the wider movement away from pure *laissez-faire* and the then pro-industry Hooverite policies towards Roosevelt's New Deal. By 1939, the accepted narrative claims, the step change of the New Deal introduced a permanent and complete government presence in many aspects of American economic life, and especially in agricultural policy. As the earliest federal attempts at regulating agricultural futures markets occurred roughly during this time, observations and conclusions about the cause and effects of the said regulation are often caught up in the same 'state versus markets' rhetoric in both the academic literature and the popular press but in the wider historiography. Although of course futures regulation was a product of its times, it is anachronistic and in other ways incorrect to assume that the motivation for futures regulations should be conflated with attempts by farmers to 'rent seek' their way to higher agricultural commodity prices.

It is dangerous to assume that contemporary or modern literature on futures regulation is unbiased. Besides natural ideological biases from

¹²⁸Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979), pp. xii, 5. Lurie mentions the basic theories of regulation only in passing, before dismissing capture outright.

classical economics and finance traditions, there are many authors who might not have displayed completely unbiased approaches to the subject, since conflicts of interest abound. For instance, John Stassen was legal counsel for the CBOT, John Rainbolt was a vice chairman of the primary futures markets regulatory body, Pashigian's research was funded by the CBOT, and Todd Petzel worked for the CME, the current owner of the CBOT. Work by other historians was commissioned by powerful actors, such as Broehl's on the grain giant Cargill, and William Falloon on the CBOT.¹²⁹ Additionally, many seminar series and edited publications were produced under the CBOT's sponsorship. Contemporary commentators were at least as conflicted. Many so-called academic studies were sponsored by the CBOT or other exchanges. Some had been funded by the Board in the interwar years.

The most popular conclusion in the existing literature is that the free grain markets successfully defeated any 'populist' government attempts to control or even ban them. Exchanges were then free to introduce their own innovations that made markets more efficient, leading to the widespread adoption of such instruments by all present and future derivative exchanges. The exchanges' victories set the stage for the development of efficient markets for managing and transferring risk by participants. That is, the enduring innovations of the period are seen as effective self-regulation in the face of irrational and anti-free market government 'populism'.

1.8 OUTLINE OF THE BOOK

Those studying both American institutional history in the 1920s and historians of particular markets unfortunately do not generally apply modern understandings of regulatory regime formation and evolution. This study analyses the history of interwar futures market evolution using such theoretical tools as are fit for purpose, applied to an inside archive that can be assumed to report history as it really happened.

¹²⁹Wayne Broehl, *Cargill, Trading the World's Grain* (Hanover, New Hampshire: University Press of New England, 1992); William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998).

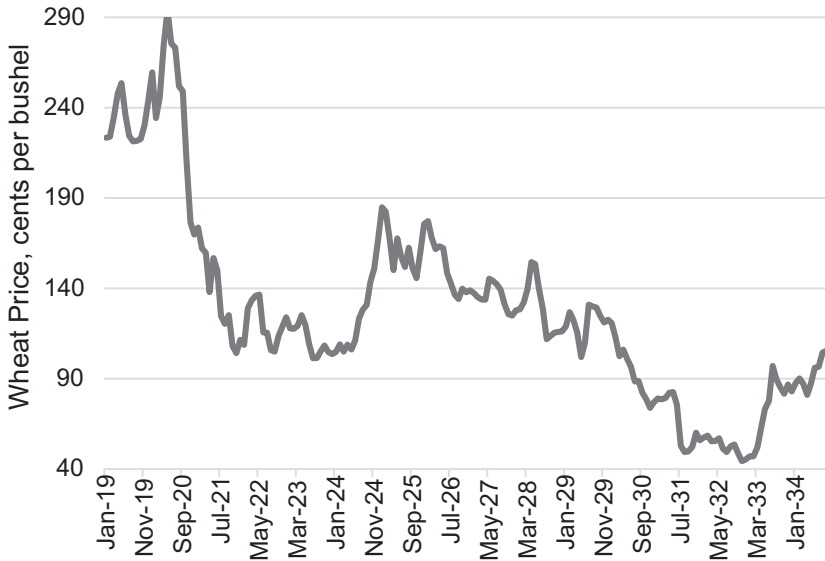


Fig. 1.1 Chicago monthly average cash wheat price 1919–1935 (Source: Holbrook Working, “Prices of Cash Wheat and Futures at Chicago Since 1883,” *Wheat Studies of the Stanford Food Institute, II* [1934])

While there can be said to be a path-dependent nature and certain ad hoc-ness to all market development, policy formation and regulatory effort, there are some observations that can be drawn out of the history of the interwar futures markets.

Chapter 2 sets the stage for the regulatory changes in the three periods by examining the political, economic and social context of the times as well as the characteristics of the main actors.

Government policy and other significant institutional changes are often reactions to serious crises.¹³⁰ The interwar period saw three major market disruptions to one of the world’s most important crops—wheat. In 1921, 1925 and 1928/early 1929, the grain markets fell from their peaks by 47, 27 and 42%, respectively (see Fig. 1.1).¹³¹ Cash Chicago wheat hit a low

¹³⁰Thomas A. Birkland, “Focusing Events, Mobilization, and Agenda Setting,” *Journal of Public Policy* 18 (1998): 53–74; John W. Kingdon and James A. Thurber, *Agendas, Alternatives, and Public Policies* (Boston: Little, Brown, 1984).

¹³¹Holbrook Working, “Prices of Cash Wheat and Futures at Chicago Since 1883,” *Wheat Studies of the Stanford Food Institute, II* (1934).

Table 1.1 Market disruptions and institutional reactions

<i>Market disruption</i>	<i>Reaction</i>
1920 Agricultural bubble and crash: The crisis of 1921	1921 Futures Trading Act 1922 Grain Futures Act 1923 Rules and regulations, including large trader reporting
1925 ‘Cutten Corner’ volatility and crash	1926 Modern clearing house 1926 Business Conduct Committee Investigations into wheat futures trading
1929–1934 The Crash of 1929 and the depths of the Great Depression	1930 Federal Farm Board intervention in wheat futures markets 1936 Commodity Exchange Act—Based on academic, government and industry legitimisation of futures markets that relied on analysis and data

of 43 cents per bushel in November 1932, down 74% from the middle of 1928 and down 81% from the reopening of futures trading in 1920.¹³² The events and activities of industry and government during the interwar years have too easily been lost amidst other events that have attained greater popular salience. For instance, the Panic of 1921 has been overshadowed by the Crash of 1929, while the CEA of 1936 has been overshadowed by the New Deal, the Glass-Steagall Act, the Securities Exchange Act and the Agricultural Adjustment Act. Additionally, the Cutten Corner wheat market volatility of 1924–1926 is considered now to have been no more than a minor hiccup in the roaring twenties.

Chapters 3–5 are each structured around one of the three crises and the interwoven administrative history. Crucially, there were different circumstances and therefore results after each crisis, and this work explains each case in detail. Chapter 3 focuses on the 1920 crisis and the government reactions (Table 1.1). Though Capitol Hill and the White House spoke out against the supposed manipulation of wheat prices at the CBOT, there was never an intent, even if there was political will, to ban or even control the futures markets. In 1921, political machinations following the post-war agricultural depression resulted in the Futures Trading Act (the 1921 Act) and the Grain Futures Act (the 1922 Act). The chapter argues that capture of the 1921 and the 1922 Acts was almost inevitable, but the resulting information transparency forced on the markets in exchange for government protection

¹³²Ibid.

was instrumental in future institutional innovations and regulations, beginning in 1925 and ending in 1936. The Act itself did little more than protect an already well-established monopoly in grain futures trading held by the CBOT. Though the 1926 and 1936 developments had their own legacies in the public interest, their construction and substance derived primarily from weaknesses of the captured 1922 Act. Up after 1980, government had ‘never edited the core text, which was hastily contrived in 1922 from the tattered remnants’ of the Futures Trading Act.¹³³ Even since 1980, key concepts from the 1922 Act remain preserved in the current legal framework of the GFA’s successor agency—the Commodity Futures Trading Commission (CFTC)—which is reflected in other regulatory frameworks, such as the Financial Industry Regulatory Authority (FINRA) for stock brokers in the USA.¹³⁴ Hence, the 1922 Act stands as an important benchmark in the history of state control of financial markets: however, it has not been subjected to adequate historical analysis.¹³⁵

Chapter 4 addresses the reactions of both industry and government to the 1924 to 1926 wheat dislocations and controversies. The ‘Cutten Corner’ volatility and price uncertainty of 1924–1925 was followed in 1926 by key institutional innovations brought about by government involvement in the grain futures trading industry, informed through data gathered under the 1922 Act. 1920s Chicago saw the introduction of many of the key features of the modern futures trading process, such as, (i) the reporting and monitoring of large positions, (ii) the collection, dissemination and analyses of vital information regarding the volume of trading and the number of open positions, (iii) the creation of a modern

¹³³John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982), p. 636.

¹³⁴Certain current aspects of commodities regulation such as the basics of self-regulation and section 3 of the CFTC Act on the justification for regulation date from this period. Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987), pp. 14–15, 28. See also John V. Rainbolt, “Regulating the Grain Gambler and His Successors,” *Hofstra Law Review* 6 (1977); John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982), p. 636.

¹³⁵William G. Ferris, *The Grain Traders* (East Lansing: Michigan State University Press, 1988), p. ix.

clearing house in Chicago, and (iv) the establishment of BCC. Chapter 4 shows that such important surviving institutions were co-constructed in a partnership between government and industry.

Chapter 5 documents the effects of further GFA investigations into the functioning of the markets since it realised that many more changes were required in order to benefit customers, thereby contributing to fairer markets for all. After 1923, new legislation was known to be unlikely and it took the Great Depression to provide the necessary shock to move the legislators. At that time, the GFA forged an alliance with certain legislators representing special interests and with the American Farm Board Federation (AFBF) to put forward key improvements. The Act that emerged protected and encouraged participation in the markets of the previously vilified small speculator—the ‘grain gambler’. The chapter also describes the legacy of intellectual study, originating from the 1922 Act, that begat, among other key concepts, the Efficient Markets Hypothesis (EMH) and the Theory of Storage. After the Crash of 1929, the Federal Farm Board intervened in the futures markets of 1930–1931, at great financial cost to US taxpayers, while the 1936 CEA followed the Great Depression devastations. At this time, investor protections against manipulation and fraud were introduced, along with ‘mandatory margining’. No substantive regulatory changes occurred after these reforms until the CFTC Act of 1974.

This work argues that these innovations, all occurring in the interwar years, were a result of collaborations or tensions between the CBOT, Federal Government legislators and bureaucracy and certain farmers’ organisations. In both Chapters 4 and 5, I show the government had to intervene in order to both solve the CBOT’s problems and improve the efficiency of markets, both by co-constructing markets in 1926 and by injecting impetus for change in the public interest in 1936.

1.9 THE COMING OF AGE OF MODERN MARKETS

By applying regulatory theory to the administrative history of the US Federal Government and the business history of the CBOT, as expressed through newly available archives, this study explains the 1922 and 1936 Acts and also the interim *de facto* regulation of the 1920s to be (i) a result of special interest lobbying by business while conforming to the dominant political, economic and social ideals of the time, resulting in

the ‘capture’ of legislators (Chapter 3), (ii) a necessary condition for the development and co-construction of key innovations in the futures markets (Chapter 4), (iii) a result and cause of intensive and expert information gathering at the Federal Government level and in the newly funded academic institutions (Chapter 4), and (iv) a result of special interest groups working with the regulatory authority (Chapter 5).

The key divergence this study makes from the recognised account is the replacement of the accepted dichotomy with a much more nuanced view of the relationship between government and industry. Though it can be argued that the early regime was captured to some degree, industry was far from the only influence, especially after 1923. The private record available in the CBOT archive conflicts with the public record in explaining how government policy is made and enforced.

This study invokes logic of collective action to explain how and why the industry could not, and therefore was not, capable of creating and managing the institutions that hindsight has shown to be critically important to the development of modern financial markets.¹³⁶ The inter-war period offered lawmakers ‘policy windows’ within which the Federal Government was able to claim authority over otherwise previous state responsibilities, as it continues to do currently, even if not always successfully.¹³⁷ The most highly contested literature is that covering the law and politics of regulation. For instance, the simple and blind ‘government command and control’ explanation for regulation has long since been rejected by most scholars, although in this century a public interest explanation has successfully countered the more cynical version emanating from the ‘Chicago School’. Futures market regulation in 1922 was designed to benefit the CBOT, even though it was disguised as a populist measure in the press and hearings. Key innovations in financial markets were a result of a ‘toothless’ 1922 Act meeting a collective action problem at the CBOT. Finally, the 1936 Act was a result of an issue of low public salience that was dominated by key technocrats and policy

¹³⁶For the pessimistic side of the results of collective action, see Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge: Harvard University Press, 2009). On the other hand, groups can function in spite of their individual interests. See, for example, Russell Hardin, *Collective Action* (New York: RFF Press, 1982).

¹³⁷See, for example, Gary Gerstle, *Liberty and Coercion: The Paradox of American Government* (Princeton: Princeton University Press, 2015).

entrepreneurs in both the USDA and effective lobby groups, where the focus was on improving the opportunities for small investors to gamble rather than restricting markets.

Context, ideology and power relations are some of the most likely explanatory variables for new regulatory initiatives. The next chapter provides much of the context for this interwar regulatory study, including the situation of the CBOT with respect to market volatility after the markets re-opened in 1920, legislative powers in Washington, the bucket shops, State legislative threats, the growing farmer cooperative movement and the obvious lack of information available to CBOT members, potential regulators and the trading publics. When markets collapsed and a ‘Pavlovian’ response was called for by legislators, the only possible result was a highly captured regime that was focused on information gathering rather than any real control.

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CHAPTER 2

The Wild Midwest

Interwar futures markets study requires an understanding of not only the market conditions at the end of World War I, but also the situations of the dominant exchange, the CBOT, vis-a-vis its competition, Washington legislators, its erstwhile State regulators and farmers' organisations. The 1922 Act's content depended primarily on the power relationship between the CBOT and federal legislators, while the 1936 Commodity Exchange Act (CEA) and key institutional changes in 1926 were shaped by the 1922 Act. This chapter firstly describes the reopening of the futures markets in 1920 and the problems faced by Board members and their constituent customers, secondly analyses the conditions at the CBOT and finally describes a collective action problem by which powerful elements of the CBOT were led to ignore problems affecting the public interest and, as a consequence, its competitive position. On its own, the CBOT could not solve its own governance and international problems. The issues faced by the CBOT are addressed in Sect. 2.4 through eight as being (i) the persistent bucket shop problem, (ii) the fight for legal legitimacy against the States, (iii) the threat from farmers' marketing organisations, and (iv) the information deficit at the Board, in government, and among the clients of the CBOT.

2.1 CHAOS UPON THE REOPENING OF THE MARKETS IN 1920

Legislative attention was focused immediately on the Chicago futures markets upon the resumption of futures trading, as the price action upon reopening was far from pre-war normalcy. After the USA entered World War I on 6 April 1917, the allied governments' grain buyers effectively began to corner the drought-affected undersupplied futures and cash markets. As a consequence, the CBOT set a maximum price for wheat futures trades, forced a settlement price for certain contracts, and halted wheat futures trading indefinitely.¹ This action also affected other exchanges. The CBOT then coordinated with the railroad companies, the Interstate Commerce Commission and other official agencies, to ease the congestion in Chicago wheat markets. This action is one good example of a private voluntary organisation taking on a governmental responsibility. However, it is clear from the communications to and from CBOT Board executives that the exchanges would have preferred to accept government imposed regulations than to have made unpopular unilateral decisions that resulted in recriminations and lawsuits.² That is, the CBOT admitted that there was a role for government in regulating futures markets, even before the first federal regulation of 1921.

Wheat futures trading reopened on 15 July 1920 for the December contract with an expanded set of deliverable grades, due to tightness of supply and the known and almost fatal transportation issues.³ Given the issues concerning transportation and marketing, as was no

¹Letter, H. Robbins to Mr. Clement, Chairman MRC, 27 December 1923. CME III.659.1; Letter, J. Griffin to the Federal Trade Commission, 21 January 1921. CME III.ss1.7.

²Ibid.

³Letter, H.M. Stratton to L.F. Gates, 4 June 1920. CME III.ss.1.6; Letter, J. Griffin to the Federal Trade Commission, 21 January 1921. CME III.ss1.7; Letter, F.B. Wells, Chamber of Commerce, Minneapolis, Chairman, General Committee, to the President, Board of Trade, Chicago, 15 July 1920. CME III.ss1.6; Meeting Minutes, General Grain Committee by Secretary George P. Case, 8 July 1920. CME III.ss.1.6; Letter to Wells, Chairman, General Committee on Resumption of Wheat Trading from the Committee, 6 July 1920. CME III.ss.16; Telegram, H.M. Wilson, Chairman Minot Branch American Red Cross to the Duluth Board of Trade, 30 October 1922. CME III.642.1; Cash wheat at a high premium to near futures indicates a problem: Letter, J. Mauff to H.M. Wilson, 4 November 1923. CME III.642.1; Letter, Marcy of Armour & Co. to J. Mauff, 19 September 1922. CME III.642.4; Letter, H.M. Stratton to L.F. Gates, 4 June 1920. CME III.ss.1.6.

doubt expected, unprecedented volatility followed. This upset the larger commission merchants, who handled professional (but non-member) ‘hedgers’ and other large profitable trades. For instance, member Thomson McKinnon wrote a letter of complaint to CBOT President Gates in July 1920, stating, ‘Since wheat trading was inaugurated, we have had a little business, with some of our orders reaching the market at inopportune moments. We have done everything possible to discourage business, even to the extent of asking prohibitive protection’.⁴ The markets were too volatile to trade. By 4 August, the Baltimore market closed due to ‘fluctuations’, with its President Hayward writing in desperation:

It was [...] far from our thought that conditions would grow worse, rather than better, after a lapse of a month’s trading [...] with no apparent reason for the wide fluctuations, serv[ing] to disgust a great many people [...] No one, either buyer or seller, feels like taking the hazard of trading in futures under present conditions.⁵

The market was functioning for scalpers and proprietary traders who took advantage of the volatility, but for the brokers’ customers—i.e. the hedgers and those who were trading from off the floor—the markets were unusable. Millers, line elevators and members of the exchange whose livings depended on outside interest in the markets, were unhappy and this unhappiness often translated into letters or meetings with the USDA, their Congressmen or, even better, members of the powerful agricultural committees either in the House or the Senate.

Rather than recognise the abrupt decline after the war in farm goods prices as a return to more reasonable levels, farmers saw it as a catastrophic yet temporary decline from record crop prices. To this day, the ‘ever normal granary’ ideal is based on 1910 prices. Understandably, and without contributing to either the conspiracy theories of populists or the threat of ‘Granger’ uprisings being invoked, farmers were concerned with their precarious finances. Having been told during the war to expand production by Hoover’s US Food Administration, in hindsight, the resultant oversupply made such expansion seem foolhardy. However, financial disasters abounded everywhere, especially since the 1920–1921

⁴Letter, Thomson McKinnon to Gates, 27 July 1920. CME III.ss1.6.

⁵Letter, Hayward to L.F. Gates, 5 August 1920. CME III.ss1.6; Letter from Hayward, Baltimore, to L.F. Gates, 6 August 1920. CME III.ss1.6.

Depression had taken its toll. But to see the regulatory response as a form of relief effort for farmers is to miss most, if not all, of the crucial private history that is the context for the legislation.

2.2 GOVERNANCE AT THE CHICAGO BOARD OF TRADE AFTER WORLD WAR I

In the nineteenth century, the CBOT and other exchanges had established rules for transacting in cash, to arrive and futures contracts, in the form of private governance by voluntary associations; the Boards of Trade and the Chambers of Commerce.⁶ By the 1920s, the CBOT was the dominant grain futures exchange. Although there was often valuable input from Milwaukee, Minneapolis and Kansas City executives, some of the smaller exchanges simply followed the CBOT's lead regarding government lobbying, public relations and legal battles over the legitimacy of markets and against bucket shops. Officials of the minor futures exchanges often rubber stamped CBOT decisions and actions: The St. Joseph Grain Exchange's secretary did not even read a certain brief sent to Congress before he signed it in February 1920.⁷

Business was transacted via private contract between two traders, a buyer and a seller, and the traded prices, known as 'board of trade quotations', were transmitted by telegraph and by telephone from the pit. While the prices were part of the official record, 'the records of the trades themselves [were] the private property of the individual members [...] who enter into these contracts. The board of directors [had] no right whatever to inquire from any member for his record'.⁸ The executive, which liaised with the committees and the membership directly, consisted of a president, two vice-presidents and fifteen directors. The president, one vice-president and five directors were elected annually in early January⁹ and the secretary, assistant secretary and treasurer, who

⁶See, for details of this process, see Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Chicago: University of Illinois Press, 1979).

⁷Letter, Secretary of the St. Joseph Grain Exchange to L.F. Gates, 1 March 1920. CME III.ss.1.6.

⁸Statement of L.F. Gates during 1919 and 1920, before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

⁹Good Old Book Circa 1890, Author Unknown, "The Chicago Board of Trade, How to Speculate." CME VII.ss2.57.2.

Table 2.1 Officials at the CBOT and the US Administration

	<i>CBOT President</i>	<i>CBOT Secretary</i>	<i>USDA Secretary</i>	<i>US President</i>
1920	Leslie F. Gates	John R. Mauff	Edwin T. Meredith	Woodrow Wilson
1921	Joseph P. Griffin		Henry C. Wallace	Warren Harding
1922	Robert McDougal	James J. Fones		Calvin Coolidge
1923	John J. Stream			
1924	Frank L. Carey		Howard M. Gore	
1925			William Jardine	
1926	John A. Fones			
1927				
1928	Sam P. Arnot			
1929		Fred H. Clutton	Arthur M. Hyde	Herbert Hoover
1930	John A. Bunnell			
1931	James C. Murray			
1932	Peter B. Carey			
1933			Henry A. Wallace	Franklin D. Roosevelt
1934				
1935	Robert P. Boylan			
1936				

held office for one year, were appointed by the directorate immediately after the annual election.¹⁰ The board of directors had authority over all concerns of the CBOT, ‘from the most petty to the most vital’.¹¹

The CBOT President generally appointed the members of as many as twenty committees—usually three members each—to cover a myriad of important issues such as market reports and new member approvals.¹² One of the main functions of the committee system was to arbitrate inter-member disputes.¹³ Additionally, committees could, and often did, intervene to set a settlement price for maturing futures contracts if deliveries were seen to be in short supply in a ‘corner’ or short ‘squeeze’.¹⁴

The CBOT executive changed regularly (Table 2.1), more frequently than the US administration and legislative authorities as well as the Washington and Chicago bureaucrats of the time. On the other hand,

¹⁰Ibid.

¹¹For more detail on the committee system, see Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Chicago: University of Illinois Press, 1979).

¹²Ibid.

¹³Report, CBOT Investigators to J. Mauff, 20 November 1922. CME III.643.1.

¹⁴Letter, J.J. Fones to a new price settlement committee, 1 June 1923. CME III.642.1.

powerful committee members left less frequently, and its presidents often remained active long after their leadership roles expired. For instance, John R. Mauff—a secretary and later executive vice-president—served on the executive for the entire interwar period while Sam Arnot played a major role in the mid to late 1920s as assistant to the president and then as president. From the turn of the century, the executive and the Legislative Committee were in regular contact with its outside counsel—Robbins, Townley, Wild, Campbell & Clark—which, not surprisingly, was well paid for its services.¹⁵

Coming out of the war, the CBOT was run by an experienced executive. Secretary Mauff was an influential supporter in F.L. Carey's 1922 run for the CBOT presidency in the face of general opposition. Mauff also moved in upper social circles, being, for example, friends with Hollywood stars, and holidaying in Lake Placid, New York.¹⁶ Mauff was later appointed to the newly created role of executive vice-president when James J. Fones was appointed secretary in 1923. Joseph P. Griffin was elected president in 1921, covering one key period of active legislation. Though the youngest president ever to serve the CBOT in 1916 (as well as serving as vice-president in 1914), Griffin was not popular with all elements of the membership. In 1919, Griffin was effectively forced to resign as chairman of the Wheat Committee as 'his extra aggressiveness was more or less embarrassing' and he did not always represent the views of the other committee members on important decisions.¹⁷ Nevertheless, he had a great deal of experience in Board matters and was an effective communicator. Griffin was succeeded by Robert McDougal on 1 January 1922, though the former continued to involve himself in grain matters, particularly legislative threats.

The committees managed the day-to-day business and, because of the disparate interests the CBOT represented, both the members and committees were often in discord. In some cases, when a committee was tasked to report on an important matter, 'very few of the members voluntarily appear[ed] with information or suggestions'.¹⁸ On the

¹⁵Letter, H.S. Robbins to J. Mauff, 17 June 1920. CME II.91.2.

¹⁶Letter, J. Mauff to Julius Barnes, 30 December 1921. CME III.642.5.

¹⁷Letter, James E. Bennett to L.F. Gates, 31 January 1919. CME III.s1.6.

¹⁸Report by Special Committee on Cash Grain to President Stream, August 1923. CME III.11.7.

other hand, members' own concerns could be voiced loudly and often, and petitions originating within the membership were very common, although most rule change proposals were rejected at committee or executive level.¹⁹ The executive could control the agenda of directorate and certain membership votes but, eventually, given enough perseverance, a member majority vote prevailed.

Membership of the CBOT was far from homogeneous, and governing was far from easy. The membership consisted of, *inter alia*, commission merchants, cash grain brokers, warehouse owners, millers and other end-users, speculators, integrated grain companies and, later, farmers' cooperatives. While some members were not opposed to the attempts to improve the policing of the markets, many traders were content with the late nineteenth-century status quo, which had no clearing house and few rules.²⁰ As detailed in Chapters Three and Four, members regularly attempted market manipulation, displaying 'wild west' attitudes, and punishment was incredibly unlikely. Worse still, majority rule meant improvements were almost impossible to effect, with manipulators, warehouses and bucketers often united in opposing new rules.

Unlike most of the members, the Board's often pragmatic executive was driven to improve its institutions, not because of a strong altruistic sense of making the markets safe for hedgers and other grain men, but because, without changes, the CBOT might lose competitiveness or, even worse, users might bypass futures markets altogether. Indeed, many farm products at the time were not traded frequently on exchanges and then, as today, there were many instances of vertical integration of the marketing chain, such as with Cargill, one of the world's largest private companies.

The larger trends in US politics were towards professional management, a belief in statistics and a balanced view of both markets and state. The private and public relationships between the USDA's regulatory agency and regulated industry, as represented by individual firms or by the CBOT, should be seen other than simply as two opposing sides constantly at loggerheads, for the Board and government were far from enemies. The USDA's regulatory agency and the CBOT executive

¹⁹Letter, J. Mauff to (petitioners) Edward Andrew, et al., 5 December 1923. CME III.642.1.

²⁰See Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979).

were often on the same side of important investigations into market manipulation. However, where there were conflicts of interest, it is hard to determine where they started and ended.

The existence of frequent battles between CBOT members highlights the need to treat the exchanges' interests as heterogeneous. Indeed, in the previous century, the largest members of the Board were in conflict over prices charged by grain trade intermediaries, such as railroads and warehouses and a pre-war struggle between middlemen provided the impetus for a Federal Trade Commission investigation into the grain trade. Elements of the Board's membership, and even some directors, were at odds with the executive on many key issues, including whether to fight the 1922 Act, adopting modern clearing, and reducing manipulation. Consequently, between 1923 and 1935 it was only through co-opting the USDA to solve the CBOT's collective action impasse that modern futures markets evolved, since it took the unprecedented volatility of 1924–1925 to stir them both into action. This supports the theory that an organisation that represents a wide variety of interests finds it difficult to resolve internal struggles.²¹

2.3 THE DAWN OF FEDERAL REGULATION

It is clear from both the historiography and the archival record that legislators who held the potential to exercise any control over the futures markets were opposed to government involvement, unless it was unavoidable. Businesses, too, were averse to the new regulation. Edward Balleisen documented how business groups set up their own self-regulatory organisations to 'fend off proposals for extensive regulatory oversight', with such 'associations' mobilising support for 'intra-industry cooperation in order to stabilise market conditions'.²² It is interesting that the CBOT did little to prevent fraud during this period because of tension in its ranks. Self-regulation relies on the market mechanism and reputational

²¹James G. March, "The Business Firm as a Political Coalition," *The Journal of Politics* 24 (1962): 662–678; Richard P. Rumelt, "Towards a Strategic Theory of the Firm," in *Resources, Firms, and Strategies: A Reader in the Resource-Based Perspective*, ed. Nicolai J. Foss (Oxford: Oxford University Press, 1997), pp. 131–145. Generally on self-regulation, see Bronwen Morgan and Karen Yeung, *An Introduction to Law and Regulation* (Cambridge: Cambridge University Press, 2007).

²²Edward J. Balleisen, "Private Cops on the Fraud Beat: The Limits of American Business Self-Regulation, 1895–1932," *Business History Review* 8 (2009): 113–160, pp. 113–116.

pressures to force firms to control themselves. However, there is no guarantee that such actions will be in the public interest, leading economist Joseph Stiglitz to label such regimes ‘preposterous’.²³ Lurie argues that private (self-) regulation was responsible for the successful evolution of the futures markets in the late nineteenth century and early twentieth century. He described three points of successful self-governance at the CBOT, (i) maintaining the commission rule, (ii) victory against bucket shops, and (iii) the elimination of privilege trading.²⁴ However, this analysis and therefore the conclusion is flawed as, firstly, the rule that required all members to charge the same fee per contract traded could not impact market efficiency in any way, and was strictly anti-competitive, enforcing restraint of trade and maintaining outsized (monopoly) returns.

Secondly, as Lurie himself observed, actions taken to eliminate bucket shops was advantageous to the large commission houses.²⁵ Thirdly, the bucket shop fight was unsuccessful internally since Board members continued to bucket throughout the interwar period. Finally, with respect to privileges, it remains unclear that such puts and calls were not in the public interest. The CBOT more likely attempted to ban them, albeit unsuccessfully on most occasions, because of the courts’ ‘intent to deliver’ rulings made privileges illegal in many States in any case, and the CBOT was not keen on riling State authorities. As such, this study diverges from Jonathan Lurie regarding CBOT’s nineteenth- and early twentieth-century self-regulation since Lurie states it was being practised by the late 1800s as being in the public interest. In fact, other explanations for the CBOT’s so-called innovations after 1890 are more compelling. The three major institutional issues documented in Lurie’s thesis can be explained by anti-competitive motivations of the membership or as not necessarily being in the public interest. This is unsurprising, as Lurie notes himself that the directors were far from impartial, and ‘it was not always possible to dissociate one’s self from [key issues]’.²⁶

²³Joseph Stiglitz, “Government Failure vs. Market Failure: Principles of Regulation,” in *Government and Markets: Toward a New Theory of Regulation*, ed. Edward Balleisen and David Moss (Cambridge: Cambridge University Press, 2009).

²⁴Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979).

²⁵Ibid.

²⁶Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979), p. 19.

This study also identifies the desire and willingness of the CBOT to engage with the Federal Government—importantly, though, not the State governments—to help solve the problems inherent in futures trading. Working with voluntary organisations was a key tenet of Hooverism, and voluntary organisations as a sort of ‘privatisation’ of regulation appear in much of the literature.²⁷ While some commentators stress the independence of these organisations from the state, Gary Gerstle observes that they were interwoven. That said, the CBOT possessed some elements of a voluntary organisation as described by recent historians, and certainly self-regulation was a priority of the Harding, Coolidge and Hoover governments.²⁸

A large body of work covers the development and legacy of bureaucratic growth in the US Federal Government, beginning in the Progressive years. Daniel Carpenter wrote that ‘bureaucratic policymaking is the hallmark of modern American government, and bureaucratic autonomy occurs when bureaucrats take actions consistent with their own wishes, actions to which politicians and organised interests defer’.²⁹ This study argues that by 1935 bureaucratic power at the USDA was just strong enough to enable interest groups to influence legislation in the public interest. Ten years previously, an informed bureaucracy had also worked with the CBOT to co-construct valuable changes to market institutions. Without such intellectual strength, market evolution might have been significantly altered.

Pragmatism and progressivism flourished in the interwar years, encouraging legislators and administrators to govern in an enlightened manner, referring to ‘facts’. Information was still paramount. Brian Balogh dates the development of a professional Federal Government administration, alongside the emergence of positivism, from just before the end of the eighteenth century. Rational-scientific approaches were to be applied based on the data that had been accumulated by both public and private

²⁷ Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from the Founding to the Present* (Princeton: Princeton University Press, 2015).

²⁸ Edward J. Balleisen, “Private Cops on the Fraud Beat: The Limits of American Business Self-Regulation, 1895–1932,” *Business History Review* 8 (2009): 130–160, p. 141.

²⁹ Daniel Carpenter, *The Forging of Bureaucratic Autonomy: Reputations, Networks, and Policy Innovation in Executive Agencies, 1862–1928* (Princeton: Princeton University Press, 2001), pp. 6–7.

organisations.³⁰ Within both bureaucracies and academia, a feeling was developing that ‘statistics’ should determine policy.³¹ For example, in 1896, Henry Carter Adams preceded the USDA’s call for more information by asking for rail regulation to be guided by statistics.³²

The shift to interventionism and scientific management dates to before both the 1922 Act and the New Deal. By the time Hoover became Secretary of Commerce in 1921, the trends towards professionalism and a focus on higher education were well developed, with 70% of the US federal civil service employed on the merit system. Therefore, the misrepresentation of Hooverism as being blindly pro-market often confuses the analysis of government intervention in the 1920s. According to Hawley, in 1920 the ‘scientists in government brought their societies together to elect Hoover as their leader’.³³ Hoover knew from his World War I experience that agricultural economic management demanded more information and better analytical tools; consequently in 1921 he was instrumental in creating the Food Research Institute and, within it, the Wheat Studies Group, at Stanford University. Similarly, in 1922, Wallace created the Bureau of Agricultural Economics and, after discovering the lack of opportunities to improve his staff’s quantitative skills, established a statistics training programme within the USDA. It was intellectual, university—trained professionals that set the agenda for US Federal state-building.³⁴ Dr. J.W.T. Duvel, a key governmental figure during the interwar years, was just one such example of the consummate academic-turned bureaucrat. With Hoover’s support, USDA Secretary Wallace pushed for new legislation that included exempting farm product marketing associations from antitrust provisions and establishing federal price support mechanisms similar to those in the New Deal, under the

³⁰Brian Balogh, *Government Out of Sight: The Mystery of National Authority in 19th-Century America* (Cambridge: Cambridge University Press, 2009), pp. 352–378.

³¹Contemporary Academic and Policy Innovator Lester Ward as in Brian Balogh, *Government Out of Sight: The Mystery of National Authority in 19th-Century America* (Cambridge: Cambridge University Press, 2009), pp. 359–360.

³²Paul J. Miranti, “Measurement and Organizational Effectiveness: The ICC and Accounting-Based Regulation, 1887–1940,” *Business and Economic History* (1990): 183–192.

³³Ellis W. Hawley, “Herbert Hoover, the Commerce Secretariat, and the Vision of an ‘Associative State’, 1921–1928,” *The Journal of American History* (1974).

³⁴Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877–1920* (Cambridge: Cambridge University Press, 1982), p. 286.

McNary-Haugen Bill. Hoover, himself, had some innovative ideas for agricultural support, which included the Hoover-Jardine plan to assist farmers with federal credits.

Importantly, the new institutions paralleled the development of the regulatory regime for agricultural futures by stressing the importance of information gathering by the state and self-regulation by industry.³⁵ Furthermore, the important administrators and their professional staff were already in place just after the end of World War I to search for solutions to the agricultural crisis that was to engulf the interwar years.

2.4 THE ISSUES OF 1920

By 1920 and the reopening of the wheat futures markets on 15 June, concerns of the directorate and the executive continued to be focused on the following:

1. Complaints from powerful users about continued manipulation that was difficult to deter and almost impossible to punish.
2. Defending the CBOT's monopoly in futures.
3. Lobbying and information gathering in Washington to defend the interest of the futures industry.
4. Fighting the war against bucketing and its consequences.
5. Fighting for its legitimacy *vis a vis* State anti-gambling regulation.
6. An existential threat of cooperative marketing.
7. General public relations problems concerning futures trading.

Each of these concerns is explained below. Their confluence, however, resulted in a Board disinclined to provide timely price quotations to non-members or any useful information, such as open interest or volume, given the risk that it could be misinterpreted or misread. The Board was fighting to keep its futures monopoly strong, defending itself against the bucket shops, attempting to be recognised as legitimate business in the courts and eliminating just enough manipulation to keep its users happy.

³⁵Louis Galambos, "Technology, Political Economy, and Professionalization: Central Themes of the Organizational Synthesis," *Business History Review* 57, no. 4 (1983): 471–493.

This study argues that the needs of the Board, as seen by its executive, explain a great deal of the legislation, regulatory regimes and outcomes during the interwar period (Chapter 3).

2.4.1 *Manipulation at the Board*

Policing the Board throughout the interwar period was almost always a thankless task. Before 1920, the executive was vigilant for any transgressions of federal laws by members, specifically against hoarding. Consequently, CBOT President L.F. Gates would write letters of admonishment to members who appeared to be attempting a corner, or even simply having large positions in either direction, even if they used hedging as their ‘official’ justification.³⁶ Pushback was common, however, and a letter from miller member Ralston Purina caused Gates to climb down and apologise thus, ‘we shall from time to time make mistakes no doubt’.³⁷

The twentieth-century CBOT was ‘not composed of saints exclusively nor of sinners’,³⁸ and the directorate often turned a blind eye to manipulation, thereby encouraging the ‘sinners’. Attempts to bring in anti-manipulation rule proposals were rejected, often with large majorities. Even when anti-manipulation rules were in effect, they were rarely applied, either to punish or prevent manipulation. Finally, the attempts to enforce anti-corner rule were often intended to rob Peter to pay Paul, strictly to take profits away from the weaker members. The powerful members were de facto exempt from possible prosecution.

Besides the outsized profits made through blatant manipulation, the volatility that often followed such schemes were thought to attract new business. Some traders were of the opinion that such corners were to be welcomed by those who earned their daily bread from speculative trading by an unsophisticated ‘public’ drawn in by the headlines. For instance, former president Griffin stated, ‘[T]o be perfectly frank about it, I think these occasional congestions add to the attractiveness of the market to

³⁶Letter, Gates to Veninga-Smith Grain Co., 29 January 1920. CME III.ss1.6.

³⁷CME III.ss1.6, Letter from W.K. Woods Vice President of Ralston Purina to Gates, President, 30 January 1920. CME III.ss1.6, Letter to W.K. Woods from Gates, 1 February 1920.

³⁸Charles H. Taylor, *History of the Board of Trade of the City of Chicago*, vol. 1 (Chicago: Robert O. Law, 1917), pp. 5–6.

the public [...] Like the congestion we had in 1921, I think that stimulated the trade, not discouraged it'.³⁹ 'Congestion' of course was a euphemism often employed in lieu of manipulative corner or squeeze.

Ignoring evidence to the contrary, the exchanges argued that their rules prevented any manipulation and, furthermore, provided for the most efficient markets possible for marketing and hedging. Unfortunately, effective enforcement was hampered by; (i) very vague rules, (ii) a lack of enough information to identify illegality, and (iii) a wilful blindness on the part of 'friends' on the key committees. The rules were difficult to enforce, especially on powerful and truculent members. Additionally, even the committees, the directorate and the executive often did not understand the rules and relied on counsel for interpretations.⁴⁰ Worse still, some rules did not in fact operate as intended.⁴¹ Such observations were made by Lurie and Taylor regarding the lack of actions taken in the public interest during the nineteenth century by the Board directorate.⁴² Members tended to push the ethical envelope in, for example, their solicitation of clients. James E. Bennett's company, for example, was taken to task by the Board executive for posting an aggressive wire, advertising easy profit on a low margin.⁴³ In response, Bennett blamed the Board operators for making the error.⁴⁴

The problem with the price action of 1921 and 1922 is that it made hedging very difficult and often dangerous.⁴⁵ H.J. Loman, an academic who later wrote on the futures market in the *Annals* of 1931, did not believe the hedging justification for futures markets

³⁹ US Federal Trade Commission, *Report on the Methods and Operations of Grain Exporters, 1922* (Washington: Government Printing Office, 1922), p. 16.

⁴⁰ Letter, J. Mauff to H. Robbins, 8 December 1921. CME III.2.641.3.

⁴¹ Ibid.

⁴² Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Chicago: University of Illinois Press, 1979). Charles H. Taylor, *History of the Board of Trade of the City of Chicago*, vol. 1 (Chicago: Robert O. Law, 1917), pp. 5–6.

⁴³ Letter, James E. Bennett to L.F. Gates, 10 August 1920. CME III.ss1.6.

⁴⁴ Ibid.

⁴⁵ Letters, H.J. Loman to J. Mauff, 17 March and 29 March 1921. CME III.2.640.1.

could be used under the current market conditions. He did not think that hedging was as widespread as was reported, nor that speculators really carried the burden of the producers, as was often asserted.⁴⁶ The reality was far removed from the theory. Not only disinterested academics but also active users of the futures markets, such as the large milling companies Ralston Purina and Pillsbury, complained to their Congressmen, the Secretary of Agriculture, the US President and the press, stating that hedging was not possible in such volatile markets. These interests could not operate in such volatile markets, blaming irrational price action on over-speculation on the long side.⁴⁷ While the politically powerful milling interests were lobbying, mostly in private, the public sphere abounded with tales of boom to bust futures markets, especially in 1922 as well as following the so-called Cutten Corner in 1925.

The CBOT executive knew that manipulation was a problem even as they were denying it: Gates wrote confidentially to Griffin to ‘see that July deliveries do not give occasion to stir up the animals here to embarrass the situation. Situation last few days of May gave them all sorts of ammunition’.⁴⁸ The end result of the lack of Board consensus on the necessity of eliminating manipulation was that little if anything was accomplished until at least the middle of the 1920s, even if many at the Board, including hedgers, felt that the markets were not efficient enough to be useful. Powerful members chose to ignore the fact that the lack of action threatened the Board’s monopoly and could have inhibited its future growth.

⁴⁶H.J. Loman, “Commodity Exchange Clearing Systems,” *The Annals of the American Academy of Political and Social Science* 155 (1931): 100–109.

⁴⁷Letter, Barnes to Fred Uhlmann, 24 December 192. CME III.13.34; Letter, F.G. Winter to Carey, 9 May 1925. CME III.18.2; Letter, Carey to Mr. Sidney C. Anderson, Millers National Federation, 8 May 1925. CME III.ss1.9; Letter, Jardine to Arthur Capper, 31 March 1925; National Archives and Records Administration, Kansas City, Record Group 180. Archival Research Catalogue Identification number 4731930 (hereafter NARA/KC), File number, Box 12, 14–16.

⁴⁸Handwritten highly confidential letter, L.F. Gates at the Washington Hotel to J. Griffin, 7 July 1921. CME III.ss1.7.

2.4.2 *Defending the Monopoly*

The CBOT was harshest, not on the manipulators, but on those attempting to cut commissions and/or break the monopoly, such as by bucketing (also see Sect. 2.4.4 below). This sometimes had unintended effects. In a prescient move, still being adopted in many anti-bribery and conflict of interest voluntary codes and laws, gifts to clients were forbidden on the grounds that they could be seen to be commission discounts.⁴⁹ However, this rule was introduced for anti-competitive rather than ethical reasons.

Between 1901 and 1911, cash, as opposed to futures, receipts in Chicago had fallen from 52 million bushels to 29 million bushels, even though futures volumes remained unchanged.⁵⁰ By the end of World War I, it was clear to the Board that it was no longer a dominant centre for trading cash grain, and it therefore focused on monopolising the futures markets and profiting from the increased futures volume that followed the war.⁵¹ By 1923, the evidence shows that the CBOT had not only neglected cash grain but it had also neglected the related ‘to arrive’ market.⁵² Members whose fortunes were tied to the cash market fought to return to cash market dominance, but this necessitated returning the elevators to their once all-powerful position as well as increasing the efficiency of the rail and sea networks serving the Chicago markets.

A committee to study the decline of the cash grain markets in Chicago reported in 1923 that the committees tasked with responsibility for the cash markets could not ‘possibly find time to ... ensure that this market be kept in its proper position’.⁵³ By this time it was clear that the future of the CBOT was in the futures market, since the Board was already the largest futures exchange. Although wedded to fixed commissions to the point of losing political battles over its desire to eliminate patronage dividends (Sect. 2.4.6), evidence shows that the CBOT did bow to competitive pressures. In 1923, following a recommendation from a Cash Grain

⁴⁹Letter, CBOT Secretary to W.H. Armitage, 14 December 1923. CME III.642.1.

⁵⁰US Federal Trade Commission, *The Grain Trade, Volume V: Future Trading Operations in Grain* (Washington, DC: Government Printing Office, 12 January 1921), p. 42.

⁵¹Report, Special Committee on Cash Grain to President Stream, August 1923. CME III.11.7.

⁵²Ibid.

⁵³Ibid.

Committee, the Board dropped minimum commissions on cash wheat to 1 cent from 1.5 cents, which suggests that the Board executive understood that it held the monopoly of futures and that it faced serious competition from the cash markets.⁵⁴

The CBOT had a history of enforcing monopolistic behaviour, as is evident in the *Chicago Board of Trade v. United States*, 246 U.S. 231 (1918) case where it had argued that its ‘call’ rule by which no member could buy grain after 2 p.m. at any price other than that set by the Board was not a restraint of trade. Thus, the legislation was highly biased towards the needs of the members, whether legitimate or borderline fraudulent, or worse. That the CBOT believed it was a monopoly after the passing of the 1922 Grain Futures Act is evidenced by an internal memo discussing an upcoming public relations campaign in 1922, stating that ‘at the present time Chicago has a monopoly on grain speculation’ and advertising campaigns should focus simply on increasing overall speculative interest.⁵⁵ That is, any new futures purchase or sale was almost certainly going to the floor of the CBOT.

2.4.3 *The CBOT in Washington*

During the interwar years, the CBOT lobbied jointly with other exchanges that were significantly less interested in the futures business, except in as much as it influenced their relatively large cash businesses. It was often the case that exchange leaders disagreed regarding the best policy to pursue in Washington. Frederick B. Wells of the Minneapolis Chamber of Commerce was the chairman of the Grain Exchange Legislative Committee during the crucial early 1920s. Full-time representatives of the Legislative Committee of the exchanges, with Mrs. P.W. MacMillan as permanent secretary, worked primarily as a lobby group against regulation, higher taxes and related legislation. Clarence B. Miller, who was the first paid lobbyist, was joined soon after by lawyer F.C. Stevens, an ex-Congressman and member of the Interstate Commerce Committee. Mr. Stevens was known to be close to all legislative classes at Washington and ‘his opinion [was] held in high regard

⁵⁴Ibid.

⁵⁵Abstract of an Education Campaign Program, ‘Purpose of Campaign: the specific purpose of the campaign is to increase speculation in grain here in the East’, 23 January 1922. CME III.ss2.653.4.

by the better element in both Houses and he commands respect as a legal authority on legislative matters'.⁵⁶ MacMillan, though a secretary, was not without connections in Washington or respect within the grain industry.⁵⁷ For example, MacMillan had a line directly to the US President.⁵⁸ Connections in Washington were crucial.

The volatile situation in futures was to get much worse in 1921 and 1922, but even before the markets reopened in 1920, lobbyists were pressuring their representatives in Washington, Springfield, Ill. and further afield for new legislation controlling the grain middlemen. Bills that emanated from populist farmer initiatives failed.⁵⁹ More credible bills, although they tended to be sponsored by Farm Bloc politicians, were more a result of lobbying by industrial consumers and middlemen of the time than by the farmers. These powerful actors, such as the millers, had been most disconcerted by market volatility upon reopening and had direct access to the key legislators. Yet when complaints were raised at the highest level, say with the Secretary of Agriculture, the bureaucrats and politicians could not respond intelligently because they lacked hard data on manipulation, the use of the markets by hedgers, and other important factors. Nevertheless, the response of legislators to consistent lobbying from so many sides wanting them to 'do something' manifested itself eventually in the 1921 Capper-Tincher Bill.

Immediately after the war, there was a strong public feeling that some bill would pass (Chapter 3), yet the CBOT privately was aware that most legislative attempts either had little chance of success or did not threaten their interests. They had enough lobbying experience to recognise a credible threat, so they would strategically mobilise their resources in Congress.⁶⁰ When one Bill was expected to sneak through in 1920, Julius Barnes, a 'grain man' mostly supportive of the CBOT during his

⁵⁶Memorandum, Members of the Exchange Legislative Committee [mid 1924]. CME III.15.8; Letter, L.F. Gates to J. Mauff, 1 February 1923. CME III.2.650.4; Letter to Stream, 5 February 1923. CME III.660.8.

⁵⁷Memorandum, Members of the Exchange Legislative Committee [mid 1924]. CME III.15.8.

⁵⁸Letter, P.W. MacMillan to Secretary, Omaha Grain Exchange, 4 November 1922. CME III.652.5.

⁵⁹Copy of Brandt Bill, 30 December 1920. CME III.ss1.6; Letter, H. Robbins to J. Mauff, 11 March 1920. CME III.ss1.6.

⁶⁰Letter, L.F. Gates to F.C. Stevens, 26 March. CME III.ss1.6.

tenure at the US Chamber of Commerce, immediately met up with Senator Gronna and according to the exchanges' lobbyists it was not re-referred to the Committee on Agriculture because 'the letter of Mr. Barnes killed it'.⁶¹ However, Congressmen Capper and Tincher, after a failure with an earlier bill, were back on Capitol Hill by the end of 1920 and, since both had significant influence on their respective agriculture committees in Congress, they were deemed a credible threat to CBOT. Consequently, on 13 December 1920, the Chicago, Milwaukee, St. Louis, Kansas City, Omaha, Duluth, Minneapolis and Indianapolis grain exchanges tasked a delegation of Wells, Lonsdale and Gates with liaising with Secretary Wallace and the Congressional committee members.⁶² The exchanges were thus ready for a fight in Washington.

2.4.4 *The Bucket Shops*

By the late 1880s futures markets were so successful in attracting grain gamblers that competitors emerged. However, instead of trading contracts for actual delivery, many competitors were 'bucket shops' that took the other side of customers 'bets' just like a bookmaker, without executing the orders on any exchange, and pocketing the customers' money if they lost. If the bucket shop ended up too much on the wrong side of a trade—i.e. short when the market had a large up move—it could always close up shop and run.⁶³ Many CBOT members were involved in bucketing both on and off the exchange.

Because the public could not tell the difference between a legitimate exchange and a bucket shop, bucketing could be detrimental to the CBOT's business. Firstly, because it was competition in that a gamble in a bucket shop was a gamble not made on the CBOT. Secondly, the CBOT suffered both reputationally and from local political pressure when losers complained to the press and their government representatives. Thirdly, not only were they taking business from the CBOT, but their failure to restore funds to winning clients gave the entire exchange industry a bad name.⁶⁴ Fourthly, gambling in bucket shops attracted the attention

⁶¹Letter, F.C. Stevens, Washington to Gates, 13 February 1920. CME III.ss1.6.

⁶²Memo, Executives of the Grain Exchange National Committee to the Boards of each of the exchanges, undated. CME III.2.650.5.

⁶³Harold S. Irwin, "Legal Status of Trading in Futures," *Illinois Law Review* 32 (1937).

⁶⁴Letter, CBOT Secretary to George Burmeister, 16 January 1923. CME III.643.3.

of the States which, during this crucial period, were deeply involved in social regulation using police powers. For instance, anti-gambling legislation was frequently used by failed speculators to renege on bets made in bucket shops, but also on the legitimate exchanges.

The CBOT exerted financial and physical pressure on illegal competition. The Board hired some real muscle in one George Burmeister, who travelled around the USA shutting down the miscreants. Even though the law was on his side, his methods were not always lawful in that Burmeister was also not averse to using a bit of force to get his point across.⁶⁵ In one letter in 1922 discussing a CBOT member who had been suspected of bucketing, Burmeister wrote to Mauff, 'You got to give that old whiskered hypocrite credit, he is a good suffer, but ...I am going to make him lay down and take the count not only for 10 but for a long time'.⁶⁶ The fight against bucket shops involved not entirely scrupulous activities and, additionally, there was a deemed need for absolute secrecy in these dealings. As a result, many telegrams and even some letters between the CBOT executive and Burmeister were written in code. In one such telegram, 'Paradox' (Burmeister) wired 'Pinafore' (Mauff) that 'tandem [was] erasing their baby' (W.W. Cohen & C. were selling out their seats on the exchange) and that 'aweyisiw will come in for third fijwii' ([known bucketter] Ware would be questioned by the authorities).⁶⁷ Geo. Burmeister was so successful as a private 'detective' for the CBOT that the Cotton Exchange asked to borrow him for an 'aggressive fight' in New York.⁶⁸

The bucket shop business was seedy at best of course, but there was also a burgeoning business in accusing legitimate traders of bucketing. Burmeister investigated one case where the accuser was 'a professional black-mailer trying to implicate respectable parties in sexual intercourse orgies'.⁶⁹

⁶⁵Letter, From Burmeister to Mauff, 10 June 1922. CME III.655.6.

⁶⁶Letter to Mauff from Burmeister in NYC, 19 November 1922. CME III.643.3—The letter also states, 'I want to get the Colonel, he wants to use our seat as prestige and to use it as a close for his being innocent in the Hughes & Dier Matter. He finally sold out his Philada seat, quit his threatened suit. ... I think I am overdue for an increase in salary.'

⁶⁷Undated coded message (with translation) from Burmeister to Mauff via private wire. CME III.ss2.654.

⁶⁸Telegram from Robbins to his Chicago office, 2 February 1923. CME III.643.3.

⁶⁹Telegram from Burmeister Re: Willis Hough, 25 May 1921. CME III.ss1.7.

In this case, the blackmailer of the CBOT as a whole rather than an individual member had already been tried and convicted of a previous attempt to extract funds from another commission merchant in Iowa.⁷⁰

Burmeister learned all the tricks of the bucket shops. On 10 June 1922, the enforcer described how bucket shops would make fictitious trades with clients but then offset the net risk on the legitimate Board through a member.⁷¹ This is a method used even today by the legitimate progeny of the bucket shops in the UK, the contract for difference houses (such as Cityindex) as well as active bookmakers laying off gamblers' trades when price and risk warrant. Burmeister reported that he had found other similar schemes in Philadelphia, and that he believed 'I will be successful and may dig up another in the meantime'.⁷² Chicago members were often unwilling abettors to the bucket shops in this way, but equally often the members knew when their clients were bucketing orders. Some members, therefore, were incentivised to fight anti-bucketing measures.

George Burmeister was clearly successful in helping rid the USA of bucket shops, one at a time, even as far away as Denver. This effort, however, wasn't inexpensive, and Gates and Mauff were often at odds over the costs. Burmeister himself stated on 22 October 1919, 'It sure is a tough job here but I feel that we can put the thing over the goal... I want to please [Gates] regarding the expense end at the same time I want to make a record and keep on being successful in my line, exterminating bucketshops. The political force back of this thing is very big but it is not so big that with proper manoeuvring the whole thing can be pushed off its pedestal in cherry creek.'⁷³ For this reason alone, The CBOT must have longed for the days of federal cooperation on this issue.

Though convictions resulted from the Board's efforts alone after the big government-aided sweep in the previous decade, convictions were not always easy to obtain. Evidence had to be properly gathered, organised and lawyers briefed before charges could be filed, and court action often took years, sometimes with suboptimal results.⁷⁴ A better solution

⁷⁰Telegram from Burmeister Re: Willis Hough, 25 May 1921. CME III.ss1.7.

⁷¹Letter, From Burmeister to Mauff, 10 June 1922. CME III.655.6.

⁷²Letter, From Burmeister to Mauff, 10 June 1922. CME III.655.6.

⁷³Letter, Burmeister to Mauff, Denver, Colo., 22 October 1919. CME III. 655.6.

⁷⁴Newspaper article clipping, incomplete title and no date. CME III.2.650.4. **This provides an** example of how hard convictions were to obtain—'Edward M. Fuller and William Frank McGee, who were convicted of operating a bucket shop in connection with the defunct brokerage firm of E.M. Fuller & Co., which failed in 1922, defrauding its

than continuous monitoring by the CBOT itself was needed to end bucketing, and until that could happen. The Board kept a very close eye on its proprietary data. At times, the CBOT went after the telegraph companies and Board members to prevent their quotes from being used and prevent the risk management of bucketing to be executed on the legitimate exchange. In one such instance, the Board obtained a restraining order on the American Telephone & Telegraph Company and CBOT member the Armour Grain Company: 'It is hereby ordered that, you and each of you by this Court be restrained and you are hereby enjoined and restrained from operating what is commonly known as a bucket shop'.⁷⁵

As a direct result of the bucketing threat, any price or other data were considered valuable and not be revealed to non-members for any reason. Thankfully for the futures industry, this predicament would change in 1923. So, enforcement was costly, uncertain and resulted in great mistrust with the CBOT membership. The Board directorate desperately wanted the situation changed.

Contrary to the accepted record, bucketing remained a problem for the exchanges after the war, since its new manifestation often appeared legitimate on the surface by holding a membership in an exchange, frequently on the CBOT itself.⁷⁶ Hence the fight against them involved not entirely scrupulous activities and was very expensive.⁷⁷ The best way for the CBOT to defend itself was to limit the distribution of quotations and other trading information to members and their direct clients.⁷⁸ Any price or other data were considered valuable and could not be revealed to non-members for any reason.

By 1921, the Attorney General had already been working with the futures industry to eliminate the most egregious bucket shops, and the Supreme Court had ruled that the CBOT in fact owned the price

customers of about \$4,000,000, received parole from Sing Sing Prison last night. They were sentenced 6 June 1923, to a term of fifteen months to four years. In June, 1927, they began to serve...Fuller was tried three times, each being a mistrial then he was placed on trial with McGee and in June, 1923, they pleaded and were sentenced. Execution of sentence was stayed pending the completion of proceedings in which their testimony was needed'.

⁷⁵Temporary Restraining Order, to The American Telephone & Telegraph Company, The Armour Grain Company, 10 June 1922. CME III.655.6.

⁷⁶The accepted history can be found in Thomas A. Hieronymus, *Economics of Futures Trading for Commercial and Personal Profit* (Washington, DC: Commodity Research Bureau, 1977), p. 90. Letter, Burmeister to Mauff, 19 November 1922. CME III.643.3.

⁷⁷Letter, Burmeister to Mauff, Denver, Colo., 22 October 1919. CME III. 655.6.

⁷⁸Ibid.

quotations from the exchange floor. Yet the fight was far from over, and the CBOT was still vigilant against any bucket shop challenge. In 1922, the executive was still concerned about prices being disseminated by the members of other exchanges, with Mauff asking its counsel what could be done to limit the use of CBOT quotations by members of other exchanges, given such users ‘are not the character of men who would be admissible to membership of this exchange’.⁷⁹ Thankfully for the futures industry, in 1922 its predicament would change due to the efforts of the Federal Government (Chapter 3).

2.4.5 *State Legislative Threats and the Fight for Legal Legitimacy*

By the turn of the century, the markets were risking run-ins with state and federal regulators. The states were interested in social regulation, while the Federal Government was focused on economic regulation. Balleisen has identified ‘enthusiastic’ support from presidents Coolidge and Hoover for industry-led efforts to battle fraud and other bad business practices.⁸⁰ But the CBOT was not as anti-fraud as it would first appear. In fact, the Board did very little to prevent what was seen as fraudulent manipulation during this period, mainly due to tensions within the Board’s membership.

The move by the Federal Government into futures regulation in 1921 occurred at a very crucial time for the development of federal over State power. The 10th Amendment had reserved all undelegated powers to the States, and, after the Civil War, Marshall’s Supreme Court supported States’ involvement in economic and social affairs for ‘the good and welfare of the commonwealth’.⁸¹ Consequently, States took control of economic and social issues under ‘police power’ doctrine, passing laws dealing with gambling, health and safety, grain storage and railway rates.⁸² Many States banned the trading of futures on gambling grounds, which was a logical justification for limiting futures trading at the turn of the century. As Emery stated in 1898:

⁷⁹Letter from Mauff to Robbins, 11 January 1922. CME III.2.641.3.

⁸⁰Balleisen, *Edward Private Cops on the Fraud Beat...*, p. 141.

⁸¹Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from Its Founding to the Present* (Princeton: Princeton University Press, 2016), p. 67.

⁸²*Ibid.*, pp. 67, 77, 79.

It is not the great speculators, but the numberless small speculators, who are the social curse. The record of defaulting cashiers and trustees that comes up from every corner of the land, shows how far this evil has extended. To what extent, however, the evil can be overcome by legislation is another serious question.⁸³

Importantly, though, State laws for futures were not applied consistently. Gary Gerstle identified the problem of both the inconsistent treatment of regulated businesses and the inconsistent quality of law enforcement thus, ‘The laws passed by the states were not always effectively enforced, and the quality of the work done by the new agencies varied greatly from state to state’.⁸⁴ Before 1921, State prohibitions on futures trading were often narrowly interpreted, so in some States trading was tacitly approved, while in others, such as Chicago in 1876, the courts positively protected the futures markets from governmental interference.⁸⁵ However, in still other States, futures transactions were considered by the courts as gambling, which was a significant problem for the CBOT and the other exchanges. This resulted in many legal problems for the exchanges when, for example, attempting to reclaim owed monies from losing investors. Up until then, the CBOT had been spending a great deal of money providing its top legal talent to legitimacy challenges in the courts.⁸⁶ Prior to 1921, futures commission merchants were losing lawsuits even to grain professionals under the protection of anti-gambling State statutes.

The Federal Government, however, did have some wide sweeping powers, such as those to impose taxes, administer the postal service and regulate interstate commerce. Gerstle has identified many attempts to use such legislative powers, such as the Interstate Commerce Act in 1887 and, in 1890, the Sherman AntiTrust Act.⁸⁷ In his Inaugural Address,

⁸³Henry Crosby Emery, “Legislation Against Futures,” *Political Science Quarterly* 10 (1895): 85.

⁸⁴Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from Its Founding to the Present* (Princeton: Princeton University Press, 2016), p. 77.

⁸⁵Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 53.

⁸⁶See, for example, Letter, H.S. Robbins to W.S. Blowney, Assistant Secretary, CBOT, 29 April 1920. CME II.91.2.

⁸⁷Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from Its Founding to the Present* (Princeton: Princeton University Press, 2016), p. 93.

Herbert Hoover asserted the right of the Federal Government to interfere in commodity distribution regulation through the use of enforced competition:

Such regulation should be extended by the Federal Government within the limitations of the Constitution and only when the individual states are without power to protect their citizens through their own power. On the other hand, we should be fearless when the authority rests only in the Federal Government.⁸⁸

According to legal expert Christopher Tomlins, *laissez faire* was considered ‘a very narrow path of inquiry’ and one limited to economic freedom by Associate Justice Stephen Field in 1885.⁸⁹ The USA entered the 1920s with strong Supreme Court support for State regulation, while at the same time defending the Federal Government’s right to interfere in interstate commerce ‘in the public interest’. Gambling was for the States to regulate, while trans-state voluntary organisations were to be supported and regulated by the Federal Government. Because futures markets were considered to be both gambling and in the public interest this caused a jurisdictional problem that was finally resolved in 1923 by the Supreme Court. Previously, though some States did not enforce their anti-futures statutes, having any chance of a contract being declared void due to State prohibition was untenable for the CBOT. Under the 1921 and then the 1922 Acts, the exchanges were well protected from anti-futures bills at State level, as well as being supported in civil claims that sought to set aside loss claims on ‘gambling’ grounds.

2.4.6 *The Cooperative Threat*

Cooperative marketing, which in a raw form had materialised during World War I when the US Food Administration replaced the grain middlemen, was considered an existential threat to the CBOT and other exchanges. The threat grew throughout the 1920s, strengthening in 1929 when the Federal Farm Board supported cooperatives over private

⁸⁸Clipping, Hoover Address on the Regulation of Business, 4 March 1929. CME III.12.8.

⁸⁹Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from Its Founding to the Present* (Princeton: Princeton University Press, 2016), p. 78.

grain concerns. The idea that farmers should help themselves was in the front of Hoover's mind when he was Secretary of Commerce and this also appealed to him when US President. In the 1920s, even business leaders supported cooperatives trying to lower the costs of grain marketing.⁹⁰

Republicans were in favour of government support for farmers as long as policies were facilitative and were not taxpayer-funded nor directly subsidised by the consumer. A popular support initiative was to encourage farmer-owned cooperatives, which were intended to handle grain from the farm to the end-user, with the profits being returned to those who utilised the service—a mechanism known as 'patronage dividends'.⁹¹ Julius Barnes, Chairman of the US Chamber of Commerce, and Henry C. Wallace were supportive of the cooperative movement gaining access to the CBOT.⁹² The CBOT, however, saw that these non-profit cooperatives had the potential to undercut profit-driven members. Furthermore, a farmer-owned supply chain might be able to bypass both cash and futures markets completely, dealing directly with large buyers. As such, CBOT President Griffin warned Barnes away from such 'proposed idealistic schemes, which are bound to have the inevitable effect of destroying competition'.⁹³

The CBOT especially—unlike some other exchanges—saw the cooperatives as a dangerous business monopoly and/or a socialist revolution, and put up a long and fierce battle to ban them from the exchanges where they would need to hedge and/or transact in grain on behalf of their owners. Some powerful members believed that cooperatives would 'seriously injure the general grain business as conducted' and that the rules of the CBOT needed to be strengthened to prevent their entrance into the membership.⁹⁴ While it was feared that, if encouraged,

⁹⁰Journal, *The Basic Farmer's Question*, 11 September 1920. CME.III.ss1.6.

⁹¹Pamphlet, *The Saskatchewan Co-operative Elevator Company Act, Together with an Explanation of Its Provisions* (The Saskatchewan Co-operative Elevator Company Ltd., Revised December, 1915). CME III.665.5.

⁹²Letter Griffin to Barnes, 7 July 1921. CME III.ss1.7; Donald L. Winters, "The Persistence of Progressivism: Henry Cantwell Wallace and the Movement for Agricultural Economics," *Agricultural History* 41, no. 2: 109–120, p. 114.

⁹³Letter, J. Griffin to Julius Barnes, 7 July 1921. CME III.ss1.7.

⁹⁴Letter, James E. Bennett to L.F. Gates, 23 June 1920. CME III.ss1.6; Letter, Bennett to Gates, 14 June 1920. CME III.ss1.6.

cooperatives would grow to dominate the grain trade, the most immediate threat was a cut in the otherwise fixed commissions on the Board. Patronage dividends violated the Board rule against commission rebating, itself obviously oligopolistic. The CBOT defence was that rules were rules, even if restrictive of trade, ignoring the fact that all rules could, of course, be changed if the membership desired. Nevertheless, cooperatives would be allowed only as long as they did not rebate commissions. On 27 June 1921, the National Grain Dealers' Association announced the formation of an organisation, with a budget of \$250,000, to fight any proposed farm relief legislation, with its first task being 'an active campaign against the United States Grain Growers Inc., a newly organised national [farmers'] cooperative marketing company'.⁹⁵

Thus the CBOT found itself isolated in the fight against cooperatives, and this stance did not go unnoticed; even those highly sympathetic to the grain marketers were critical of the exchange. Senator Kenyon submitted a Resolution (SR 110) to examine 'any threats to cooperative marketing'.⁹⁶ On 24 October 1922, Alexander Legge, President of the International Harvester Company and eventual Head of the Federal Farm Bureau, addressed a large crowd, which included Julius Barnes and financier Bernard Baruch.⁹⁷ While the crowd was supportive of the CBOT in general, the speech itself was highly critical of the exchange. Legge complained that:

The great American farmer who furnishes the grain that has kept the exchanges alive all these years is to be denied a membership on the principal exchange; he is not good enough to join this holy sanctuary at the end of La Salle Street!⁹⁸

Legge was appalled that cooperatives that were trying to help the farmer without the benefit of public funding should be so poorly treated by the CBOT, warning that 'the farmer will get a full measure of public sympathy and support later on, and when he does there will be somebody

⁹⁵Clipping, US Congress, *Draft Senate Resolution SR 110, Committee on Agriculture and Forestry*. CME III.ss1.8.

⁹⁶Ibid.

⁹⁷Invitation to an American Farm Bureau Federation Luncheon, James R. Howard, President, 24 October 1922. CME III.2.646.5.

⁹⁸Ibid.

else asking for sympathy'.⁹⁹ Yet the membership had nothing to gain from voting in these farmer-sponsored competitors to break the current monopoly, and so the CBOT fought the battle against cooperatives on many sides. In a 1921 brochure entitled *Farming the Farmer*, the cooperative firm US Grain Growers Inc. was accused of (i) attempting to be more economical than the most economical system in the world, as stated by Herbert Hoover, (ii) having gotten into such financial trouble it needed bailing out from its members, and (iii) being profligate in having expensive offices and paying high salaries.¹⁰⁰ When cooperatives attempted to join the CBOT, the exchange appealed to the courts and obtained a temporary restraining order in September 1921 against the enforcement of the Missouri State Cooperative Law. Exchange presidents Griffin and Hargis were both delighted with the outcome.¹⁰¹

The cooperative movement was gaining momentum, however. By 1921, the newly formed American Farm Bureau Federation was making very public demands on both parties through the Farm Bloc. Many were supportive of Legge's arguments of 24 October.¹⁰² The exchanges were not helped by the passage of the Capper-Volstead Act, which recognised the social usefulness of farmer cooperatives by exempting them from certain sections of the Sherman Act.¹⁰³ Important CBOT member, James Bennett, was 'greatly impressed by the prevalence of Farm Bureau signs in Iowa and the Prairie Farmers Association in the State of Illinois.'¹⁰⁴ The well connected LC Stevens wrote to Gates that he felt the pro-cooperative legislators in 1920 were not necessarily anti-futures. Stevens sent up a speech, published in the *New York Times*, to Minneapolis

⁹⁹ Ibid.

¹⁰⁰ Joseph Griffin, Brochure 'Farming the Farmer', 31 May 1921. CME III.ss2.664.2.

¹⁰¹ Letter, J. Griffin to B.L. Hargis, President, Kansas City Board of Trade, 23 September 1921. CME III.ss1.8.

¹⁰² Invitation to an American Farm Bureau Federation Luncheon, James R. Howard, President, 24 October 1922. CME III.2.646.5.

¹⁰³ Clipping, Chamber of Commerce Congressional Record, Bills Which Became Law Between 5 December 1921 and 22 September 1922 Status: passed House, 5-4-21; passed Senate, 2-8-22; House concurred in Senate amendments, 2-II-22; approved by the President, 2-18-22 (Public No. 146). CME III.ss2.645.4.

¹⁰⁴ Letter, James E. Bennett to J. Griffin, 6 September 1921. CME III.ss1.7.

farmers from gubernatorial candidate Senator Harding that cooperatives must be allowed memberships of the exchanges, but noted that ‘there is nothing destructive about that’.¹⁰⁵ Bennett wrote to Gates in 1921 that ‘the Board of Trade will have a harder battle at the next Legislature than it had at the last, and to this end I would suggest that some effort be made to build up a war chest for a red hot campaign about next election time or shortly prior thereto’.¹⁰⁶

The fight against cooperative marketing affected both CBOT and government policy throughout the entire interwar period. By December 1922, the end of the period covered in the next chapter, the cooperatives had started their own lobby group in Washington, based on a meeting of a National Council of Farmers Cooperative Marketing Associations.¹⁰⁷ On 12 December 1922, E.H. Cunningham, President of the US Grain Growers Inc., in a speech to the Fourth Annual Convention of the American Farm Bureau Federation in Chicago, stated:

[When] the exchanges announced they would fight the constitutionality of the Capper-Tincher bill [...] our application [to the CBOT] was turned down as was the application at Omaha, and the widely heralded statement that we would be welcome [...] became a scrap of paper [...] They have deceived us [...] Legislation should compel admission of lawful producer-owned companies to the grain exchanges [...] Let us have a little more light on the practices of those who deal in our own products.¹⁰⁸

Indeed, thanks to the passing of the Grain Futures Act, more transparency is exactly what they got, even though the cooperative battle for admission dragged on for many more years.

¹⁰⁵Letter, L.C. Stevens to L.F. Gates, 7 October 1920. CME III.ss1.6.

¹⁰⁶Letter, Bennett to Griffin, 6 September 1921. CME III.ss1.7.

¹⁰⁷Letter, P.W. MacMillan to Secretary, Omaha Grain Exchange, 4 November 1922. CME III.652.5.

¹⁰⁸Address of E.H. Cunningham, US Grain Growers Inc. to the American Farm Bureau Association, 12 December 1922. NARA/KC, 101-1-1.

2.5 THE INFORMATION DEFICIT

The CBOT was concerned almost entirely with confirming its monopoly in the trading of US grain futures, and to this end wanted to eliminate the less egregious forms of bucketing that fostered competition and risked delegitimising the markets.

As shown above, in its fight against the bucket shops, the Board's biggest weapon was its control over its quotations. The Supreme Court finally ruled that the prices of transactions on the CBOT were the Board's property, and the executive made the most of these rights, preventing any use or dissemination by non-members for any reason. An example of how serious the CBOT took the threat comes from this a letter to one of the partners as the CBOT's main counsel,

You will note in paragraph 2 of the application, the insertion of a provision respecting the location of blackboards, etc., and the enforcement of regulations as respects persons entering the place where the quotations are, which I think will put us in a position to deal with any exchange that gets lax in protecting the quotations, as the New York Produce Exchange, I think, recently has.¹⁰⁹

In another similar letter from the Board to their counsel on 13 April 1922, the Board is found attempting to control the dissemination of Chicago futures quotes over the radio by other exchanges.¹¹⁰ The 1922 Act's substantive contribution to the futures markets was to free the Board from bucketing concerns, making them comfortable enough to release the data we all accept is crucial to our understanding and the functioning of futures markets. The use of this information is the subject of the next chapter.

In 1920, futures markets remained poorly understood by farmers and their representatives such that hedging was rarely if ever used by producers and hardly common among country elevators. Because no one was collecting and analysing data, knowledge levels were low throughout the land, even among so-called experts. The president of the American Farm Bureau Federation in 1920 did not even understand how hedging worked.¹¹¹

¹⁰⁹Letter to Mauff from H.S. Robbins, CBOT Counsel, 8 April 1922. CME III.2.641.1.

¹¹⁰Letter to Robbins from Mauff, 13 April 1922. CME III.2.541.1.

¹¹¹Letter, J.R. Howard, President American Farm Bureau Federation to L.F. Gates, 12 July 1920. CME III.ss1.6.

Indeed, nobody even knew if hedgers were actually reducing risk, given the severe and abrupt fluctuations that could occur in absolute wheat prices and in the ‘basis’; the price difference between cash and futures, futures of different months, of the same futures contract on different exchanges.

Attempts to placate those who would often lose money trading or hedging, or simply could not comprehend the irrationality of markets failed due to the lack of shared knowledge. The archives are littered with letters to politicians, bureaucrats and industry executives from those without sufficient knowledge to understand the cause and effect of the markets, let alone the complicated and intricate details.¹¹² The CBOT often appealed to government officials to intervene in private disputes in order to explain the facts to plaintiffs and publics.¹¹³

Whenever futures markets were seen to be in danger of being heavily constrained or even regulated out of existence, defenders claimed that the farmers were the primary beneficiaries of the Chicago pits. In this regard, the academics of the era attempted to legitimise fully the futures industry by regularly repeating the hedging motivation for futures trading. Emery in 1896 was the first to attach an economic justification to the speculation in futures markets, and his tome was the leading source on futures theory for forty years, according to one of the leading experts of the interwar period.¹¹⁴ The respected academic George Wright Hoffman, wrote: ‘Either directly or indirectly, the primary source of [treatises on speculation in economics textbooks and futures analysis] is Emery’.¹¹⁵ Alfred Marshall and possibly John Maynard Keynes also borrowed heavily from Emery in the interwar years.¹¹⁶ In 1937, Hoffman summarised Emery as follows:

¹¹²See NARA/KC. 14-6 for hundreds of such documents.

¹¹³Letter L.F. Gates to Alfred Brandeis, Chief, Cereal Enforcement Division, US Food Administration, Washington, DC, 5 November 1919. CME III.ss1.6; Letter, Thomson McKinnon to Gates, 18 October 1919. CME III.ss1.6.

¹¹⁴William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998), p. 68.

¹¹⁵George Wright Hoffman, *Future Trading upon Organized Commodity Markets in the United States* (Philadelphia: University of Pennsylvania Press, 1932), p. 300.

¹¹⁶Marco Dardi and Marco Gallegati, “Alfred Marshall on Speculation,” *History of Political Economy* 24 (Fall 1992): 571–594, p. 578.

Organised exchanges provide a special class of speculators who carry the price risks of merchants and manufacturers. Through this facility, these trade interests are able to hedge or insure themselves against price hazards and in turn narrow their margin of profit to benefit the consumer or producer or both.¹¹⁷

This can be seen in the legal record as well as the political one. In his *Christie* decision, Justice Oliver Wendell Holmes stated that, without adequate evidence to the contrary, the default view of the courts should be that ‘natural evolutions of a complex society are to be touched only by a very cautious hand’.¹¹⁸ Representative Tincher, in introducing the Capper-Tincher Bill, which eventually became the 1922 Grain Futures Act, argued that:

The only one absolutely in favor of entirely abolishing the legitimate hedge, I think, is a man who does not know what a legitimate hedge is. I do not think any good-thinking man in the United States is in favor of preventing the farmer from selling his wheat for future delivery.¹¹⁹

The CBOT sometimes took its battles with legislators public, and rhetoric and normative theory rather than empirical observations were used to legitimise Board activities. In one article in 1922, Secretary John Mauff used the hedging justification for futures, specifically claiming that this ‘commercial price insurance’ resulted in a higher price for farmers.¹²⁰ He added that, ‘The committee on economic research of Harvard University [...] has expressed through its chairman the opinion that [government interference] could not have any effect but to react injuriously upon the farmers.’¹²¹ But where was the evidence for such conclusions? Before Federal Government intervention, there was not enough information to make any claims about the futures markets.

The exchanges also defended themselves with the help of other academics and their research: ‘Some of the best articles we used in the Grain Futures litigation were from the compilation referred to by Dr. Huebner

¹¹⁷George Wright Hoffman, *Future Trading upon Organized Commodity Markets in the United States* (Philadelphia: University of Pennsylvania Press, 1932), p. 301.

¹¹⁸*Board of Trade v. Christie* 198 U.S. pp. 247–248.

¹¹⁹US Congress, House, Cong. Rec. *Futures Trading: Hearings Before the Committee on Agriculture: Remarks of Representative Tincher*, 67th Cong. 1st Sess., 1921, p. 7.

¹²⁰Clipping, John R. Mauff, “1922 Brings Unmistakable Signs of Business Improvement—Professional Agitator Losing Prestige in Farmers’ Eyes,” *The Country Grain Supply*, undated. CME III.2.650.4.

¹²¹*Ibid.*

[...] and the [1911] *Annals of the American Academy of Political and Social Sciences*'.¹²² Professor Heubner was seen as a valuable ally, and in 1923 'it would seem that he should be encouraged and given assistance'.¹²³ The editor of the *Annals*, Dr. Clyde L King, commissioned a volume for the Academy that in 1923 Heubner himself had said:

Should nevertheless be thoroughly constructive in character and the purpose of the volume would be primarily to set public opinion right on practices which you know the great majority of non-participants in our markets do not understand, and therefore thoughtlessly oppose.¹²⁴

The Board appreciated the benefits of the academic record favouring futures markets, especially from Harvard University, with Mauff stating at the end of 1922, 'After the first of the year, we must get together with all of these professors and give them more cooperation, and that will be one of the things that I will look forward to with pleasure'.¹²⁵

Today, it is hard to imagine a world price-setting futures market not distributing timely quotes or other key market metrics, but such was the case before the mid-1920s. Early in the interwar period, before the protections of the 1922 Act, the CBOT was paranoid over its future existence. The idea that the Grain Futures Act was primarily an information gathering tool was stated accurately and concisely by the USDA in a press release on 20 April 1923 on the upholding of the Act by the Supreme Court. The release stated 'the law gives authority to observe and inquire into the operations on grain exchanges and to speak with authority concerning such matters'.¹²⁶ As was in the case of other markets—insurance bureaus, for example—in 1923 the data required to begin to understand how futures markets truly functioned, and therefore improved, thus began to be accumulated.¹²⁷

¹²²Letter, A.C. Wied to Mauff, 6 April 1923. CME III.659.2.

¹²³Ibid.

¹²⁴Letter, S.S. Huebner to J.J. Fones, CBOT Secretary, 29 March 1923. CME III.659.2.

¹²⁵Letter, Mauff to A. Clement Wild, Counsel to CBOT with Robbins and Townley, undated, circa December 1922. CME III.659.3.

¹²⁶CME III.667.6, USDA Press Release, "Grain Futures Trading to Continue," 20 April 1923.

¹²⁷Marc Schneiberg and Tim Bartley, "Regulating American Industries: Markets, Politics, and the Institutional Determinants of Fire Insurance Regulation," *American Journal of Sociology* 107 (2001): 101–146.

2.6 TOWARDS A LEGISLATIVE SOLUTION

The 1920–1921 grain troubles brought unwanted attention to the dangers of manipulation in the futures markets to the monopoly franchise of the CBOT at a time when the monopoly of the Board was under attack from without and also from within. The next chapter explains how the scene that was set by the 1920–1921 Depression was harnessed by the CBOT. The eventual legislation and subsequent regulatory regime provided solutions to the challenges faced by the CBOT listed above. Due to the strength of the CBOT lobby, together with the overriding philosophy of the Federal Government not to interfere, the Acts passed by Congress in 1921 and 1922 did nothing to curb manipulation directly, or control the exchanges in any way, but resulted in a protected and legitimised CBOT, setting it up for dominance into the late twentieth century.

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The Grain Futures Act of 1922 and the Dominance of the CBOT

3.1 INTRODUCTION

The US Federal Government issued the first regulations for the vast grain futures markets in 1921 with the passing of the Capper-Tincher Bill into the Futures Trading Act. When key sections of this Act were declared unconstitutional in 1922, a new Capper-Tincher Bill, which was to become the Grain Futures Act of 1922 (1922 Act), was hastily introduced and was passed by both houses with large majorities. When the Commodity Futures Trading Commission (CFTC) was created in 1974, the underlying Act incorporated important legal and administrative provisions, as well as phraseology, from both these earlier Acts.¹ It is often thought that the current co-regulatory model for financial markets is a recent invention, yet it was created under the Commodity Exchange Act (CEA) in 1936, itself a short evolutionary step from the earlier 1922

¹John H. Stassen, "Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)," *Chicago-Kent Law Review* 58 (1982): 635–656; John V. Rainbolt, "Regulating the Grain Gambler and His Successors," *Hofstra Law Review* 6 (1977): 1–27; Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987).

Act. Current futures market regulation has been heavily influenced by the interwar regime.²

For most of the twentieth century, the Department of Agriculture has been responsible for the regulation of all exchange-traded futures and options. Indeed, the current regulator of all exchange-traded futures and options in the USA, together with many over-the-counter derivatives—as per the Dodd-Frank Act of 2010—is still named the CFTC, even if only a small portion of its mandate is commodity markets. The CFTC is the direct descendant of the agency set up in 1923 to administer the 1922 Act—the Grain Futures Administration (GFA).

This chapter argues that the intent, form and substance of the 1921 and 1922 Acts were influenced by the CBOT to such a degree that Congress failed to bestow upon the USDA any meaningful control over the exchanges. Legislators were satisfied with being seen to be responding to farm crises, even though they were aware that the Acts would not benefit farmers in any way. They appear to have deliberately limited USDA authority to information gathering and analysis. The powers, or lack thereof, under the 1922 Act significantly influenced the development of the regulatory regime and market microstructure of the CBOT throughout the interwar years.

Robert Gallman observed in a commentary on Jonathan Lurie’s narration and interpretation of the passing of the 1921–1922 Acts, that the latter’s work begs the questions of how the regulation worked in practice: ‘Did it suit the needs it was intended to serve?’ and ‘How did regulation develop?’³ This chapter will examine the causes and substance of the 1921 and 1922 futures market regulations. The voices of the farmers, though easily identifiable in the hearings and in the popular press, are almost entirely absent from the final legislation. It is difficult, therefore, to reconcile the accepted view that the farmers demanded the

²Jake Keaveny, “In Defense of Market Self-Regulation: An Analysis of the History of Futures Regulation and the Trend Toward Demutualization,” *Brooklyn Law Review* 70 (2004): 1419–1452. See also William G. Ferris, *The Grain Traders* (East Lansing: Michigan State University Press, 1988); and John Rainbolt as quoted in John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982), p. 636.

³Robert E. Gallman, “Commentary,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Tanja H. Peterson (Washington, DC: Howard University Press, 1980), p. 274.

futures market regulation, which was the end result of the activities of ‘populist’ politicians within the Farm Bloc, with the following facts: that (i) the regulation bestowed no real power on the government to control speculation on the exchanges and (ii) the Act provided the exchanges, especially the CBOT, with lasting benefits. The view that the federal regulation offered the exchanges support and protection was well understood at the time. As Senator Connally observed in 1938, the 1921 and 1922 Acts did nothing to control markets as promised. Rather the opposite, he said on the Senate floor:

The Senator from North Dakota and the Senator from Kansas were members of the Committee that came here and said “We want Congress to regulate and control the commodity markets”. So we accepted their request; Congress passed an act in 1921 to anoint them, to approve them, to bless them, to say “God bless you Mr Commodity Market; go ahead now under Government supervision”.⁴

The general scholarly consensus is that the Act was intended to be, and in some cases was successful in being, harmful to the grain futures exchanges. One contemporary newspaper was of the opinion that the passing of the 1922 Act ‘precipitat[ed] the grain trade from the frying pan into the fire’.⁵ A modern scholar erroneously concluded that the Act did not contain the changes the CBOT lobbied for.⁶ The general impression among scholars and mainly legal practitioners is epitomised in a current standard reference dictionary:

The Capper-Tincher Act was a product of the farm bloc’s demand for reform [...] Many [farmers] continued the old Populist refrain that middlemen were reaping huge profits while the farmers starved [...] It gave the secretary of agriculture the power to regulate the Chicago Board of Trade to prevent futures speculation that was designed to corner commodity markets.⁷

⁴US Congress, Senate, Cong. Rec. *Remarks of Senator Tom Connally*, 75th Cong. 3rd Sess., 8 April 1938, p. 5036.

⁵Quote from *Northwestern Miller*, 17 May 1922 in Wayne Broehl, *Cargill, Trading the World’s Grain* (Hanover, NH: University Press of New England, 1992), p. 274. See Chapter One for a detailed description of this literature.

⁶Ibid.

⁷James Olson and Abraham Mendoza, *American Economic History: A Dictionary and Chronology* (Greenwood: ABC-CLIO, 2015), p. 92.

Even a Board-sponsored biography stated, falsely, that the 1922 Act ‘placed position limits on large traders’.⁸

The 1922 Act was far from a product of ‘populist’ pressures. It is true that it was of a piece with some agricultural legislation that served the interests of both grain producers and middlemen. The passage of the Capper-Volstead Act of 1922, which coincided with the second Capper-Tincher Bill, granted agricultural cooperatives exemption from certain Sherman Act antitrust provisions, while the Department of Agriculture’s (USDA) Packers and Stockyards Administration heavily controlled those businesses.⁹ This benefited middlemen more than farmers by protecting the former from being defrauded by their own and was therefore welcomed by the grain trade.¹⁰ Indeed, this study argues that the middlemen of the grain trade actually drove futures regulation in the crucial period between 1921 and 1926.

This chapter firstly documents the opening of a policy window in the form of the depression of 1921. The 1920–1922 period ended with the first successful federal regulation of grain. Successive sections of the chapter narrate the history of the 1921 Act and then the 1922 Act, detail and discuss the substance and immediate effects of the regulation, and furnish theoretical explanations of its substance. The final section sets the scene for Chapter 4, identifying the legacy of the 1922 Act and explaining why the formal regulatory regime did not change until 1936.

The 1922 Act was welcomed by the CBOT’s executive, and the Act’s substance was in fact a product of intense lobbying of the USDA and legislators by the exchanges, whose biggest challenge had been to present a united front despite collective action problems. Congress legitimised futures trading in the face of individual legal challenges and efforts by State legislatures to regulate or prohibit the practices. In doing so, Congress had also ensured that the already-illegal bucket shops would now be finally eliminated, while also bestowing other monopoly powers on the CBOT, allowing it to evolve unimpeded by any real competition or control up until the end of the twentieth century.

⁸William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998), p. 127.

⁹Wayne D. Rasmussen, “The People’s Department: Myth or Reality,” *Agricultural History* 64 (1990): 291–299.

¹⁰Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), pp. 88–92.

The chapter further reveals how the Act and the associated Rules and Regulations of 1923 (Rules) mandated that certain information be collected and disseminated, leading to further legitimisation and co-construction by government and business of futures markets in the interwar period. Until the involvement of the Federal Government in futures markets, private action and government policy were both driven by the supposed normative theory about the functioning of futures markets—for example that large speculative interests facilitated hedging markets during the crucial grain marketing period.¹¹ Yet that trope was easily dismissed by the end of the interwar period.

3.2 THE FORGOTTEN DEPRESSION OF 1921

The depression of 1920–1921 is generally recognised as the most severe period of price and wage deflation in US history, worse, even, than the Great Depression of 1929–1933.¹² After a slight post-war increase, between 1920 and the end of 1921 wheat prices fell by more than half. Growing supply from the US Midwest, which had been driven by European demand during World War I, collided with a faster than expected recovery by European farmers due to post-war reconstruction. US GNP fell 21% between 1918 and 1921, just as the fall in wheat price created liquidity problems for farmers and grain men.¹³

The US agricultural economy was devastated by the abrupt and deep fall in product prices. The 1922 Secretary of Agriculture’s annual report referred to the results of a study into the conditions of farmers in 1921. In the grain-producing states, almost 10% of farm owners had lost their farms, 15% were close to bankruptcy, and an even higher percentage of tenants had lost their properties.¹⁴ In 1922, of all US bankruptcies,

¹¹Alfred Marshall, *Industry and Trade: A Study of Industrial Technique and Business Organization and of Their Influences on the Conditions of Various Classes and Nations* (London: Macmillan, 1920). See also Henry Crosby Emery, “Legislation Against Futures,” *Political Science Quarterly* 10 (1895); James E. Boyle, *Speculation and the Chicago Board of Trade* (New York: Macmillan, 1920).

¹²James Grant, *The Forgotten Depression: 1921: The Crash That Cured Itself* (New York: Simon & Schuster, 2014).

¹³Jeremy Atack and Peter Passell, *A New Economic View of American History: From Colonial Times to 1940* (New York: W. W. Norton, 1994), p. 565.

¹⁴US Department of Agriculture, *Annual Report of the Secretary of Agriculture 1922–1923* (Washington, DC: Government Printing Office, 1923), p. 9.

30% involved farmers.¹⁵ This chapter focuses here on the responses to the wheat crisis from the grain men, futures market users, legislators and bureaucrats.

As Capper warned in a famous speech to the National Wheat Conference:

If we take the average level of farm prices in 1913 as representing a percentage of 100, the average level in May, 1920, stood at 238. The hard-boiled deflation, engineered largely by Eastern Influence, started then and there was a rapid decline to a percentage of 94 in December 1921. Just think of it, a decline from 238 to 94 in about a year and a half! Although in the last three years farmers have been severely, in fact outrageously punished, they have not turned red. Farmers are not wreckers or revolutionists.¹⁶

As was the case in much of the rest of the agricultural economy, the damage to CBOT member and Board finances was tremendous, triply so as: (i) the exchanges and their members suffered from horrendous publicity over the so-called speculative bubble in grains that was allowed to take hold after the war, (ii) grain prices and the general economic environment meant that revenues on all sides were lower than they had been and (iii) the price declines resulted in speculative losses among member firms and other members' clients.

By early 1922, the CBOT President Griffin was concerned about the possibility of failing firms bringing down the system. This generated a call for closer monitoring of members' financial positions, the scrutiny of year-end accounts and a tightening of clearing requirements.¹⁷ As an illustration of how poor the finances of some of the members were, it was reported that 'a great many of the local individual traders [...] are in a rather deplorable financial condition on account of the markets'.¹⁸ Alongside these troubles with its members' finances, the CBOT's sources of revenue were squeezed. In 1921 and early 1922, business in general, and at the Board in particular, was being hurt by the depression, with

¹⁵Ibid.

¹⁶Copy of speech, Arthur Capper, National Wheat Conference Program, 19–20 June 1923. CME III.657.1.

¹⁷Memo, Griffin to the Finance Committee, 6 February 1922. CME III.2.640.5

¹⁸Letter, J. Mauff to H. Robbins, 15 March 1922. CME III.2.641.1.

telegraph operators and wire houses purchasing fewer real-time quotations from the Board.¹⁹

As such, the 1920–1921 grain crisis exposed major flaws in the institutional structure of futures trading at the CBOT. For example, the CBOT had not yet adopted modern clearing that was already in use at regional exchanges. Not only were CBOT members exposed to each other’s financial situation, the good faith margins, even when demanded from other traders, were often secured by questionable collateral. In January 1922, there had been evidence of a major problem with the meeting of margin requirements with ‘very, very old [...] personal bonds’.²⁰ As a result, under most circumstances, a trader entering into a futures trade sometimes as much as a year before the delivery date was exposed to the credit risk of the other side of the trade. For instance, if the other side declared bankruptcy, or simply refused to pay, large losses could ensue. A few high-profile incidents occurred during this crisis, serving as warning that the entire system was flawed.²¹ Additionally, the market was revealed to have been subject to some severe manipulation. A Senate hearing heard that ‘attention has been called to the fact that this condition was most manifest on the Chicago exchange, where there was evidently a straight-out manipulation of the market’.²²

Congress could not wait for the Federal Trade Commission (FTC) to produce its reports on the grain trade.²³ Instead, after the initial panic in 1920, it commissioned its own investigation that identified over-speculation as a significant contributor to the volatility of 1921–1922. Yet neither the FTC nor Congress recommended the abolition, or even control, of the markets.

3.2.1 *Legislation Threatens*

A thoroughly Republican Congress and White House oversaw all early futures regulation. Henry Cantwell Wallace, newly installed as the

¹⁹Letter, H. Robbins to J. Mauff, 28 January 1922. CME III.2.641.2.

²⁰Letter, J. Mauff to H. Robbins, 30 December 1921. CME III.2.642.3.

²¹Ibid.

²²US Congress, 67th Congress, 2nd Sess., House of Representatives, Report No. 1095, 13 June 1922. CME III.ss2.663.3.

²³US Federal Trade Commission, *Report of the Federal Trade Commission on the Grain Trade*, 7 vols. (Washington, DC: U.S. Government Printing Office, 1920–1926).

Secretary of Agriculture, was responsible for developing and administering the Futures Trading Act and the Grain Futures Act of 1922. Wallace, who reported to the newly elected US President Warren G. Harding, at first had strong support from the Farm Bloc formed in April 1921.²⁴

In March 1920, the American Farm Bureau Federation (AFBF), a farm lobby group active to this day, was launched and it was the AFBF's Chester Gray who organised the first meeting of the Farm Bloc in Washington.²⁵ But Washington was far from dominated by agrarians during the interwar years, and the so-called Progressives, in power during the first part of this era, fought both for and against the populists, depending on the particular issue. After the newly elected legislators took office in January 1921 and prior to the unprecedented collapse in US prices, Congress held five hearings on futures trading.

The resulting original futures Bill was somewhat less benign than the final Act, yet first versions should not be taken as evidence that heavy control of futures trading was the goal of the Bill. First drafts as opening gambits are often authored in anticipation of future compromise due to lobbying, logrolling and other political negotiations and trade-offs.²⁶ As such, on the first word of a bill in Congress, the CBOT and its representatives across the country, but especially in Chicago and Washington, mobilised quickly. The CBOT immediately decided not to fight the Bill in totality, but to lobby extensively for amendments that not only removed its teeth but bestowed benefits on the exchanges. Very few bills actually sought prohibition or even substantial curbs, as the House and Senate Committees were powerful filters of aggressive proposals. As such, the

²⁴Edward L. Schapsmeier and Frederick H. Schapsmeier, *Henry A. Wallace of Iowa: The Agrarian Years, 1910–1940* (Ames: Iowa State University Press, 1968), p. 57; Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 64.

²⁵Edward L. Schapsmeier and Frederick H. Schapsmeier, *Henry A. Wallace of Iowa: The Agrarian Years, 1910–1940* (Ames: Iowa State University Press, 1968), p. 54.

²⁶Logrolling is the advance agreement of legislators to vote on each other's initiatives. For example, see Douglas A. Irwin and Randall S. Kroszner, "Log-Rolling and Economic Interests in the Passage of the Smoot-Hawley Tariff," *Carnegie-Rochester Conference Series on Public Policy* 45 (1996); Christian Joerges, Bo Stråth, and Peter Wagner, *The Economy as a Polity: The Political Constitution of Contemporary Capitalism* (Hove: Psychology Press, 2005), p. 117.

rhetoric in the historiography that ‘100s’ of bills to ‘control’ futures markets were tabled in Congress is exaggerated and unhelpful.²⁷

As part of the public and private battle over the contents of the Bill, CBOT Secretary Mauff regularly encouraged Midwestern Congressmen, such as Republicans McCormick and Nelson and Democrat Reed, to confront Senator Capper in the Senate and in the press, or put pressure on fellow Congressmen.²⁸

To provide but one example of the depth and breadth of the CBOT’s Washington connections around this time, the exchanges’ representatives were able to discover what the Federal Trade Commission’s report on the grain trade was to say, and how seriously it would be taken in Washington. F.C. Stevens, the Washington lobbyist, was able to meet privately with Senator Kellogg after the latter’s meeting with the Chairman of the FTC. Kellogg was said to have opined that ‘the Commission did not have facts which authorised any extended or severe criticism of the exchange system of the various exchanges’.²⁹ Stevens advised Gates to seek more information, but to not mention the meeting with Kellogg ‘for reasons that you can readily appreciate’.³⁰

CBOT President Griffin was also active in the battle to keep the language of the final Bill pro-exchange and kept in close contact with local Congressmen, such as Representative John Rainey from Illinois. Rainey was supportive of the CBOT and volunteered to put its questions directly to witnesses such as Secretary Wallace.³¹ Through its lobbying of Congress and the administration, the CBOT was able to obtain legislation that left the exchanges free to run their own affairs while also providing them with significant protection and legitimacy.

²⁷For examples of such exaggeration, see Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406, p. 286; William G. Ferris, *The Grain Traders* (East Lansing: Michigan State University Press, 1988), p. x.

²⁸For an example of the former, see Letter, Mauff to Patten, 12 July 1921. CME III.2.640.1 For an example of the latter, see Letter, CBOT President to Senator Sherman, 29 June 1921. CME III.2.641.7.

²⁹Letter from F.C. Stevens to L.F. Gates, 7 February 1920. CME III.ss.1.6.

³⁰Letter from F.C. Stevens to L.F. Gates, 7 February 1920. CME III.ss.1.6.

³¹Telegram, Representative Rainey to Griffin, 3 June 1921. CME III.2.640.4.

3.2.2 *Senator Capper and the Capper-Tincher Bill*

The earliest bills in 1920–1921 were sponsored in the Senate by Arthur Capper, a radio and newspaper baron from Kansas who was elected to his first of five terms on 4 March 1919. Capper, one of the original Farm Bloc members, immediately took up a role in the important Committee for Agriculture and Forestry, eventually serving as its chairman in the 80th Congress.³² The exchange's representative in Washington, L.C. Stevens, described Capper in less than glowing terms, and certainly not as an ideologically driven legislator:

Senator Capper is endeavoring to get great glory out of this legislation, but has had little to do with its framing and progress so far. Senator Capper [...] is very ambitious, but of limited ability. He is a first-class demagogue and will push any measure which he thinks will promise greater success for himself. He depends on the ability of the right people.³³

This study confirms Capper's demagoguery as well as his reliance on experts to help devise, frame and execute his agenda. Capper was a great orator and prolific writer, competing for hearts and minds through articles in his own newspaper, the *Chicago Tribune* and his widely distributed political reports from Washington, DC and his office in Topeka, Kansas. In his rhetoric-filled *Capper's Weekly*, he condemned speculation on futures exchanges as damaging to the farmers' interests. Opposition to him in the press could at times be very critical; for instance, on 5 April 1923, the *Washington Star* wrote, 'Arthur Capper [...] is a socialist'. He was accused of 'deliver[ing] a ringing address to empty seats in the Senate, and through his papers on pet topics'.³⁴

Capper, however, meant to keep the state out of, rather than involved in, the affairs of industry and the farmer by eliminating over-speculation—especially on the short side—and encouraging the

³²Kansas Historical Society, *Biography of Arthur Capper*. Available at <http://www.kshs.org/kansapedia/arthur-capper/12001>. Accessed 1 March 2017.

³³Letter, L.C. Stevens to L.F. Gates, 7 October 1920. CME III.ss1.6.

³⁴Archive Clipping, *Washington Star*, 5 April 1923. CME III.2.650.4.

cooperative movement. The farmer's 'Magna Carta' was introduced by Representative Volstead, with Senator Capper's sponsorship, as the Capper-Volstead Bill on 4 May 1920.³⁵ This Bill was essentially 'an attempt to repeal the Sherman anti-trust law as applied to farmers'.³⁶ Capper expected farmer-owned marketing to coalesce into some national marketing effort in order to obtain the best possible prices for their produce.³⁷

Senator Capper kept up his rhetoric during the debates, even if it was often inconsistent and even contradictory. In *Capper's Weekly*, he predicted that his Bill would drive the exchanges out of business, contrary to both the official line from the USDA and his own private opinions.³⁸ On the passage of his legislation, however, he confirmed that the 1922 Act 'does not in any way restrict the market except to eliminate the vicious gambling practices and the violent fluctuations in prices brought about by the gambling evil'.³⁹ A month later he went further by stating that 'the machine for [wheat] marketing [...] operates more smoothly and economically than any other product of the soil'.⁴⁰ He also stated that futures markets were necessary for the effective functioning of the cooperatives, even if some believe that Capper's intent was not to legitimise the futures markets.⁴¹

³⁵House Calendar No. 205, 66th Congress, 2nd Sess., HR 13931. 'A BILL: To authorise association of producers of agricultural products.' For an excellent history of the Capper-Volstead Act and the justification in it being the farmers' Magna Carta, see James L. Guth, "Farmer Monopolies, Cooperatives, and the Intent of Congress: Origins of the Capper-Volstead Act," *Agricultural History* 56 (1982).

³⁶CME III.ss1.6, letter from L.C. Stevens to Gates, 7 October 1920.

³⁷Arthur Capper, "Option Trading Must Be Eliminated," *Mississippi Valley Magazine* (September 1920).

³⁸Letter, Mauff to MacMillan from Mauff, undated but likely September or October 1922. CME III.652.5.

³⁹CME III.657.1, Capper's Speech, National Wheat Conference Program, 19–20 June 1923.

⁴⁰Open letter to CBOT members, J.F. Lamy, chairman, public relations committee, quoting Capper from his *Capper's Weekly*, 26 July 1923. NARA/KC, 101-1.

⁴¹John H. Stassen, "Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)," *Chicago-Kent Law Review* 58 (1982): 635–656, p. 647.

3.3 THE FUTURES TRADING ACT

Senator Capper and Representative Tincher introduced identical bills into the 67th Congress as S 593 and HR 2363, respectively.⁴² Both were based on the taxing powers of Congress and proposed that certain classes of futures transactions would be exempt from a 20% per bushel tax. Though classified as a tax bill, the drafters, sponsors and the exchanges understood that the Capper-Tincher Bill was an oversight bill ‘masquerading under the guise of a Revenue Measure’.⁴³ The Bill applied to wheat, corn, barley, rye and sorghum. To be tax-exempt, under most circumstances futures trades were required to be made on a so-called contract market that, as per Section 5, must:

- 5(a) Be located in a terminal market (‘where cash grain is sold in sufficient volumes’).
- 5(b) Have members keep records of all transactions for 3 years, open for inspection by the government.
- 5(c) Prevent the dissemination of false or misleading reports.
- 5(d) Prevent manipulation.
- 5(e) Have no private wire connections to non-contract market locations.⁴⁴

In the final Bill, the private wire section was dropped and a section mandating that exchanges accept cooperatives as members was added as section 5(e). Section (a) was intended to enforce the monopoly of CBOT members, while sections (c) to (e) had no teeth at all; the main goal of the Act was to obtain information as to how markets actually functioned, as per section 5(b).

Chester Morrill of the USDA’s Bureau of Markets, treated by both agricultural committees as their own private counsel, was responsible for the contents of the Bill.⁴⁵ Morrill, a lifelong consummate technocrat,

⁴²‘A BILL Taxing contracts for the sale of grain for future delivery, and options for such contracts, and providing for the regulation of Boards of Trade, and for other purpose.’

⁴³Memo, Executives of the Grain Exchange National Committee to the Boards of each of the exchanges, undated, 1921. CME III.2.650.5.

⁴⁴A private wire is a branch office of a broker where futures business could be transacted. Internal memorandum re: Future Trading Legislation, no date. NARA/KC, Box 37; 35-9.

⁴⁵Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 66.

and Capper were good friends, but the Senator ignored him when Morrill pointed out that relying on taxing power for federal authority would sink the legislation.⁴⁶ Even as the Bill was being drafted in private, the Department of Agriculture, following its usual policy of meeting with interests affected by any proposed regulations, held its own hearings and conferences.⁴⁷ In early 1921, Congress held hearings on grain trading and heard from a variety of grain men and farmers' groups. Even though the Capper-Tincher Bill was not meant to be coercive, the sheer volume of public testimony against futures markets dominates the historiography. Close examination of the private story of the regulation from behind the scenes is critical to an understanding of the passage of this legislation.

Many State legislators were biased against futures trading, which they saw as gambling, and State bills and acts were generally more restrictive than the new federal Bill. In April 1921, contemporaneous with hearings being held in Washington, anti-futures measures were pending at the Springfield Illinois State legislature.⁴⁸ While battles raged in Washington and Springfield, L.F. Gates took an extended 'holiday' at Battle Creek Sanitarium. Griffin joked, 'I only hope that troubles do not accumulate so rapidly here that I shall be obliged to wire you to reserve a room for me adjoining yours'.⁴⁹ Griffin was elated to report to another member on June 4, 'that in my judgment we have successfully demonstrated that legislation in this state against exchanges is unwise'.⁵⁰ However, in D.C. the Capper-Tincher Bill was still very much alive, and the CBOT was concerned that 'other ambitious senators and Congressmen are prepared to submit additional [less benign] bills' if the Capper regulation failed.⁵¹ This observation further supported the Board's decision to work from

⁴⁶Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 71.

⁴⁷Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 84. In one case, Morrill attended eighteen hearings in nineteen days.

⁴⁸Letter, J. Griffin to L.F. Gates c/o Battle Creek Sanitarium, 17 April 1921. CME III.ss1.7.

⁴⁹Ibid.

⁵⁰Letter, J. Griffin to G.F. Ewe, The Van Dusen Harrington Co., Minneapolis, MN, 4 June 1921. CME III.ss1.7.

⁵¹Letter, J. Griffin to L.F. Gates, 17 April 1921. CME III.ss1.7.

the inside to change its most objectionable elements, even while publicly protesting against any and all governmental regulatory proposals.

3.3.1 *The Private Wire Question*

In 1921, the CBOT was confronted with a classic collective action problem, and exchanges struggled to present a united lobbying front. The ‘private wire’ question is one of the best examples of how the lack of unity at the CBOT could frustrate the Board’s lobby from achieving fully captured regulation in the interest of the exchanges. From the earliest days of the futures markets and the telegraph, offices were opened in the exchanges’ hinterland to solicit orders mostly from small speculators and sometimes small elevators who were hedging. This business was often funnelled to the regional futures exchanges, but the largest commission merchants wanted to see the orders come directly to Chicago.

George McDermott, lawyer for the Kansas Grain Dealers’ Association, had complained about the wire ‘houses’, firms that took the orders in the countryside and filled them on the exchange floors, in the 1921 hearings. He faulted such ‘private wires’ for encouraging gambling outside the major grain centres.⁵² Capper seized on this idea, blaming the private wire houses for encouraging the small gamblers, who were playing in a rigged game.⁵³ Internally, the Board was divided on the issue. An anti-private wire group at the CBOT had sent an amendment with over 200 member signatories—including some important members—for the approval of CBOT President Griffin, limiting private wire offices to major grain centres, but the Board took no action.⁵⁴ These rebel members seized upon the statement by Representative Tincher that ‘95% of the pure gambling is done in the private wire houses which dot every State [...] Eliminate them and 95% of the pure gambling is done away with’.⁵⁵ They appealed directly to the chairman of the House Committee

⁵²US Congress, Senate, *Futures Trading: Hearings of the Senate Committee on Agriculture and Forestry*, 67th Cong. 1st Sess., p. 90.

⁵³*New York Times*, 19 August 1921.

⁵⁴Telegram, Gates to Griffin, 6 July 1921. CME III.ss1.7; Letter, Committee of Hoyt et al. to Honourable Geo W. Norris, chairman, Senate Committee on Agriculture, 8 June 1921.

⁵⁵*Ibid.*

on Agriculture on 8 June 1921. The CBOT executive then became concerned that the private wire question was dividing the membership, and—more importantly—that a ban on country wires would be bad for the overall business prospects of the exchange. Consequently, the executive coordinated a delegation to the Senate Agricultural Committee’s hearings.⁵⁶ Before the official testimony, however, Gates privately communicated to the Committee the official stance of the executive. Gates provided evidence to the effect that country elevators and other grain men in the hinterland were supportive of the country wires in that they were more trusted as commission merchants than the Chicago-based membership,⁵⁷ and that:

The only discordant element to this official view is a self-constituted group of five or six members who [... for] purely competitive reasons are attempting to drive out the private wire, despite the admitted fact that it is a great modern facility used to expedite business.⁵⁸

Though the private wire ‘Hoyt’ group had garnered significant support, Gates countered that a pro-wire petition had been signed by almost twice as many members.⁵⁹ Partially due to the disunity among exchange lobbyists, the private wire section disappeared, reappeared and then disappeared again. Gates mounted a lengthy formal defence of country wires in a letter to the Senate Committee on Agriculture and Forestry dated 6 July 1921. He cited government reports as evidence that the country wires supported markets rather than contributed to over-speculation:

The whole question of Private or Leased wires and their uses, has been the subject of two exhaustive investigations, one by the Interstate Commerce Commission, [...] the other by the Federal Trade Commission Private or leased Wires are the principal avenue through which outside speculative support reaches the Grain Markets.⁶⁰

⁵⁶Ibid.

⁵⁷Handwritten letter, J.J. Guild & Son, Illinois, to the CBOT President, 15 April 1921. CME III.ss1.7.

⁵⁸Letter, Griffin to Gates, Hotel Washington, 1 July 1921. CME III.ss1.7.

⁵⁹Letter, Gates to Senate Committee on Agriculture and Forestry, United States Senate, 6 July 1921. CME III.ss1.7.

⁶⁰Ibid.

Gates further argued to the Senate Committee that the anti-wire house petition was ‘not in harmony with the avowed intent’ of legislators who wanted the Bill to favour farmer interests and added that ‘the Secretary of Agriculture has testified in these hearings, that he considers interference with this leased wire system inexpedient at this time’.⁶¹

The Senate Committee accepted the CBOT’s proposals almost entirely.⁶² Soon after, the House Committee removed the private wire section that Capper had somehow sneaked back into the Senate version, and on 7 July, the Capper-Tincher Bill was ordered out of the Senate Agricultural Committee with a unanimous favourable vote.⁶³ In Washington, Gates reported to Griffin that Senator Capper had reneged on his agreement with the CBOT lobby and re-introduced the private wire section even after it had been removed when reported out of the House, as Capper wanted to appease the Kansas Grain Dealers Association and a group known as the ‘Kansas City boys’. Kansas City had ‘already gone on record [...] against private wires’.⁶⁴ Wells wondered ‘whether all Kansas men are liars [...] I cannot see that Capper was in any way warranted in breaking his word and introducing the private wire feature into the Bill’.⁶⁵ Capper’s intention, however, was not to shut down markets or even eliminate speculation, but to reduce the harm that gambling could inflict on inexperienced smaller traders in the countryside. The private wire section could have, in his opinion, helped accomplish that goal.

In the event, the fight was not as difficult as expected. After examining the Bill just before the Senate convened on 8 July, Gates found that Capper’s last private wire amendment had little in common with the one so vilified by the exchange lobby. The new clause was:

As innocent and harmless as a new-born babe [...] We figure that by making a general opposition to the Section and not calling attention to its form, will lead either to the elimination of the paragraph or to its

⁶¹Ibid.

⁶²Telegram, Gates to Griffin, 7 July 1921. CME III.ss1.7. Details in Letter, Gates, 1020 Munsey Building, Washington, DC, to Griffin, 7 July 1921. CME III.ss1.7.

⁶³Newspaper clipping, Associated Press, “O.K. Given to ‘Futures’ Bill,” CME III ss1.7.

⁶⁴Letter, L.F. Gates to J. Griffin, 7 July 1921. CME III.ss1.7.

⁶⁵Letter, F.B. Wells, Chamber of Commerce, Minneapolis, MN, to Gates, 1020 Munsey Building, Washington, DC, 8 July 1921. CME III.ss.1.8.

incorporation in the Bill in the form in which it appears above, either of which would be entirely satisfactory to us.⁶⁶

The CBOT had won the fight on private wires, whether or not the clause was included.

The private wire Bill as amended by the so-called anti-futures Capper was so benign as to have no impact on the CBOT's business. Still the Board continued to lobby hard to ensure that the previous more restrictive language was not somehow re-incorporated. The CBOT was also pleased with other outcomes that stemmed from their aggressive lobbying. Certainly, the CBOT had a power base among Washington legislators, and it could count on Illinois Senator McCormick and Senators Nelson and Reed to work on its behalf.⁶⁷ Senator McNary, for example, 'made a very good fight for us', according to Gates.⁶⁸ As a result, Gates concluded that 'the Bill in the form in which it leaves the committee, is immensely improved'.⁶⁹

The CBOT pulled most of the regional exchanges into line in public—if not always in private—on the private wire issue, even if the executive could not completely control its own membership. The Toledo Produce Exchange, for example, though strongly against the existence of country wires soliciting speculative businesses from small towns:

Refrained from going on record as [being] against the private wire systems, as in the Exchange Committee Meetings it was decided that we would allow the Chicago Representatives to take care of the private wire subject.⁷⁰

Later, however, the Toledo exchange quietly demanded that the CBOT forbid its members to reopen private wires in the smaller towns of the exchange's hinterland of Ohio and Indiana.⁷¹

⁶⁶Letter, Gates to F.B. Wells, copies to J. Griffin, and preceded by similar telegram to Griffin, 8 July 1921. CME III.ss1.7.

⁶⁷Letter, Mauff to Patten, 12 July 1921. CME III.2.640.1.

⁶⁸Ibid.

⁶⁹Letter, Gates to F.B. Wells, copies to J. Griffin, and preceded by similar telegram to Griffin, 8 July 1921. CME III.ss1.7. Letter, Gates to Griffin, 12 July 1921. CME III.ss1.7.

⁷⁰Letter, certain members of the Toledo Produce Exchange to Board of Directors, CBOT, 2 December 1921. CME III.ss1.8.

⁷¹Ibid.

Because the final Act did not include the private wire amendment, the Board executive had notched up a very illustrative victory in the final hour. Though it had been thought that the private wire section might have been removed due to Wallace's testimony at the hearings,⁷² the evidence points to a more complex and informative story. The archival record reveals that lobbying by the CBOT resulted in both a watered down private wire clause and the clause's eventual removal, even though it would have helped accomplish the goals of Bill's sponsors. The Committees of the time had neither the strength nor the desire to impose real restrictions on futures markets. The next section documents the only successful control feature of the Act, although it, too, was diluted through exchange lobbying.

3.3.2 *The CBOT, Lobbying and the Cooperative Clause*

The CBOT had many friends on both Congressional agriculture committees. On the House Committee as of 1 June 1921, the CBOT executive identified eight representatives as being friendly to the exchanges, with one being considered 'OK'.⁷³ The other thirteen included not only Tinchler but also Gilbert N. Haugen, yet even Haugen was not entirely unsympathetic to the grain trade. One great friend of the exchanges, the outspoken T.H. Caraway, introduced his own bill in 1921; it was so sympathetic that, according to the USDA, it had a 'practical effect by removing any restrictions [...] on futures exchanges as at present conducted'.⁷⁴ But even some of those seeking more government oversight met regularly with the grain exchanges and circumstantial evidence exists that such meetings helped the exchanges negotiate legislation in private.⁷⁵ By 25 June 1921, exchange lobbyists had reached most of the Senate and House Committee members, and it was felt by all involved that 'at the present time there exists in the Senate quite a general knowledge of

⁷²Roberta Romano, "The Political Dynamics of Derivative Securities Regulation," *Yale Journal on Regulation* 14 (1997): 279–406, p. 293.

⁷³Supporters included John Rainey of Illinois, though Marvin Jones from Texas was later an adversary.

⁷⁴Internal Memorandum re: Future Trading Legislation, undated. NARA/KC, Box 37; 35-9. Later Caraway turned anti-futures.

⁷⁵Letter, Mauff to MacMillan, 26 November 1922. CME III.652.5.

the exact facts [through] [...] a most active and intimate canvass'.⁷⁶ For example, the amendment on allowing for appeals by contract markets to rulings by the Federal Government looked likely to be accepted.⁷⁷

The CBOT executive was generally happy with the Bill, although they felt that amendments were still needed. The exchanges' lobbyists were told to move for quick action to secure a bill with all the amendments agreed between the CBOT's representatives and the Department of Agriculture.⁷⁸ By 9 July 1921, Griffin was pleased with the legislative response to the private wire petition, and so he was generally 'convinced, beyond all question of doubt, that we must fight [...] the section compelling us to admit representatives of co-operative marketing concerns'.⁷⁹ However, support from legislators to eliminate the cooperative clause appeared unlikely, given the situation as outlined in Chapter 2. Moreover, Griffin was certain that other exchanges would not support the elimination of the private wire and the cooperative sections.⁸⁰ Though the Washington delegation was confident that the private wire section could be eliminated in a showdown in the Senate, the cooperative section had support in both Chambers and therefore looked unlikely to be removed in its entirety.⁸¹ Although all exchanges mostly agreed on the danger of granting membership privileges to the patronage dividend-paying farmer cooperatives, Gates saw no chance of overturning the current language, mainly due to generally supportive Julius Barnes of the Chamber of Commerce 'whose sympathies lead him to feel that the cooperative representatives should be admitted on practically their own terms'.⁸² Barnes was adamant that the cooperative problem was solvable, but Griffin complained that Barnes had 'fallen into the common error of believing the Exchanges are making a mistake in not adopting special rules for the benefit of cooperative marketing concerns. The advocates

⁷⁶Letter, C.B. Miller to Griffin, 25 June 1921. CME III.ss1.7.

⁷⁷Ibid.

⁷⁸Ibid.

⁷⁹Letter, Griffin to Gates, response to 7 July 1921 letter, 9 July 1921. CME III.ss1.7.

⁸⁰Ibid.

⁸¹Letter, Gates to Griffin, 12 July 1921. CME III.ss1.7; Letter, Griffin to Gates, response to 7 July 1921 letter, 9 July 1921. CME III.ss1.7.

⁸²Letter, Gates to Griffin, 12 July 1921. CME III.ss1.7.

of this plan utterly fail to take into consideration that it is a step toward monopoly'.⁸³

Other exchanges were not particularly supportive of attempts to weaken any controlling features of the Bill. Rampant speculation may have been beneficial to the futures commission merchants who earned a fee on every transaction and did not have a stake in making a profit on the marketing of the cash grain harvest. Representatives of other exchanges, however, where hedging and cash transactions dominated, were less than convinced that self-regulation could reduce manipulation and other abuses. The Kansas City Board of Trade (KBOT), for example, rebuffed the Legislative Committee on Grain Affairs' request to lobby Missouri and Kansas senators in protest of the current version of the Bill on its passage in the House.⁸⁴ John Fennelly of the KBOT wrote on 30 June 1921 that, 'I have spoken to a number of the Members on the Floor today and [...] it would appear to them, and to me, that apparently your Exchange, if left to itself, cannot control manipulation of your futures'.⁸⁵ Some KBOT members were actually in favour of harsher regulation than the Capper-Tincher Bill offered, including control of manipulation by the Federal Government and the elimination of private wires, thereby limiting trading to 'specified terminal markets'.⁸⁶ Fennelly's letter concluded, 'In view of the above, I do not feel justified in writing to the various Senators'.⁸⁷ But by this point, the CBOT's lobbyists held the upper hand in the Legislative Committees and stricter regulation was no longer on the table. Gates had seen the US President lunch at the Senate Restaurant and that his talk about the pending bills in Congress led some of Gates' 'friends' to believe that the grain Bill might not get through in that particular session of Congress.⁸⁸ Gates wrote to Wells on the 8th that 'I still believe that it would be best to

⁸³CME III.ss1.7; Letter, Griffin to Gates, response to 7 July 1921 letter, 9 July 1921. CME III.ss1.7.

⁸⁴Letter, John Fennelly, KBOT, to Mr. Manefield, chairman, Legislative Committee, 30 June 1921. CME III.ss1.7.

⁸⁵Ibid.

⁸⁶Ibid.

⁸⁷Ibid.

⁸⁸Handwritten highly confidential letter, L.F. Gates, Washington Hotel, to Griffin, 7 July 1921. CME III.ss1.7.

secure the amendments which we desire and forestall other and possibly more vicious legislation during the next Session of Congress'.⁸⁹

The battle between the CBOT and the cooperatives hit a new low in July 1921, when CBOT President Griffin was accused of 'mudslinging' in an article by editor and manager M.R. Myers in the 'American Cooperative Manager' and accused the former of obtaining the minutes of the US Growers Company illegally.⁹⁰ Griffin wrote to the editor stating that the minutes had come from on the US Growers' own, 'Mr J. Ralph Pickell, Publisher of a grain trade paper, who stands as high – if not higher, than any other man in his field'.⁹¹

Trusting to private meetings to obtain concessions brings the risks that other inside interests are more persuasive. When it appeared as if certain amendments would not go through, the patchwork group of exchanges were prone to panic, or at least refuse to follow CBOT's lead. As the KBOT president stated when he responded to possible setbacks in July, 'I have felt for some time that the Capper Bill should be bitterly fought and that exchanges are wrong in trying to temporise on the subject of legislation'.⁹² It is noticeable that this was said soon after the KBOT stated it was in favour of the private wire amendment. That is, the major exchanges were divided on most issues. Yet in Washington on 12 July 1921 Lonsdale concluded, after a private conference with the Senate Agriculture Committee, Secretary Wallace and several other senators, that 'some bill will pass'.⁹³ After a conference of the exchanges, the exchange delegation in Washington consisting of Lonsdale, Gates, van Dusen, Stevens and C.B. Miller, wired an agreement that if the exchange amendments were adopted, the exchanges would not fight its passage.⁹⁴ An 8 July letter to F.B. Wells from Gates in Washington and a similar telegram to Griffin on the same date show how little the exchanges were worried, 'we have come off better with the Committee than we had any

⁸⁹Letter, F.B. Wells, Minneapolis Chamber of Commerce, to Gates, Washington, DC, 8 July 1921. CME III.ss.1.8.

⁹⁰Letter to M.R. Myers, manager, American Cooperative Publishing Co., from Griffin, 19 July 1921. CME III.ss.1.7.

⁹¹Letter to M.R. Myers, manager, American Cooperative Publishing Co., from Griffin, 19 July 1921. CME III.ss.1.7.

⁹²Letter, Hargis to Griffin, 13 July 1921. CME III.ss.1.7.

⁹³Ibid.

⁹⁴Telegram, C.B. Miller to Griffin, 12 July 1921. CME III.ss.1.7.

reason to expect' and that it would be much better if the key points were adopted than asking for a new bill to be proposed.⁹⁵ Wells agreed the current Bill with amendments was as good as it could get and that the exchanges 'got off pretty well'.⁹⁶

As Gates wrote to Griffin on 12 July, 'if it is the consensus of opinion of the majority of Congress that some legislation might pass, then we want such an Act as will admit of our functioning'.⁹⁷ The CBOT during this period operated under the opinion of Griffin and other top executives that legislation could not be avoided; therefore, the Exchanges main attitude was to 'have the Bill passed in the best possible shape'.⁹⁸ An additional concern in seriously opposing the Bill was that it could be seen by some who considered the CBOT's earlier pro-regulation comments at the April Congressional hearings as Board 'double dealing'.⁹⁹ In such hearings the CBOT was not entirely against new regulations when faced with attacks over failures to curb excessive speculation.¹⁰⁰

It was common knowledge at the USDA and at the Board's executive level that the final Bill's cooperative clause was effectively weakened. That the exchanges were unable to have the final cooperative clause removed seems not to have impacted the final result. The archives are silent on exactly how such a result came about, there is strong circumstantial evidence that it was the result of Board lobbying. President Stream responded to a Kansas City cooperative leader, who asked at a 'friendly' dinner between farmers and grain men if he could obtain a seat on the Board, 'Sure, if you comply with the same rules all the other members subscribe to'.¹⁰¹ As this quote and the post-1922 historical record show, the cooperative clause had no teeth and the CBOT knew it.

On 13 July, Gates sent out the last Capper-Tincher Bill, as 'reported out' by the Senate Committee.¹⁰² Gates commented that most

⁹⁵Letter Gates to F.B. Wells, copies to Griffin and preceded by similar telegram to Griffin, 8 July 1921. CME III.ss1.7.

⁹⁶Letter, Wells to Gates, Washington, DC, 9 July 1921. CME III.ss1.8.

⁹⁷Letter, Gates to Griffin, 12 July 1921. CME III.ss1.7.

⁹⁸Ibid.

⁹⁹Ibid.

¹⁰⁰See, for example, *Hill v. Wallace*, 259 US 44.

¹⁰¹"Chicago Board of Trade Gets Friendly," *American Cooperative Journal* (March 1923).

¹⁰²HR 5676, Calendar No 224; Telegram, Griffin to L.F. Gates, Washington Hotel, 15 July 1921. CME III.ss1.7.

exchange representatives favoured lobbying individual Senators to push for the final exchange-friendly changes.¹⁰³ Meanwhile, KBOT President Hargis wanted to have the entire Bill scrapped by the Senate as late as 13 July. Griffin had to convince him that the current Bill should be supported as it was almost benign in its control of the exchanges.¹⁰⁴ Griffin succeeded, and by 15 July, Hargis wrote to Senator Reed suggesting that while—according to the Legislative Committee—it was likely to be impossible to stop legislation, Reed’s efforts should be put into ‘emasculating’ whatever bill was going to pass.¹⁰⁵ The sections on ‘false or misleading trade gossip, the elimination of privileges and the right to investigate seem to be fairly sound and at least harmless’.¹⁰⁶ That is, all energies were focused on getting a ‘harmless’ bill passed to preclude any truly restrictive legislation.¹⁰⁷ Importantly for the subsequent evolution of the markets, CBOT executive erroneously viewed the right of government to require reports and launch investigations to have been ‘harmless’, an opinion they were to change in 1923.

Yet despite regular differences with the presidents of the regional exchanges, Griffin was effective in rallying the exchanges in response to perceived setbacks. On 1 August, after surprise legislative scrutiny, he sent for Hargis to ‘bring the best possible committee’ to join him in Washington the next day.¹⁰⁸ On 9 August, the Bill, in a version without the private wire section but containing the cooperative section, left the floor of the Senate ‘with the approval of exchange and grain interests and was not opposed’.¹⁰⁹ The cooperative section, allowing those paying patronage dividends to be exempt from the minimum commission rules of the exchanges, was considered dangerous, but it was hoped that the section could be eliminated in private.¹¹⁰

¹⁰³Letter, Gates to J. Griffin, 13 July 1921. CME III.ss1.8.

¹⁰⁴Telegram, Griffin to B.L. Hargis, KBOT, 15 July 1921. CME III.ss1.8.

¹⁰⁵Letter, Hargis to Senator James A. Reed, 15 July, 1921. CME III.ss1.7.

¹⁰⁶Ibid.

¹⁰⁷Telegram, Griffin to Gates, Washington Hotel, 15 July 1921. CME III.ss1.7.

¹⁰⁸Telegram, Griffin to Hargis, 1 August 1921. CME III.ss1.7.

¹⁰⁹The agreement that the Bill was fine other than ‘minor changes [in] Section E, Paragraph 5 [the cooperative clause] which [we] hope to adjust in conference’ is documented in a note, Griffin to Mauff, 9 August 1921. CME III.ss2.653.3.

¹¹⁰Ibid.

The wording of section 5(e) of the Grain Futures Act provides another illustrative case (after the private wires section) of how lobbying worked for the Board at times. In 1921, the Futures Trading Act specifically recognised that cooperatives should be admitted as members of futures exchanges, adding ‘No rule of a contract market against the rebating commissions shall apply to the distribution of earnings among the bona fide members of any such cooperative association’.¹¹¹ However, the CBOT’s own rules would not allow cooperatives who rebated commissions as patronage dividends as members. The lobby got its watered down cooperative clause in the end, as the final wording specifically allows the Board to exclude cooperatives with the language: ‘such [cooperative] association [must] comply with such terms and conditions as are or may be imposed lawfully on other members of such board’¹¹²; that is, the Board won another of its key fights.

Under the revised cooperative section, the CBOT could deny a poorly resourced cooperative membership almost indefinitely through a long and complex appeals process that could—and did—end up in the Supreme Court. A refusal stood until the cooperative complained to the USDA, a resolution was obtained, and any appeal by the exchanges to a USDA ruling was completed.¹¹³ This was best illustrated by the fight for CBOT clearing membership by the Farmers National Grain Corporation (FNG), which was denied in early 1932 and finally received approval in 1934 after ‘several hundred of thousand dollars’ in costs.¹¹⁴ No other cooperative would have had enough resources to attempt such a sustained challenge.

The CBOT likely need not have worried about competition from the cooperatives in the pit or at the cash grain table. The experience in Canada was that the large cooperatives (though granted they were not patronage dividend payers but simple joint stock companies) were no threat to normal futures trading operations, as R. Magill wrote to Mauff on 19 March 1923: ‘On the whole, however, the competition arising from the operation of these two companies [the United Grain Growers

¹¹¹Future Trading Act. 67th Cong. 1st Sess., chs. 85, 86, Stat. 187.

¹¹²Grain Futures Act 68th Cong. 2nd Sess., ch. 369.

¹¹³Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406, p. 327.

¹¹⁴Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 259.

and the Saskatchewan Co-operative Elevator Co.] was no keener than had the companies been simply commercial companies; indeed, I think it is generally recognised in the trade that the competition of the farmers' companies has not been very effective. I have never heard a manager of an elevator express any particular fear of the competition of the farmers' companies'.¹¹⁵ In fact, the cooperatives were quite conservative. That is, as they learned about the ins and outs of the grain trade, the co-ops tended to fall in line with accepted practices and norms. As Magill wrote in 1923, 'On the other hand, the managers of the farmers' companies and most of their directors, and, I may add, a large number of the stock-holders, know more about the grain business now just because of their experience than they did before, and in our recent struggles about government interference we found that these managers, directors and share-holders are almost as conservative as the trade'.¹¹⁶

On 24 August 1921, the Capper-Tincher Bill became the Futures Trading Act.¹¹⁷ The press reported that the CBOT would now be subject to oversight by the Federal Government, and that it was lucky not to have been banned. Yet the CBOT executive—other than the cooperative section that was watered down in its final form—got everything it wanted from the Bill, even though the membership vocally protested against the regulation in public.

3.3.3 *The Public Record*

The literature on the Grain Futures Act generally stresses the rhetorical outbursts of legislators, but the government was not out to destroy the futures industry. Stassen wrote that 'Senator Capper was a particularly vocal and impassioned critic of the Chicago Board of Trade, characterising the Board as the world's greatest gambling house'.¹¹⁸ Capper could indeed be aggressive in public. His strong words—'abolition' and 'out of business'—suggest Capper was out to ban futures trading. As described in the introduction on the passage of the Futures Trading Act in 1921,

¹¹⁵Letter, R. Magill to Mauff, 19 March 1923. CME III.2.650.4.

¹¹⁶Ibid.

¹¹⁷On 24 August 1921, HR 14657 was passed as the Future Trading Act (Capper-Tincher Act). 67th Cong. 1st Sess., chs. 86, 42, Stat. 187.

¹¹⁸John H. Stassen, "The Commodity Exchange Act in Perspective—A Short and Not-So-Reverent History of Futures Trading Legislation in the United States," *Washington & Lee Law Review* 39 (1982): 825–844, p. 829.

Capper stated, ‘The grain gamblers have made the exchange building in Chicago the world’s greatest gambling house. Monte Carlo or the Casino at Habana are not to be compared with it’.¹¹⁹ This ‘gambling’ tirade by Capper is cited as evidence that what these ‘populist orators lacked in economics they made up for in elocution’.¹²⁰ Some members wanted to sue Capper for defamation when he claimed that the CBOT was a ‘gambling hell’, and the Board executive had to fight to restrain them.¹²¹

There was public sparring between some of the more rebellious grain interests and those who supported federal oversight. For example, on 20 November 1922, Representative Tinchler gave an interview where he accused the ‘grain men’ of financing his opponent’s campaign, as well as others ‘who opposed sitting members who favoured the Grain Futures Act’.¹²² He had earlier quoted precise amounts of financing, even though these reports turned out to be inaccurate.¹²³

In general, however, the public record was biased in favour of the interests of the exchanges, and there is plenty of evidence that the CBOT influenced, and even coerced, the Chicago and Midwestern press.¹²⁴ Such strong public relations were no accident. The Board’s executive ordered thousands of reprints of favourable articles, granted access in return for supportive articles and withheld access to those who were not fully supportive.¹²⁵ On 10 June 1922, the *Chicago Tribune* reported that the promotion committee of the CBOT was to raise \$120,000 over three years from member assessments to promote the message that ‘the great national service of future hedging markets far outweighs the incidental abuses of that system’.¹²⁶ In addition,

¹¹⁹US Congress, Remarks of Senator Capper, Cong. Rec., 67th Cong. 1st Sess., 9 August 1921, p. 4761.

¹²⁰John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, pp. 635, 641.

¹²¹Letter, H.S. Robbins, counsel of the CBOT, to Mauff, 22 June 1923. CME III.659.1.

¹²²Letter, MacMillan to Mauff, 22 November 1922. CME III.652.5.

¹²³Ibid.

¹²⁴See, for example, letter, Mauff to editor, *The Chicago Daily News*, 23 February 1923. CME III ss2.645.7; Letter, Mauff to Mr. Charles Dennis, Managing Editor, *Chicago Daily News*, 24 April 1923. CME III ss2.645.7.

¹²⁵Ibid. Many letters between press representatives and the CBOT executive in CME III ss2.645.7.

¹²⁶*Chicago Tribune*, “Board of Trade Raises Fund to Educate the Public,” 10 June 1922.

many of the witnesses called to the Congressional hearing were, in fact, grain men, biased in favour of unrestricted free markets.

The public posturing by the CBOT that the 1922 Act and its Rules damaged market confidence continued well into the 1930s and has been too often misinterpreted by historians. In the annual presidential address by James C. Murray to the Grain Dealers National Convention on 14 October 1931, he argued that the ‘Passage of the Grain Futures Act [...] did serve to discourage public interest and support by making proper business secrets available for inspection by men employed by the government’.¹²⁷ Even publicly, however, a note of triumph can be detected at the Board, as the president responded to the Act’s passing by exclaiming that ‘grain exchanges have now been given the stamp of Government’.¹²⁸ Legal legitimacy was finally achieved.

3.3.4 *The Private Record*

Author William Ferris claimed that there is a paucity of archival material dealing with futures trading, as ‘businessmen in general do not keep diaries’.¹²⁹ Ferris is, therefore, ‘thrown back upon contemporary newspaper accounts more than otherwise would be the case’.¹³⁰ Similarly, Leon Kendall’s doctoral thesis neatly critiques his own approach to the history of the CBOT as well as the histories of many others by rightly observing that:

To the degree that the actual attitude and beliefs of the respective parties differed from their official pronouncements, the dissertation is delimited. The activities of lobbyists and resolutions adopted in the oft-mentioned smoke-filled rooms, for example, were rarely brought to public attention except under duress.¹³¹

¹²⁷James C. Murray, *Politics and the Grain Trade, Address of the President, Board of Trade at Chicago* (1931). CME III.23.1.

¹²⁸G.O. Virtue, “Legislation for the Farmers: Packers and Grain Exchanges,” *The Quarterly Journal of Economics* 37 (1923), p. 703.

¹²⁹William G. Ferris, *The Grain Traders* (East Lansing: Michigan State University Press, 1988), p. x.

¹³⁰Ibid.

¹³¹Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 4.

Without access to the private record, scholars are unable to fully comprehend what forces were actually at work during the policy-making process. While comments made during the 1920–1921 hearings dominate the scholarship of this period, the private record has been virtually ignored. The archives reveal many instances where the CBOT executive admitted that the Futures Trading Act was ‘toothless’ and would preclude any substantially harmful legislation from being tabled should it become law. As documented above, the executives at the CBOT admitted the best course of action was to let the Capper-Tincher Bill pass with watered down clauses.

The executive realised that whatever legislation emerged would be the last for a long while, and that viewpoint, according to Gates, ‘percolated to the legislative channels’.¹³² Therefore, it was worthwhile encouraging the passing of a mostly harmless bill rather than risk more restrictive legislation at a later date. Griffin observed that, while the legislation could be defeated, the best course of action was to let it pass as the CBOT draft ‘which [was] suggested to the Secretary would pretty largely draw the teeth from the Bill as it passed the House. I am personally of the opinion we could function under such a law’.¹³³ On 11 July, Griffin reiterated the same to Gates in a telegram: ‘I agree must accept the best possible bill’.¹³⁴

Days before Bill’s final passage into the Act, CBOT Secretary John Mauff had written to the Board’s executive stating that Capper’s comments in Congress and in the press about the CBOT being a ‘gambling hell’ were worrying some members and also the other Boards. The response in a letter dated 16 August 1921 by the CBOT President was quoted in full in Chapter 1.

That letter provides compelling evidence that the 1922 Act was favoured by the Board executive. Only the cooperative section remained in spite of attempts by the exchanges to remove it, but even there, Griffin wrote, the Board ‘forced a compromise where, as nearly as we can determine, it will do us no injury’.¹³⁵ The CBOT President

¹³²Letter, Griffin to Gates, Washington, DC, 4 June 1921. CME III.ss1.7.

¹³³Ibid.

¹³⁴Telegram, Griffin to Gates, 11 July 1921. CME III.ss1.7.

¹³⁵Letter, CBOT President to J. Mauff, 16 August 1921. CME.III.ss2.658.2.

acknowledged that the Act gave the CBOT the monopoly powers and legitimacy it strenuously lobbied for, while also satisfying any need on behalf of the legislators to be seen to be doing ‘something’ about low grain prices. Nevertheless, the CBOT executive regularly tussled with members and even directors who wanted to have the 1922 Act overturned and new legislation put in its place.¹³⁶

The CBOT executive was aware that many bills that claimed to do one thing really accomplished quite another, and lobbying could dilute bills to the point that they were shadows of their former selves.¹³⁷ Nobody knew this better than the regional exchanges that had previously succeeded in stripping all substance from some State bills. In 1921, one anti-short selling bill in Minnesota was viewed favourably by the grain trade, as ‘the “teeth” of the bill had been extracted’.¹³⁸ The CBOT’s lobbying power is in evidence in the substantive content of the final Act as signed by the president.

Tellingly, the Board executive recognised that it would have been potentially embarrassing to challenge Capper in the courts, as the essence of his ‘gambling’ accusation had already been adjudicated as true to some extent. A year or so after this episode of Capper’s perceived slander, Henry Robbins, counsel for the CBOT, wrote to Mauff about an equally damning speech Capper gave to 600 delegates at the 1923 Wheat Conference. Robbins argued there was nothing the courts could do and ‘and a hostile jury might render an adverse verdict which would be more hurtful than these remarks of Senator Capper’.¹³⁹ It was often best for the Board to keep quiet, in public, but also in private.

The CBOT executive avoided damning the Act in private letters to individual members, even when pushed. Mauff wrote one of many such letters on 23 July 1923, stating it was impossible to say if the 1922 Act had discouraged trading.¹⁴⁰ While both the CBOT members and the directorate vilified the new regulation publicly, privately the executive

¹³⁶See, for example, letter, Carey to Gates, 7 May 1924. CME III.11.9.

¹³⁷Letter, F.L. Carey to L.J. Keating, Graceville, Minnesota, 4 February 1924. CME III.ss1.9.

¹³⁸*Chicago Tribune*, “World’s Grain Market News,” 25 March 1921.

¹³⁹Letter, H.S. Robbins, counsel of the CBOT, to Mauff, 22 June 1923. CME III.659.1.

¹⁴⁰Letter, Fones to Mr. C. Vincent, President, Vincent Grain Company, Omaha, Nebraska, 23 July 1923. CME III.ss2.664.6.

was delighted. Capper was also privately—and sometimes even publicly—supportive of free futures markets. In a letter to Paul Mehl from the GFA, he stated ‘much to my amazement, I find that a good many folks would go even farther than the position I have taken so far, and abolish all futures trading. I fancy that some of these folks might revise their opinions if they had a broader view of the problem’.¹⁴¹ Capper favoured the use of futures markets for risk reduction in the marketing process. The Senator, therefore, had no intention of banning futures or making markets unworkable for producers or consumers. In this case, as in many others, the public and private record diverge to such an extent that research based on hearings and press reports cannot purport to reveal the real story. Some senior Board officials did indeed publicly support the Act, with Wells stating in hearings that, ‘I think we court [federal regulation ...] I think we ask for it’.¹⁴² Griffin was equally welcoming, ‘I endorse the Tincher Bill’.¹⁴³ As further evidence of the benign nature of the final Act, several opponents of futures trading were exceedingly unhappy on 4 May 1921 when the Bill exited the House committee with unanimous approval; this will be the subject of the next section.¹⁴⁴

3.3.5 *The Constitutional Challenge in a New Light*

For all the public warnings of doom, neither the CBOT nor any other exchange found it necessary to challenge the 1921 Futures Trading Act. It took a suit by eight members of the CBOT acting of their own accord to overturn parts of the Act on constitutional grounds (*Hill v. Wallace* 1922).¹⁴⁵ The trouble, identified by Morrill in 1921, was that the Court generally rejected federal powers of taxation when such legislation was not obviously for the purposes of revenue raising. Other than

¹⁴¹Letter, Capper to Mehl, 28 July 1931. NARA/KC, Box 12, 14-6.

¹⁴²US Congress, Senate Committee on Agriculture, Hearings on Future Trading, 67th Cong. 1st Sess., 1921, pp. 98–99.

¹⁴³US Congress, Senate Committee on Agriculture Hearings on Future Trading, 67th Cong. 1st Sess., 1921, p. 149.

¹⁴⁴Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 243–244.

¹⁴⁵*Hill v. Wallace* (1922), 259 US 44, 45.

relying on taxation authority rather than the ICC, there were few differences between the Futures Trading Act and the 1922 Act that followed (Sect. 3.5).

It is often thought that the constitutional challenge illustrates the animosity the Board had to the 1921 FTA. However, the challenge was actually launched by those who felt it did nothing to reduce manipulation on the exchanges rather than because it was too harsh. This fact alone challenges the narrative of an unhappy set of newly regulated business associations and their members protesting government regulation,¹⁴⁶ whereas they were actually protesting that it was not regulating *enough*.¹⁴⁷ The Board did not challenge the Act as its lobbying had successfully made the Act exchange-friendly. At the time, the information disclosure requirements had been viewed as benign, though in 1923 views shifted. After excellent observations about the *Hill v. Wallace* case, Lurie comes to the unsubstantiated conclusion that the Board welcomed Hill's action, even though the archival evidence shows otherwise.¹⁴⁸ In fact, the CBOT executive bemoaned, 'the impatience of a few members who acted contrary to the advice of the Grain Exchange Legislative Committee and in opposition to the official position of all Western Grain Exchanges *brought about the nullification of the Future Trading Act at an inopportune time* [italics added]'.¹⁴⁹ The collective action problem in the exchange administration once again revealed itself. The CBOT would have been better off without the independent members' 1921 challenge, as the executive felt it risked harsher replacement regulation in the future.¹⁵⁰ Even the press realised that the CBOT would have been better

¹⁴⁶John H. Stassen, "Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)," *Chicago-Kent Law Review* 58 (1982): 635–656, p. 642.

¹⁴⁷Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 252–253.

¹⁴⁸Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), p. 254.

¹⁴⁹Letter, Gates to Carey, 23 February 1924. CME III.11.9.

¹⁵⁰*Ibid.*

off with the 1921 Act. The *Chicago Tribune* on 20 May 1922 cautioned the grain men that ‘If [the Supreme Court decision] is a victory for the exchanges as Mr Wells [chairman of the Legislative Committee] states, it is a strange victory’.¹⁵¹ The Board’s executive knew better than to challenge legislation that was clearly in the Board’s favour.

Even before the legislation had been finalised, the CBOT and the USDA were already opening the ‘revolving door’ to provide for a weak and captured regulatory agency to supervise the exchanges. On 17 October, Chester Morrill, the assistant to secretary, asked the executive to provide a reference for an applicant to the future enforcement agency.¹⁵² The CBOT confirmed he was a former president of the exchange but had been expelled for ‘the making of false and fictitious trades’. Nevertheless, President Griffin concluded that he ‘is well qualified by experience and training to fill this or any similar position’.¹⁵³ Such was the power of the CBOT lobby that even fraudulent insiders had a chance to make policy.

All exchanges applying to be contract markets under the newly passed Future Trading Act met on 26 October to discuss harmonising the rules across exchanges to ensure compliance with the new law.¹⁵⁴ Confidentially, the CBOT advised the other exchanges that the first rule changes should go no further than necessary to meet the legal requirements in order to be able ‘to make further concessions and enlargements of our amendments if the Secretary so demands’.¹⁵⁵ On 9 November 1921, the CBOT passed the rules in compliance with basic provisions of Capper-Tincher Bill and, soon after, the Board applied for contract market status.¹⁵⁶

¹⁵¹ *Chicago Tribune*, “One More Such Victory and We Are Lost,” 20 May 1922.

¹⁵² Letter, Chester Morrill, Assistant to the Secretary, USDA, to Griffin, 17 October 1921. CME III.ss1.8.

¹⁵³ Letter, Griffin to Morrill, response to letter of the 17th, 20 October 1921. CME III.ss1.8.

¹⁵⁴ Letter, Griffin to Hargis, 19 October 1921. CME III.ss1.8.

¹⁵⁵ Letter, Griffin to F.C. Van Dusen, Minneapolis, 19 October 1921. CME III.ss1.8.

¹⁵⁶ Amendments for a ballot vote, record: CBOT, undated—Sections 1 and 2 of Rule XXIII-A. CME III.2.655.1; Telegram, Griffin to Morrill, 19 December 1921. CME III.ss1.8; Telegram, Morrill to Griffin, 12 December 1921. CME III.ss1.8; Telegram, Morrill to Griffin, December 1921. CME III.ss1.8.

3.4 THE GRAIN FUTURES ACT

The Grain Futures Act became law on 21 September 1922, having passed the House on 27 June and the Senate on 14 September.¹⁵⁷ Just before it passed the house, Illinois Congressman Wheeler informed the CBOT lobby that the Bill ‘had many friends’.¹⁵⁸ Indeed, the newly amended Grain Futures Bill HR 11842, ‘an Act for the prevention and removal of obstructions and burdens upon interstate commerce in grain, by regulating transactions on grain future exchanges, and for other purposes’, passed the House quickly and then the Senate after only fifteen minutes of discussion.¹⁵⁹ The drafting of the replacement Bill was once again the sole responsibility of Chester Morrill, and he was put in charge of both the Packers and Stockyards and the GFA as assistant to the secretary in September 1921.¹⁶⁰

3.4.1 *Interstate Commerce*

The Committees in both the House and the Senate relied on the Interstate Commerce Clause (ICC) of the Constitution to justify the 1922 Act: Futures trading was claimed to be ‘affected with a national public interest’ involving ‘interstate commerce’.¹⁶¹ Many, including the CBOT executive and its counsel, believed that this faith was mistaken. In fact, the executive questioned even the investigative role of the FTC in its investigation of grain marketing, with Mauff stating as early as 22 April 1919 that futures trading was ‘clearly not interstate commerce’.¹⁶²

The CBOT had good reason to be confident. Prior to the interwar period the ICC had often been narrowly interpreted by the courts when federal powers were challenged by individual States. But the USDA, the

¹⁵⁷US Congress, Congr. Rec., Grain Futures Act, 67th Cong. 2nd Sess., ch. 369, 42 Stat. 858.

¹⁵⁸Telegram, Congressman L.E. Wheeler, 6 June 1922. CME III.ss2.654.

¹⁵⁹Letter, MacMillan to Mauff, 15 September 1922. CME III.652.5; Letter, MacMillan to Robert McDougal, 21 September 1922. CME III.652.5.

¹⁶⁰Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 71.

¹⁶¹Article I, Section 8, Clause 1 of the US Constitution. See *Board of Trade of the City of Chicago v. Olsen*, 262 U.S. 1 (1923), p. 1.

¹⁶²Letter, Mauff to Robbins, regarding FTC hearings, 22 April 1919. CME III.2.641.3.

Supreme Court and Tincher's House Committee saw it differently in this case. In its 1922 decision, the Court had set out a precise template for an act that would be recognised as constitutional. Indeed, experienced commodities lawyer Morrill rewrote the Futures Trading Act into the new Capper-Tincher Bill by following precisely what Chief Justice Taft had stated was required in *Hill v. Wallace*.¹⁶³

From the earliest legislative activity through the enactment of the 1923 Rules based on the 1922 Act, Washington and Chicago connected by telegram, telephone and mail almost daily. Mrs. MacMillan was secretary of the grain exchanges' lobbyists, at this point the Grain Committee on Legislative Affairs. She reported on not only the public side of the legislative effort—i.e. hearings, Senate and House sessions and press reports—but also private meetings that she had attended or even only heard about. On 24 June, she wrote to Wells and other exchange leaders that, contrary to the public record, the:

[Desired] amendments are in the proper hands. Speeches are ready, and the attitude and sentiment of the Exchanges will be clearly presented to the House as a basis for consideration in the Senate Committee and Senate. In the Senate the friends of the Exchange are watching and will ascertain at the earliest possible moment when the senate committee proposes to consider the Bill.¹⁶⁴

With the Bill now the Grain Futures Act, its enforcement fell to the man responsible for its drafting, Chester Morrill, and Dr. J.W.T. Duvel, as the Grain Exchange Supervisor for Chicago. Duvel already knew many traders and CBOT executives from when the 1921 Act was challenged in the Supreme Court. When the 1922 Act had passed the Senate, few CBOT members commented, although some 'seemed a little surprised that some of the amendments which they have sponsored were not brought up for discussion'.¹⁶⁵ This dissatisfaction was mostly due to a misreading of the (weak) cooperative clause 5(e) that eventually passed both Houses.

¹⁶³Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 77.

¹⁶⁴Letter, MacMillan to Wells, copy to all exchanges, 24 June 1922. CME III.655.5.

¹⁶⁵Letter, Duvel to Morrill, 15 September 1922. NARA/KC, 101-1-1.

3.4.2 *Section 5(f) Removed*

Soon after the Supreme Court decision on the Futures Trading Act, in May 1922, a corner began to develop, followed by mass selling.¹⁶⁶ Duvel wrote, ‘Many [members] did not hesitate to say that it was one of the most disgraceful situations seen on the Board for many a year’.¹⁶⁷ One director stated ‘trading had no relation whatever to the actual value of wheat or to supply and demand [...] for legitimate purposes’.¹⁶⁸ Even the exchanges supporters such as Julius Barnes could see that manipulation remained an important part of business practices.¹⁶⁹ The manipulation of 1922 was considered embarrassing by the USDA, Senator Capper and the CBOT directorate, and there was a feeling that the secretary should be able to reduce the possibility of corners. In response, Section (f) was inserted into the new Capper-Tincher Bill. This was designed to give the Secretary of Agriculture power to deal with ‘the question of grades that may be delivered on contract, premiums and discounts, inadequate elevator capacity, and any other conditions that may have similar importance in relation to the prices and executions of contract’.¹⁷⁰ This section would have bestowed real command control powers on the USDA, what one thinks of as ‘traditional’ regulation. However, the section was deemed too vague to be useful and it was quietly dropped, quite likely due to exchange lobbying. True government regulation was not to come in 1922.

3.4.3 *The Second Legal Challenge*

The CBOT executives were advised, erroneously it turns out, by counsel on 8 April 1922 that ‘even a hasty reading of this Bill shows that it is clearly unconstitutional, because it [...] is clearly an attempt to exercise local police power, which the Supreme Court has held repeatedly cannot

¹⁶⁶Attempt to purchase most of the underlying supply of a commodity in order to force the price up at delivery time. See Chapter 1.

¹⁶⁷Memorandum, May Wheat on the Chicago Board of Trade in 1922, 28 June 1922. NARA/KC, 101-1-1.

¹⁶⁸Ibid.

¹⁶⁹Ibid.

¹⁷⁰Attachment to Memorandum: US Congress, House, Report No. 1095—Views of the Minority, 67th Cong. 2nd Sess., 13 June 1922. CME III.ss2.663.3.

be exercised by Congress'.¹⁷¹ On 25 September 1922, CBOT counsel Robbins recommended a suit to test the validity of the Act, stating that it 'is unconstitutional [...] so I therefore recommend that the Board of Trade institute a suit'.¹⁷² Robbins, however, believed the law should be challenged even if it had been considered to be constitutional. Robbins and the CBOT executive believed that,

The decision of the Supreme Court upon the former Act has undoubtedly created in the minds of many grave doubts as to validity of this new Act; and if the Act is valid, it would doubtless conduce to a better compliance with it by the many members of your Exchange and their customers, if these doubts should be set at rest by the authoritative decision of our highest court.¹⁷³

In order for the CBOT to ensure the compliance of its own membership, the Act needed to be backed by legitimate federal authority. The CBOT President confirmed to Secretary Wallace as the suit was being filed that judicial validation would make it 'much easier for this Board to secure from its members a ready compliance with the Act if it is upheld'.¹⁷⁴ The CBOT wanted the USDA to know that the suit was needed to ensure compliance with the new law by the reactionary membership. This story in the archives differs from the accepted wisdom that the exchanges were embarrassed into a suit by Justice William Howard Taft.¹⁷⁵ An alternative explanation for the lawsuit by Romano, claiming the CBOT brought the legal challenge itself as it was not actively involved in the 1922 deliberative process, is also not supported by the private record.¹⁷⁶

The CBOT was the best resourced and the most motivated of all the exchanges and, as such, bore the majority of the costs for challenging

¹⁷¹Letter, Washington counsel to Mauff, 8 April 1922. CME III.655.2.

¹⁷²Letter, Robbins to Robert McDougal, 25 September 1922. CME III.659.4.

¹⁷³Ibid.

¹⁷⁴Letter, McDougal to Henry C. Wallace, 10 October 1922. CME III.s22.663.7.

¹⁷⁵John H. Stassen, "Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)," *Chicago-Kent Law Review* 58 (1982): 635–656, pp. 642, 650; See *Hill v. Wallace*, 259 US 44 (1922), pp. 61, 74.

¹⁷⁶Roberta Romano, "The Political Dynamics of Derivative Securities Regulation," *Yale Journal on Regulation* 14 (1997), p. 296.

the 1922 Act in the Supreme Court—counsel Henry Robbins Bill alone was \$31,285.¹⁷⁷ At first, though, some exchanges refused to pay their share, which caused a minor liquidity crisis at the Board.¹⁷⁸ With the most money and the most to gain and lose, the Board was sole appellant in the case. Although it was the CBOT directorate that voted to test the constitutionality of the Act, the executive knew that this was risky.¹⁷⁹ As incoming President John Stream reminded the membership in January 1923, ‘A declaration that the act is unconstitutional may beget other congressional enactments harmful to our interests which this administration will oppose by every honorable means’.¹⁸⁰

This second legal challenge, *Board of Trade of City of Chicago v. Olsen*, was decided by the Supreme Court on 16 April 1923, with the court upholding the validity of the Act.¹⁸¹ The CBOT immediately declared it would apply to become a contract market and President John Stream asked the other exchanges to follow suit.¹⁸² Publicly, both the CBOT and the USDA moved swiftly to assure futures markets users that nothing had changed and the USDA denied reports that the law would ‘put the grain exchanges out of business or interfere with their legitimate functions.[...] The marketing facilities of the Board of Trade are unimpaired and available to all desiring to use them’.¹⁸³

In 1923, the GFA was established to supervise the exchanges, in turn supervised by the newly formed Grain Futures Commission (GFC) consisting of the Secretary of Agriculture, the Secretary of Commerce and the Attorney General. The GFC could suspend or revoke an exchange’s license for violations of the conditions by which they were designated. Chester Morrill was as surprised as anyone that he was chosen to write

¹⁷⁷Letter, Mauff to Plumb, secretary of Milwaukee Chamber of Commerce. CME III.2.650.5.

¹⁷⁸Letter, Mauff to Gates, 13 July 1923. CME III.2.650.5.

¹⁷⁹Press release, CBOT, 10 October 1921. CME III.650.5.

¹⁸⁰Excerpt of speech, J. Stream, 1923. CME III.660.8.

¹⁸¹262 U.S. 1 (1923).

¹⁸²Telegram, J.J. Fones to H.J. Smith, president KBOT and others, 20 April 1923. CME III.2.650.5.

¹⁸³Copy of US Department of Agriculture Press Release, “Grain Futures Trading to Continue,” 20 April 1923. CME III.667.6.

the new Rules, devise and submit a budget as well as to establish the new agency.¹⁸⁴

In an important postscript to the legal challenge, during this period all interactions between the exchanges and the cooperatives were interrupted, another reason that the cooperatives were effectively shut out of the exchanges for the entire interwar years. The original Bill's power was mitigated through lobbying and through the equivalent of gerrymandering for the coming decade. The cooperative threat had receded, permanently as it turned out.

3.5 THE SUBSTANCE OF THE GRAIN FUTURES ACT

The Grain Futures Act was judged an immediate success in providing for a more controlled market, even if it provided no controlling powers at all. Senator Capper proclaimed victory over the exchanges in 1923:

The people need a Farm Bloc to give the producer a just reward for his labour and to prevent the consumer from paying excessive prices to gamblers in food [...] For years every wheat grower in the United States has been regularly victimised [...] at the hands of big manipulators who virtually have been in control of the Chicago Board of Trade [...] and fixed the price for the benefit of the speculator and against the producer and consumer. [...] In the famous May squeeze a year ago [...] a half dozen grain gamblers "cleaned up" something like two million dollars in 24 hours, which was more than all the farmers in Kansas made out of their entire crop of 1922. This will not be possible with the Capper-Tincher law in operation.¹⁸⁵

The newspapers generally agreed. The *Northwestern Miller* reported that 'President John Stream, of the CBOT, has shown that he takes defeat with the cheerfulness of a sportsman, and is wise enough to recognise the good features of a difficult situation'.¹⁸⁶ Yet the Act was a short

¹⁸⁴Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 73.

¹⁸⁵Copy of speech, Arthur Capper, National Wheat Conference Program, 19–20 June 1923. CME III.657.1.

¹⁸⁶Wayne Broehl, *Cargill, Trading the World's Grain* (Hanover, NH: University Press of New England, 1992), p. 270. Broehl cites the *Northwestern Miller*, 13 April 1923.

piece of legislation with very little authority bestowed upon government to supervise, and none to control, the futures markets Tincher, himself, admitted that the exchanges had strong support on Capitol Hill, both in committee and on the floor. As a result, the legislation was never going to be anti-futures in any way. Certain amendments, he said, did not make it better but ‘strengthened the bill insofar as getting support for it is concerned’.¹⁸⁷ The Act is a very good example of a ‘captured’ legislative process as predicted by the economic theory of regulation.

While Romano identifies each of the benefits that the exchanges achieved for themselves, she does not consider the benefits under the regulation as the result of a captured regime.¹⁸⁸ Lurie similarly dismissed a capture argument, even though he agreed with Romano that the substance of the Act was heavily skewed towards industry.¹⁸⁹ However, the degree of regulatory capture is apparent when the form and the substance of the legislation are treated together, which is the task of this section.

Much of the academic literature repeats the canard that the original drafts of the Bill were so harsh as to threaten the very existence of the markets.¹⁹⁰ However, the only harsh regulatory proposal in the original Bill, HR 2363, was the limitation of trading to those already involved in the grain markets, and this clause did not survive its next iteration. The potentially problematic section 5(f) also did not last more than one iteration. One day after the hearings of April–May 1921 were completed, a perfectly harmless bill, close to the final product, was tabled. Thus, the only slightly harsher opening gambit of Congressmen Tincher and Capper

¹⁸⁷Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), p. 252.

¹⁸⁸Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406, p. 297.

¹⁸⁹Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 254–255.

¹⁹⁰Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 240–241.

was completely softened somewhat in HR 5676. Further amendments suggested by the Board found their way in to HR 5676, the most important of which was the ability of the exchanges to appeal any decisions taken by the Secretary of Agriculture regarding designation as a contract market.¹⁹¹ This clause was used to delay the admission of cooperatives to exchange membership throughout the 1920s and early 1930s and was a significant victory for the CBOT lobby. While Lurie saw the compromise as a mistake by Wallace and Tincher,¹⁹² there are other equally valid explanations, including, as argued here, the strength of the CBOT lobby. In fact, as Lurie himself cites, Wallace's response to Capper's inquiry about the advisability of the compromise admits that the goal of the legislation was to 'assure us of free, open markets'.¹⁹³ Robert Gallman, commenting on Lurie's paper, wondered why the Act's sponsors allowed so many changes in favour of the exchanges.¹⁹⁴ The answer is provided in this study: The Act had been captured by the exchanges from the earliest days. The government needed the exchanges to cooperate in data provision and/or perhaps because the legislators needed to be seen to be doing 'something'. Overall, the Federal Government was not in favour of restricting businesses of this kind; thus, it obtained access to information in exchange for granting the CBOT and others legitimacy and monopoly.

The 1922 Act did not provide the means of controlling or meaningfully disciplining exchanges or their members. The archives provide

¹⁹¹For an excellent summary of the amendment, see Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 249–251.

¹⁹²Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 243–244. Yet Tincher, himself, according to Lurie (p. 237), 'admitted the [original tougher] bill fell far short of [that] called for by more militant agrarian spokesmen'.

¹⁹³Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), p. 244 citing a Wallace letter to Tincher 24 May 1921.

¹⁹⁴Robert E. Gallman, "Commentary," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Tanja H. Peterson (Washington, DC: Howard University Press, 1980), p. 274.

numerous examples of USDA staff, who had day-to-day responsibility for enforcement on the ground, often being informally admonished, formally sanctioned or simply isolated from inside knowledge, for being overly interfering in individual businesses or in CBOT affairs.¹⁹⁵ A final important administrative point applies the theory of regulatory rules to the powers that the government held between 1922 and 1936. The USDA could resort only to the biggest possible ‘stick’ to keep the exchanges in line—i.e. total shutdown. This might at first seem like a powerful tool for ensuring compliance. However, as regulation expert Robert Baldwin points out in *The Rules Don’t Work*, such a ‘bazooka’ is hard to use in practice and, consequently, is generally not a credible threat and, therefore, no threat at all.¹⁹⁶ It comes as no surprise that such light touch regulation should come from the USDA. At the time, the Agriculture Department was well-known to have been more collaborative with its regulatees, compared with the heavy-handed legalism that permeated the FTC at the time.¹⁹⁷ Chapters 4 and 5 will make the case that the agency set up to administer the Act was cognizant of the problem of enforcement and lobbied the USDA and Congress for more flexible regulatory tools to ensure compliance with anti-manipulation measures.

3.5.1 *Legal Legitimacy*

The archival sources show that one of the most important outcomes of the regulation was to recognise the futures industry as being ‘in the public interest’ and to provide it with the full legal support of Federal statute. From 1922 onwards, the CBOT and other exchanges were protected from anti-futures bills at the State level and supported in civil courts that previously had frequently set aside CBOT member claims for repayment of futures trading losses on ‘gambling’ grounds. Previously, the CBOT had spent a great deal of money on court actions when attempting to reclaim owed monies from investors who had suffered

¹⁹⁵ See, for example, Letter, Barnes to Carey, 2 January 1930. CME III.14.13.

¹⁹⁶ Robert Baldwin, “Why Rules Don’t Work,” *The Modern Law Review* 53 (1990): 321–337; Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014).

¹⁹⁷ Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952); Letter, J. Mauff to Robbins, 22 April 1919. CME III.2.641.3.

heavy losses.¹⁹⁸ As a result, the CBOT had wanted a rescue from the shambles of State regulation.¹⁹⁹ After the passage of the 1921 and 1922 Acts, the States lost their powers to regulate the exchanges, even where a transaction was fully consummated within the State.²⁰⁰ Thus, in 1923, when counsel advised the CBOT executive that, ‘the decision of the US Supreme Court will curtail state legislative action’, CBOT Secretary Mauff, for one, agreed.²⁰¹

Privately, Mauff was convinced that the regulation would be beneficial for all involved, assuring the GFA’s Duvel that:

This [1922 Act] does for the first time probably in any country of the world, uphold the legality of this future contract by statutory enactment. If the department can make a success of this super-vision we will be a beneficiary of it.²⁰²

President Stream was quoted in the *Chicago Evening Post* on the day the Supreme Court ruled in favour of the 1922 Act as saying ‘We feel that this [Act] will tend to encourage the grain trade into greater use of the future trading system for hedging’.²⁰³ Similar articles were published in other major centres. One pamphlet agreed that the Act had bestowed upon the exchanges ‘governmental approval of its existence and operation’.²⁰⁴ L.F. Gates agreed publicly that government supervision was ‘in the national interest’.²⁰⁵

¹⁹⁸Letter, Robbins to W.S. Blowney, CBOT assistant secretary, 29 April 1920. CME II.91.2.

¹⁹⁹Letter, Morris Townley to James K. Riordon, acting chairman, Legal Advice Committee, CBOT, 29 April 1925. CME III 16.7; Letter, Robbins to Mauff, 17 June 1920. CME II.91.2.

²⁰⁰Telford Taylor, “Trading in Commodity Futures: A New Standard of Legality?” *The Yale Law Journal* 43 (1933): 63–106.

²⁰¹Letter from Mauff to Robbins, 28 April 1923. CME III.659.2.

²⁰²Letter, Mauff to Duvel, 13 June 1923, CME III.667.4.

²⁰³*Chicago Evening Post*, “Decision Clears Grain Trade Sky,” 17 April 1923.

²⁰⁴Clipping, Rudolf A. Clemen, Economist, Illinois Merchants Trust Company, “Is the Grain Trade Changing?” (November 1924). CME VII.ss2.57.34.

²⁰⁵US Congress, Senate, *Futures Trading: Hearings of the Senate Committee on Agriculture and Forestry*, 67th Cong. 1st Sess., 1921, p. 397. F.B. Wells and Julius Barnes made similar statements in these hearings.

Both academic work and the 1924 USDA *Annual Report* focused on the Supreme Court of Kansas opinion that the 1922 Act ‘supercedes the direct penal provisions of the Kansas statute’, and this would apply even for transactions ‘on approved grain exchanges consummated wholly within state lines’.²⁰⁶ CBOT counsel Townley confirmed on 6 July 1923 that State Supreme Courts, such as Oklahoma, were now ruling in favour of the Board with respect to issues of futures legality.²⁰⁷ In *Missouri v. Christopher*, Townley ‘wanted [...] a decision holding [that] generally speculative orders on contract markets are authorised by the Grain Futures Act, and not subject to state prohibition’.²⁰⁸ As Missouri customers trading on Chicago were engaged in interstate commerce, the 1922 Act covered and protected these transactions from State bans.²⁰⁹ It was clear in the ruling that, without the 1922 Act, the interstate trades would have been illegal.²¹⁰ This is a good example of the use of the ICC to wrest important regulatory powers away from the States to the Federal Government. Congress knew exactly what it was doing in 1922 with the ICC, with the minority view in the House protesting that ‘this is an unwarranted invasion of State rights’.²¹¹ This transfer of police powers for social and economic regulation via the commerce clause continues to this day.²¹²

The Missouri court ruling had an anti-competitive benefit for the CBOT as well. The State law was held to be applicable in intra-state trades on the KBOT, yet there was no Illinois law that held such sway

²⁰⁶Telford Taylor, “Trading in Commodity Futures: A New Standard of Legality?” *The Yale Law Journal* 43 (1933). See also US Department of Agriculture, *Annual Report of the Secretary of Agriculture for the Year Ended June 20, 1924* (Washington, DC: Government Printing Office, 1924).

²⁰⁷Letter, Mauff to counsel Townley, 6 July 1923. CME III.659.1.

²⁰⁸Letter, Townley to James K. Riordon, acting chairman, Legal Advice Committee, CBOT, 29 April 1925. CME III.16.17.

²⁰⁹Ibid.

²¹⁰Ibid.

²¹¹Attachment to memorandum: US Congress, House, Report No. 1095—Views of the Minority, 67th Cong. 2nd Sess., 13 June 1922. CME III.ss2.663.3.

²¹²Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from the Founding to the Present* (Princeton: Princeton University Press, 2015). For contemporary examples of the transfer of powers from the State to the federal level, see Thomas McCraw, *Prophets of Regulation* (Cambridge: Harvard University Press, 2009).

over the CBOT. As such, KBOT futures trading remained in legal limbo throughout the interwar years.

Sixty years after the event, ex-CFTC chairman John Stassen accused the 1922 Act of codifying ‘a populist anti-speculative bias which totally misperceives the function and purpose of futures markets’.²¹³ Stassen further claims that the Act’s language was biased against the exchanges, in reference to his assumption that markets can be, and were, manipulated, which was simply rhetoric, since the USDA was given no substantive powers to prevent such activities invalidated by the archival record that shows that the actions, text and legal interpretation of, and bureaucratic motivation for, the 1922 Act were anything but populist. As such, contemporaries understood the legitimacy benefit better than more recent observers. By 1927, it was generally accepted that the market had only gained from the federal licensing by way of granting legitimacy, and even supporters of futures markets could see that the 1922 Act could cause little harm through control.²¹⁴

While the Warehouse Act of 1916 and the Cotton Futures Act of 1914 had both resulted in real and measurable improvements in the functioning of the grain and cotton futures markets, the 1922 Act put few, if any, limits on the behaviour of market participants. It is an accepted fact, even by those who were ideologically opposed to it, that the Act had few teeth, no matter how vociferous opposition to it appeared to be in the press and in hearings. The 1922 Act had no mechanism for limiting the Board. This was intentionally accomplished through a combination of lobbying by the CBOT, hands-off political ideology in Congress and the White House and sleight of hand by the legislative drafters.

The 1922 Act does not, in fact, call the futures market ‘a gambling hell’, but rather an institution whose existence is ‘in the national public interest’.²¹⁵ What remained in the final Act contained almost no anti-industry rhetoric, but according to many contemporary and modern

²¹³John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 636–656, p. 655.

²¹⁴J.A. Pattern and Boyden Sparkes, “In the Wheat Pit,” *Saturday Evening Post*. Reprint Curtis Publishing Company, 1927.

²¹⁵*Hill v. Wallace*, 259 US 44, 1922.

commentators it was still biased towards government interference.²¹⁶ The language of the 1922 Act has since been viewed by the Supreme Court as being supportive of the futures industry. In *CME vs Teiken*, the Supreme Court ruled that ‘[T]his court can take judicial notice [...] that futures trading is generally accepted, under proper regulation, as a useful and lawful business’.²¹⁷ The Act also bestowed intellectual and popular legitimacy on the futures markets. As the *American Elevator and Grain Trade* reported that the passing of the predecessor to the Grain Futures Act was ‘a final Government endorsement of the practice of futures trading as a hedging operation’.²¹⁸

3.5.2 *Monopoly*

All actors from the CBOT to Arthur Capper were aware that the Act would protect the CBOT’s monopoly. At the 1921 Capper-Tincher hearings, it was accurately observed that ‘the men who buy [...] will not have any place to buy unless they do business through a contract market. [The] bucket shop is wiped out by this bill’.²¹⁹ Such were the negative connotations of taking an order without filling it on the floor of an exchange that bucketing remains banned in the USA to this day, even as modern bucket shops such as ‘spread betting’ operations thrive in the UK. Noticeably, although bucket shops were banned, bucketing at the Board itself was still a major problem among members, since they were free to take unrestricted advantage of customer orders. So, while competition was eliminated outside major grain centres and in bucket shops, bucketing by members of legitimate exchanges was still problematic, as will be discussed in Chapters 4 and 5. Therefore, the bucketing rule appears to have been designed to benefit the futures industry rather than exchange users. In fact, the Illinois anti-bucket shop legislation

²¹⁶John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, pp. 645–647, though Stassen’s reading of the Act and its effects is not supported by his own footnotes.

²¹⁷*Chicago Mercantile Exch. v. Teiken*, 177 F. Supp. 660, 666.

²¹⁸*American Elevator and Grain Trade* (15 October 1921), p. 293. Available at <https://archive.org/details/usda-americanelevatorandgraintrade>. Accessed 1 March 2017.

²¹⁹US Congress, House Committee on Agriculture, *Hearings on Future Trading*, 67th Cong. 1st Sess., 1921, 11 May 1921.

was already being used to prosecute CBOT members, and the 1921 and 1922 Acts were focused solely on bucketing off the CBOT floor.²²⁰ In effect, the Act granted monopoly powers to the few exchanges that could satisfy USDA requirements, including limiting exchanges to cities with substantial cash grain markets.

The CBOT, of course, already had a history of enforcing monopolistic behaviour, as is evident in the *Chicago Board of Trade v. United States*, 246 US 231 (1918) case where the Board argued that its ‘call’ rule whereby ‘no member could buy grain after 2 pm at any price other than that set by the Board’ was not a restraint of trade. Yet there can be no doubt that enforced fixed commissions are anti-competitive. The fact that the legislation was highly biased towards the needs of the members and away from the needs of the end users, i.e. the farmers and their representatives, is easily explained by the CBOT obtaining relief from the government.

3.5.3 *Market Data Reporting and Information Gathering*

Today, it is hard to imagine a market so much in the public interest and world price-setting as was Chicago wheat futures in the interwar years. Yet, before World War I, transactions and their prices were the exclusive property of the CBOT and/or its members. Before the protections brought about by the 1922 Act, the CBOT was rightly extremely paranoid about threats to its existence. Not only were its timely price data closely guarded, but other data, now taken for granted as key indicators in financial markets such as futures volume and open interest, were not collected by anyone; hence, neither the governments nor the exchanges knew much about how markets were used or abused. Not until the early twenties did the CBOT systematically accumulate data now taken for granted. Until 1923, the Board directorate successfully fought hard to keep data private. This is evident in the following telling exchange at a House hearing in 1922 between Representative Tincher and L.F. Gates:

Mr Tincher: as I understand you, they [the Federal Trade Commission] could get the actual volumes of that business only by going to the books of each company doing business on that exchange and taking it from their books?

²²⁰Letter, Robbins to Mauff, 2 March 1923. CME III.659.2.

Mr Gates: yes, sir. There was no place where the totals were collected. No one knows, Mr. Tincher. I hope you will believe me on that. I tell you as sincerely as I can that we have not that data, either officially or any individual, and we can not get it.²²¹

When the Chairman of the House Committee on Agriculture asked for an analysis of volume data, Gates' response was, 'I ask that you request it of [the Bureau of Internal Revenue of the Department of the Treasury]'.²²²

Before the 1923 Rules were passed, Board members and their executive were overly suspicious of requests for volume or open interest numbers. The justifications for this reticence were: (i) data could be used to justify legislative control, (ii) specific data referring to the positions of clearing members or individual trading accounts could be leaked for the profit of less scrupulous members—i.e. the members did not trust one another and (iii) the bucket shop problem.

The CBOT was sensitive to public and media scrutiny that futures market volume was so many multiples higher than the entire grain harvest. The CBOT was even suspicious of friends of the Board requesting information. On 5 September, Griffin and Hargis of the KBOT even withheld such information from Julius Barnes, a powerful major supporter of the exchanges, on the grounds it required member authorisation. To Griffin, who agreed, Hargis added, 'My personal opinion is that no one man should be able to get exchange figures as to trade volume and make his own deductions in representations at Washington. I feel also that to give these figures out for use in any private case would be very injurious unless specifically authorised by the directors of the exchange affected'.²²³

Members too were prohibited from publicly disclosing information. When a KBOT member disclosed to the *Chicago Tribune* the open interest of large commission firms from 25 to 27 September 1921, such a move was deemed 'reprehensible and highly prejudicial to the best

²²¹Statement of L.F. Gates, House Committee on Agriculture, 13 January 1921. CME VII.ss3.65.2.

²²²Ibid.

²²³Letter, B.L. Hargis, KBOT president, to Griffin, 5 September 1921. CME III.ss1.7.

interests of this and other markets'.²²⁴ The KBOT directors responded by 'circumscribing the matter of gossip and giving out of information which might tend to affect the market' in early October, prohibiting the dissemination of 'information as to the volume of outstanding open trades'.²²⁵ This volume and open interest information, crucially important and now published by all exchanges, was filed under the category 'misleading information and false gossip' by the industry.²²⁶ Indeed, the exchanges had previously told the Senate Committee on Agriculture that any USDA distribution of futures volume figures 'would influence the market and be unwise'.²²⁷ By the end of the 1920s, however, volume and open interest was being provided daily by the GFA. Today, they form an integral part of the technical analysis of commodities markets by professional investors and speculators.

In the hearings, Secretary Wallace made what he wanted to achieve very clear: 'There ought to be authority to inquire into [...] everything that goes on these exchanges'. He added, 'nobody seems to know what ought to be done'.²²⁸ Control was not in the USDA's mind. Wallace, Morrill, Tincher and Capper believed the solution was to obtain enough information to determine whether or not the exchanges were acting in the public interest, as well as to force them to provide more information to its users. Tincher specifically thought what is now common in environmental regulation, that disclosure in itself would make markets less susceptible to fraud and corners. Wallace had publicly stated on the passing of the 1922 Act that, 'In a year or so we should be able to speak with authority concerning grain exchange dealings. Nobody can do that now'.²²⁹

²²⁴Letter, Hargis to T.E. Cunningham, c/o Harris, Winthrop & Co, 1 October 1921. CME III.ss1.8.

²²⁵Ibid.

²²⁶Ibid.

²²⁷Ibid.

²²⁸US Congress, House Committee on Agriculture, *Hearings on Future Trading*, 67th Cong. 1st Sess., 1921, p. 332.

²²⁹Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), p. 237; Copy of US Department Agriculture Press Release, "Bills: HR 11843," 21 September 1922. CME III.667.6.

The trade-off for legitimacy, monopoly and protection from anti-gambling laws was that the Boards had to accept the information component of the Bill. The 1921–1922 Acts, therefore, were an obvious compromise, captured in some aspects and meeting the Federal Government’s need to subject the markets to scientific inquiry and information disclosure. The idea that the 1922 Act was primarily an information gathering tool was stated accurately and concisely by the USDA in a press release on 20 April 1923 on the upholding of the 1922 Act by the Supreme Court.²³⁰ The key demand of the USDA was the requirement for exchanges to keep detailed records and for the Departments of Justice and Agriculture to have access to these on demand. The administration was further authorised to require daily reports from exchange members. Using this data, the government was expected to engage in, and make public, regular investigations on the functioning of the markets.

Even in 1922, the executive was still concerned about prices being disseminated by the members of other exchanges. Mauff asked counsel what could be done to limit the use of CBOT quotations by members of other exchanges who receive them, given such users ‘are not the character of men who would be admissible to membership on this exchange’.²³¹ The monopoly powers finally granted in 1922 made the exchanges much more confident, supported as they were by US Attorney General and GFA enforcement. Before 1922, basic price and volume information was jealously guarded. For example, one commission company had to paint out its windows so its quotes could not be seen from the street, or face fines.²³² Since the 1922 Act made bucket shops illegal in federal law, along with other anti-competitive restrictions, the CBOT’s monopoly was enhanced, which allowed the exchanges to relax the draconian rules regarding who could access timely trading prices and quotations from the floor. Eventually, such quotations were available to anyone, anywhere.

Data collected by the exchange and the USDA, combined with large trader reporting established in 1923, offered new datasets to newly interested academics as well as policy-makers and even the industry itself, as

²³⁰Copy of US Department Agriculture Press Release, “Grain Futures Trading to Continue,” 20 April 1923. CME III.667.6.

²³¹Letter, Mauff to Robbins, 11 January 1922. CME III.2.641.3.

²³²Letter, Market Report Committee, CBOT, to S.C. Christopher & Co, 18 May 1923. CME III.666.9; Letter, J. Mauff to R.W. McKinnon, 4 January 1923. CME III.662.4; Letter, Mauff to H.S. Robbins, 13 April 1922. CME III.2.541.1.

will be described in Chapter 5. Yet without federal protection from the bucket shops and other competitors formally written into the Act, the CBOT might have been less easily convinced to allow timely price, volume and open interest information to be disseminated to the public. The fight for data was not easy, as Chapters 4 and 5 reveal.

3.6 EXPLAINING THE LEGISLATION

The extensive CBOT archive provides an excellent opportunity to study the establishment of a new regulatory regime, a rarity given that most modern institutional changes are path dependent and therefore based on previous institutions.²³³ So far this chapter has provided a narrative of the events surrounding the passing of the Grain Futures Act into law in 1922 and an analysis of the detailed substance and form of the law in terms of what it bestowed on the CBOT. However, it is equally important to determine why the 1922 Act ended up in its final form. The claim that the 1922 Act was the result of agrarian populism is easy to reject. Focusing on any oversimplified explanation obscures a much more interesting history of market regulation, including co-regulation, government-protected monopoly and the search for information.

3.6.1 *Agrarian Populism*

The study of interwar relations between industrial America and farm interests is generally viewed only as a battle between populism and market liberalism. This is perhaps unsurprising as this (apparent) struggle between grain interests, and the people was, and in some cases still is, ingrained in the social and cultural fabric of the USA. In a popular novel published in 1903, Frank Norris wrote:

Think of it, the food of hundreds and hundreds of thousands of people just at the mercy of a few men down there on the Board of Trade. [...] They say just how much the peasant shall pay for his loaf of bread. If he can't pay the price, he simply starves.²³⁴

²³³Philip K. Howard, "The Crippling Hold of Old Law," *Wall Street Journal*, 2 April 2016. Available at <https://www.wsj.com/articles/the-crippling-hold-of-old-law-1459536718>. Accessed 1 March 2017.

²³⁴Frank Norris, *The Pit* (New York: Penguin, 1994 [1903]).

The Granger uprisings and the subsequent populist movements, such as the Farmer's Alliance, had provided agrarians a voice against speculators in agriculture futures.²³⁵ Grain prices were low throughout the Long Depression and beyond, and during this time, there were several attempts to regulate the growing grain futures markets in the Midwest, yet none were passed into law.²³⁶ The rhetoric of the Grangers and their successors was strongly anti-grain trade. As late as 1914, Minnesota Representative Manahan stated at the House Committee on Rules:

Controlling [exchange] members [...] depress or raise the price of wheat to suit the purpose of their gambling operations; that the prices are by such combination and manipulation depressed while the farmers are compelled to market the heavy portion of each crop and raised and manipulated so as to tempt speculative investors after the bulk of each crop is in [their] control.²³⁷

However, there are a number of problems with an agrarian populist theory of futures regulation. In the first instance, it is unclear that the populist movement's campaign for antitrust busting of railway and storage monopolies originated with farmers. George Miller argues that the few laws against anti-competitive behaviour that were passed at the turn of the century appear to have been instigated 'to assist individual shippers in their judicial struggles with giant corporations'.²³⁸ Indeed, it can be 'demonstrated that the Granger advocacy of regulation was dominated by merchants and shippers [...] rather than by dirt farmers themselves'.²³⁹ That is, medium-sized businesses were fighting for free markets against the larger monopolists, with both groups represented in industry organisations.

²³⁵Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979).

²³⁶Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987), pp. 10–11.

²³⁷US Congress, House, *Hearings Before the Committee on Rules: HR 424*, 63rd Cong. 2nd Sess., 5–7 March 1914, p. 3.

²³⁸Georde Hall Miller, *Railroads and the Granger Laws* (Madison, WI: University of Wisconsin Press, 1971).

²³⁹Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877–1920* (Cambridge: Cambridge University Press, 1982), p. 126.

The timing of agrarian power in government does not correspond with the timing of the early futures regulation. John Mark Hansen argues that:

The competitive advantage of the farm groups in Midwest was ambiguous until about 1926, despite the creation of the Farm Bloc in 1921, despite agrarian unrest in the 1922 elections and despite the advent in 1923 of a well-orchestrated pressure campaign for the McNary-Haugen subsidy bill.²⁴⁰

For example, President Coolidge was anti-interventionist enough to veto the McNary-Haugen Bill on numerous occasions. Additionally, the mismatch between the (re)emergence of Midwest agrarian power in Washington by 1926 and futures legislation in 1922 and 1936 needs explaining.

Jonathan Lurie in 1980 made the common error of identifying the 1921–1922 Acts with farmer discontent, yet the simple dichotomy is more confusing than useful in understanding this earliest legislation. This study argues that the producer had no voice in the development of the legislation, was not a user of the futures markets and did not have an organised campaign on Capitol Hill or in the public eye with respect to futures regulation. During the 1920s, in committee after committee, for every politician who came across as a ‘dangerous populist’, numerous legislators and bureaucrats who utilised the discourse of the futures industry were seen as benign bastions of efficient free market capitalism. Representative Ellis, for example, argued frequently against the 1922 Bill, thus: ‘There is nothing in it to praise; there is everything to condemn. The bad features of the old [1921] bill are made distinctly worse [...] More than all, and worse than all, this bill reeks of populism’.²⁴¹ But just how much did the Act ‘reek of populism’? To answer this question, it is important to understand the role of the bipartisan Farm Bloc. The Bloc picked up the cause of agrarians in the early 1920s, and two of its members introduced the Capper-Tincher Bill to

²⁴⁰John Mark Hansen, *Gaining Access: Congress and the Farm Lobby 1919–1981* (Chicago: University of Chicago Press, 1991), p. 20.

²⁴¹Representative Ellis in 62 Cong. Rec. 9420 (1922) as quoted in John H. Stassen, ‘Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),’ *Chicago-Kent Law Review* 58 (1982): 635–656, p. 647.

supervise the exchanges. But Representative Tincher, according to Lurie, ‘admitted the [original tougher] bill fell far short of [that] called for by more militant agrarian spokesmen’.²⁴² The final legislation was even less controlling than that already criticised by some as being powerless. Additionally, Senator Arthur Capper was not anti-futures. He simply favoured an act that would eliminate activities that were for the ‘benefit of the speculator and against the producer and consumer’.²⁴³

Robert Gallman in his comments on Lurie’s 1980 work observed, ‘why the farm bloc should be concerned with [gambling on exchanges] is not altogether clear’.²⁴⁴ Pashigian, who stated that ‘some regulation can be explained by opposition by special interest groups’, correctly concludes that:

The most easily identified group is the farm sector. [But] not all segments of the farm sector have opposed futures trading, and the position of some groups of farmers has changed over time. While some farmers have opposed futures markets, the underlying reasons for this opposition have never been satisfactorily explained.²⁴⁵

Any ‘farm lobby’ cannot be assumed to be a unified interest group, and it is in any case unclear why farmers would oppose futures markets. While he was Secretary of Agriculture, Henry C. Wallace was very supportive of Farm Bloc efforts. Yet neither the Secretary nor the Bloc was anti-futures in practice. In fact, Wallace was a firm believer in the free markets as determinants of agricultural prices, even if he was no friend to the grain trade.²⁴⁶ In the CEA, the fact that a farmer’s organisation was at the heart of lobbying efforts and co-wrote the Bill once again

²⁴²Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), p. 237.

²⁴³Capper’s Speech, National Wheat Conference Program, 19–20 June 1923. CME III.657.1.

²⁴⁴Robert E. Gallman, “Commentary,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), p. 274.

²⁴⁵B. Peter Pashigian, “The Political Economy of Futures Market Regulation,” *The Journal of Business* 59 (1986): S55–S84, p. 556.

²⁴⁶Donald L. Winters, “The Persistence of Progressivism: Henry Cantwell Wallace and the Movement for Agricultural Economics,” *Agricultural History* 41 (1967): 109–120.

causes observers to equate futures regulation with agrarian populism. However, the new archival data in no way suggest that the goal of the farmer's organisation was to extract benefits for the farmers, as is shown in Chapter 5.

This study disentangles the history of futures market regulation from farm relief efforts, successes and failures. The fact that some grain futures regulation occurred at roughly the same time as significant efforts to aid the farmer and was often supported by the same legislators should not allow one to assume that all legislation had the same goals and were aimed at the same constituents.

3.6.2 *A Better Explanation*

Interpretations of attempts to regulate the futures industry view them as intentional fatal attacks, with the pro-business Supreme Court or president of the time defending free markets by either declaring the legislation unconstitutional or exercising a veto.²⁴⁷ In this view, populist legislators, responding to lobbying by the public, would propose anti-business legislation that was then struck down by the Courts in defence of free markets against state control. It has been argued that politicians proposed legislation in the 1920s in the 'public interest' of grain producers during the interwar years that would either ban or severely restrict futures markets, and that these attempts were countered by futures industry lobbying.²⁴⁸ However, the evidence recorded above shows that the Act actually bestowed on the CBOT the following benefits:

1. Protection from bucket shops.
2. Protection from other exchanges not in grain trading centres.
3. Protection from anti-gambling State laws.

²⁴⁷For example, see Charles R. Geisst, *Wheels of Fortune: The History of Speculation from Scandal to Respectability* (Hoboken: Wiley, 2002), p. 39.

²⁴⁸For example, see John H. Stassen, "Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)," *Chicago-Kent Law Review* 58 (1982): 635–656, p. 652; Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980).

4. Legal legitimacy.
5. Intellectual legitimacy.

Lurie, who argued that Tinchler's ideal was to force the exchanges to better self-regulate, under threat of future federal penalties, found the Act to have been far from conservative when he stated that 'implicit in the law was the fact that the federal government could now intervene in the internal activities of private exchanges'.²⁴⁹ Yet the archival record of 1921–1922 contains no proof of this.

The 1922 Act was actually made by, and for, the CBOT, and the Chicago exchange might have found it difficult to survive controversies in the 1920s and 1930s without this early Federal Government intervention. The Federal Government, rather than punish and penalise the futures markets as were many US States, might have actually ensured its survival. Why was the Act written in such a way as to provide exchanges with monopoly powers through government licensing, especially in the face of egregious market manipulation and fraud? One answer may lie in the analysis of the private interests of the regulated. Indeed, the evidence supports the belief that the 1922 Act was 'captured' in the Chicago School sense of the word by the CBOT, specifically its executive.

Another potential influence on the legislation was the technocratic call for information that was prevalent throughout US governments in the 1920s.²⁵⁰ The USDA, like other federal departments, sought information to understand before acting rashly, while the CBOT wanted to protect its monopoly. Both interests achieved those goals. The farmer, on the other hand, got nothing. Manipulation was not directly reduced by the Act, powerful cooperatives were not able to become members of the Board (Chapter 5), and the government was not given power to control the markets. The legislation, therefore, was not the result of a regulatory impulse by interest groups opposed to free futures markets, a desire to limit gambling, or a desire to protect investors, which were the three

²⁴⁹Jonathan Lurie, "Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government," in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980), pp. 237, 256.

²⁵⁰William E. Akin, *Technocracy and the American Dream: The Technocrat Movement, 1900–1941* (Berkeley: University of California Press, 1977).

reasons for regulation listed by Peter Pashigian.²⁵¹ While Pashigian saw the failures of many bills to pass after the original legislation as a victory of free market advocates over irrational legislators and regulators, Markham saw them as a failure of rational and appropriate legislation to take hold due to the politics of capture.²⁵² The archival record supports Markham.

Politicians from the Midwest, of course, could see as well as anyone the effects low farm prices were having, and it was common in the press to see polemics on futures trading and the evils of speculation; therefore, putting two and two together was simple. It was as important, then as it is today, that politicians are seen to ‘be doing something’ in a crisis; hence, hasty solutions were proposed, most of which solved nothing—i.e. they were ‘Pavlovian’ responses.²⁵³ The 1920–1921 crisis had a similar effect on Midwestern Congressmen. However, many legislators from the grain-producing states were disinclined to endorse Federal Government control over grain middlemen, let alone support banning the futures industry altogether. The archive shows that Senator Arthur Capper and Representative Tincher were opposed to any ban on the futures industry, even though in the press they appeared to demand it.²⁵⁴ It also shows that the millers, other grain end users and many middlemen had access to key politicians and, judging by both private and public records, they successfully influenced the lawmakers.²⁵⁵ For all Capper’s assurances that he represented the people against the grain interests, he

²⁵¹B. Peter Pashigian, “The Political Economy of Futures Market Regulation,” *The Journal of Business* 59 (1986): S55–S84, p. S56 He limits regulation reasons to (1) investor protection, (2) prohibiting or limiting ‘gambling’ or (3) opposition to free futures markets by ‘interest groups’.

²⁵²Ibid. Jerry W. Markham, “Manipulation of Commodity Futures Prices—The Unprosecutable Crime,” *Yale Journal on Regulation* 8 (1991): 281–305.

²⁵³Christopher Hood and Martin Lodge, “Pavlovian Innovation, Pet Solutions and Economizing on Rationality?: Politicians and Dangerous Dogs,” in *Regulatory Innovation: a Comparative Analysis*, ed. Julia Black et al. (Cheltenham: Edward Elgar Publishing Ltd., 2009).

²⁵⁴See John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 636–656, pp. 248–249.

²⁵⁵Letter, Barnes to Fred Uhlmann, 24 December 1929. CME III.13.34; Letter, Capper to Jardine, 19 July 1928 I. NARA/KC, 14-6; Letter, Duvel to Capper, 28 July 1924. NARA/KC, 14-61.

appreciated the usefulness of the futures market. While the 1922 Act did incorporate public interest elements regarding information gathering, the historical record provides both actual and circumstantial evidence that the 1922 Act was ‘captured’ by the CBOT since, during the legislative process, the key sections controlling the exchanges were either eliminated or watered down, while a clause beneficial to the exchanges was added. While Lurie mentioned and dismissed Kolko’s thesis that during the 1920s industry groups actively sought government interference in their markets, even he agreed that his own archival evidence suggested this was true of the CBOT.²⁵⁶ Lurie provided no evidence against the ‘capture’ theory. Yet highly technical market regimes with few newsworthy outcomes, such as a financial market, are prime candidates for ‘capture’. In fact, the 1922 Act limited federal power to, at most, minimal oversight, while public salience in futures regulation was very low, since few who were not actively involved in grain marketing were in a position to comment.²⁵⁷

Millers’ and grain men’s interests, rather than that of the farmers, were best represented in Washington in 1921–1922 when it came to futures trading, and the highly volatile markets created havoc with the business plans of the powerful milling industry. Millers were much more knowledgeable about grain marketing than the farmers and their representatives. They were also important voter clients of Senator Capper, so both publicly and privately he supported them. He crowed after the 1922 Act was declared constitutional that, ‘our great milling industry [will no longer be] upset by “bear raids” by “May squeezes” by vicious short selling on a huge scale at the hands of big manipulators who virtually have been in control of the Chicago Board of Trade’.²⁵⁸ Yet again, however, rhetoric trumped substance. Neither the farmers nor the millers obtained relief from manipulated markets, although the millers did obtain an implicit promise from the Federal Government to investigate markets with the possibility of updating

²⁵⁶Jonathan Lurie, *The Chicago Board of Trade, 1859–1905: The Dynamics of Self-Regulation* (Urbana: University of Illinois Press, 1979); Jonathan Lurie, “Regulation of the Commodity Exchanges in the 1920s: The Legacy of Self-Government,” in *Farmers, Bureaucrats, and Middlemen: Historical Perspectives in American Culture*, ed. Trudy H. Peterson (Washington, DC: Howard University Press, 1980).

²⁵⁷Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406, pp. 292–294.

²⁵⁸Copy of speech, Arthur Capper, National Wheat Conference Program, 19–20 June 1923. CME III.657.1.

the regulation at a future date. Even Capper, although he sometimes stated otherwise in public, did not rent-seek on behalf of farmers via the 1921 and 1922 Acts. Therefore, Farm Bloc sponsorship of the futures trading bills should not automatically lead to a conclusion that the legislative goal was to help farmers. The CBOT, the only successful rent-seekers, obtained a monopoly and legitimacy. In return, the government received an (eventual) information gathering mandate that was to improve the markets forever through transparency and understanding.

3.7 CONCLUSIONS

The Grain Futures Act of 1922 was not an ineffective populist attempt at raising rents for farmers by controlling a previously free market, as some claim, but a carefully engineered compromise, both in intention and practice. A mistaken focus on the often public and heated debate between farmers as the ‘public’ and grain interests over the earliest futures regulation, especially the 1922 Act, without attending to the private record, misses most, if not all, of this highly relevant history. Markham agrees that ‘the Grain Futures Administration was an impotent agency that had no effective means of regulating the markets’.²⁵⁹ Indeed, during the interwar years, the CBOT was never in any danger from legislators, even though it often acted publicly as if it was being threatened, and was asked to defend itself in many hearings and investigations; this public debate obscured the full support the CBOT actually received from the key actors in the administration, the legislature and the USDA. The degree to which the Act can be seen as captured depends on one’s view of what the CBOT expected it would be required to reveal in terms of information to the GFA. The view of this paper is that the CBOT believed that it had negotiated a completely benign Act, though the informational requirements turned out to be higher than the Board expected.

Benign legislative efforts did not end in 1922. A key argument of the next two chapters is that the information provided by the GFA as a result of the 1922 Act provided important support for legislators to deal with further threats against the futures business, ensuring its survival reasonably free from government interference. What little government control that did manifest before 1936, as will be described in Chapter 4,

²⁵⁹Jerry W. Markham, “Manipulation of Commodity Futures Prices—The Unprosecutable Crime,” *Yale Journal on Regulation* 8 (1991): 281–305, p. 304.

specifically relied on weaknesses in the 1922 Act. Additionally, information gathering, which began in 1923, influenced not only the changes to the institutional framework of the CBOT in 1926 but also the CEA of 1936.

This chapter showed that it was lobbying by the CBOT executive that resulted in an act that was industry-friendly to such a degree that it resulted in an immediate legacy of legitimacy and monopoly, and later was partially responsible for other key institutional changes that have lived on into the present day. Thus, the 1922 so-called ‘orgy of populist rhetorical excess’ quite possibly saved the exchanges by carrying CBOT members forcefully into the twentieth century; this will be covered further in Chapter 4. The legitimising function of the Grain Futures Act was further in evidence when Duvel advised Mauff on 25 May 1923 that, at their bottom, physical futures contracts should read, ‘Subject to supervision by the Secretary of Agriculture under authority of the Grain Futures Act’.²⁶⁰

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²⁶⁰Letter, Duvel to Mauff, 25 May 1923. CME III.667.4.

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The Co-construction of Modern Futures Markets, 1923–1926

4.1 THE CO-GOVERNANCE OF THE FUTURES MARKETS

The CBOT emerged from World War I lacking many key institutional characteristics that had been adopted earlier by its competitors. By the end of 1926, however, the market's institutional environment, if not its formal regulatory framework, was greatly changed, mainly because modern clearing had been adopted, large quantities of timely and well-curated data and analysis had become available, to governments, industry, academics and the general public. Additionally, manipulators could be held accountable through self-regulated committees. This chapter analyses the effects of the 1922 Grain Futures Act (1922 Act), together with the resulting 1923 Rules and Regulations (Rules), on the evolving regulatory regime and market microstructure of the emergent futures markets during the mid-1920s and beyond. It will focus on three key changes that occurred between 1923 and 1926.

This chapter shows that the informal relationships that developed between government and industries were due to the failures of the formal regulatory regime. The creation of such insider relationships then led to the two important characteristics of modern futures markets—central clearing and BCCs—that are now taken for granted. A third key feature of the markets originating at this time, Special Accounts reporting, was mandated under the 1923 Rules and Regulations (Rules). Two out of the three market institutions that developed during this period were a

product of a formally powerless USDA, usually being unduly influenced by the CBOT's desire to solve collective action problems. The Grain Futures Administration (GFA) began collecting data from CBOT members, including reports about the largest speculators and hedgers—over 500,000 bushels in daily trading volume or in open interest—which were classed as Special Accounts. By using its information-gathering mandate, the GFA could now uncover inefficient and even criminal practices. However, it still had no real power to prosecute. Secondly, a combination of the influence of industry on the laws and their administration, together with the information gathered, led to the adoption of modern clearing in 1926. Modern clearing is now so ubiquitous that three-quarters of all interest rate swaps and many other derivatives totalling over \$300 trillion that had been arranged bilaterally in the over-the-counter (OTC) market by the end of 2016 were centrally cleared.¹ Thirdly, the information gathered by the GFA and pressure from the USDA spurred the CBOT to adopt a Business Conduct Committee (BCC) to address manipulation identified by the government. While only the CBOT had any enforcement power over its membership, it was not privy to GFA data. Initially, the GFA could only hand over relevant evidence to the CBOT and hope that it would take action. BCC resulted precisely because the GFA had been so powerless to intervene in the so-called volatile 'Cutten Corner' markets in 1925 (Fig. 4.1). The BCC, which fell under the Board's authority, was a controlling institution by which the government and the industry could collectively tackle fraud and manipulation.

The CBOT lobby was strong, but its membership was conflicted, the government was pro-business and the bureaucracy diligently explored the markets by information gathering and analysis. Consequently, institutional changes could only be made with the support of all actors. As a result, all three of the innovations of 1926 were very much in the public interest, benefiting as they did everyone except perhaps a small group of reactionary grain futures traders. Therefore, modern clearing, Special Account reporting, the development of BCCs and information gathering and analysing, together with reporting on the exchanges, all contributed to a more efficient futures markets for all users—from millers to farmers to speculators.

¹ Philip Stafford, "Derivatives 'Big Bang' Catches Market Off Guard," *Financial Times*, 1 February 2017; Soniya Sadeesh, "Clearing and Margining OTC Derivatives," *Deutsche Bank Special Report*, 27 February 2017.

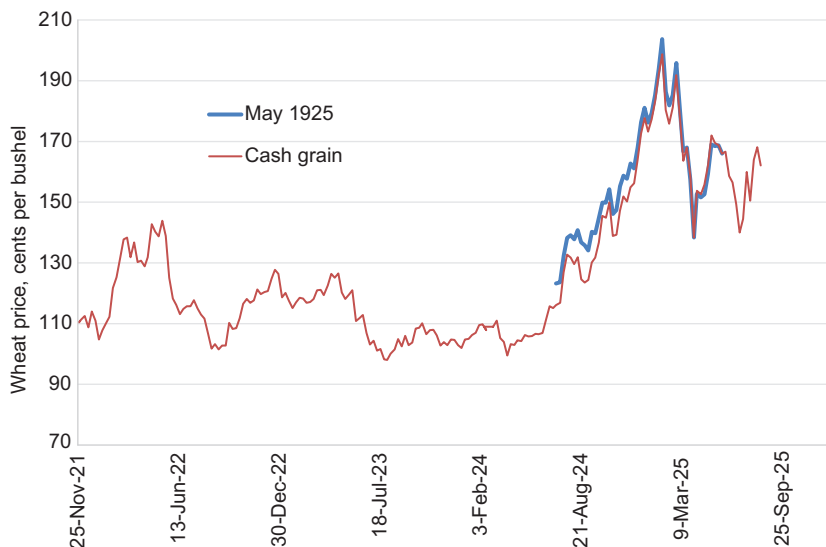


Fig. 4.1 March 1925 wheat future compared to long-term cash wheat (*Source* Holbrook Working, “Prices of Cash Wheat and Futures at Chicago Since 1883,” *Wheat Studies of the Stanford Food Institute II* [1934])

In 1923, the GFA was set up by the USDA to supervise the exchanges and was in turn supervised by the newly formed three-person Grain Grain Futures Commission (GFC), which included the Secretary of Agriculture. The GFC could suspend or revoke an exchange’s license for violations of the conditions by which they were ‘designated’. As was mentioned in the previous chapter, Chester Morrill led the new agency.² When the GFA began supervising the exchanges, the CBOT had established its legitimate and protected monopoly, immune to state-level interference since all the actors knew that any tougher federal regulation seemed extremely unlikely in the mid-1920s to the early 1930s. Soon after the Rules took effect, however, the wheat markets entered one of the greatest bull markets of the twentieth century, rising to a high of 206 cents per bushel in very early January 1925,

²Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 73.

followed by a sharp decline in 1925 (Fig. 4.1). In this highly volatile market environment, the GFA performed some of its best investigative work.

When examining the full archival record of the relations between the CBOT executive, Board members, the GFA, the USDA and Congress, two things become very clear. Firstly, the Board executive did not always see eye-to-eye with its membership, other exchanges and their members or other interested parties. The Board's executive and directorate were continually balancing the varied and varying interests within the membership with the other, smaller, exchanges. Secondly, the CBOT was well connected in Washington.

This chapter will argue that the substance of the 1922 Act alongside the limited power of government to act formally, combined with strong information-gathering powers, resulted in the three key innovations described above. Although the GFA lacked regulatory authority, the CBOT and its membership were not free to act indiscriminately. Competitive pressures threatened, with many powerful users of exchanges, including millers and exporters, concerned about improving market efficiency, especially by controlling counterparty credit risk and egregious manipulation. Normatively, this could lead directly to customer-driven change. Yet organisations of individuals do not always function logically. The chapter will show that the CBOT, itself, consisting as it did of a membership with often competing interests, could not effect the changes that the executive and many outside interests felt would modernise its markets. As a result, the executive turned to the USDA to 'threaten' its members into action, even though the threats were very likely idle since new legislation was unlikely. It is intriguing that the exact market innovations that were effected in 1925–1926 were of a type usually associated with successful self-regulation, yet the CBOT was not able to self-regulate these changes alone. Both co-construction and co-regulation involving the Federal Government was required to make markets better for all, including most Board members.

The two biggest challenges for the CBOT were to contain other elements of the grain trade from endangering the regulatory regime that the CBOT had fought hard to obtain in 1921–1923, and to maintain the supremacy of the CBOT as the world's grain futures market. While suppressing any calls for a renegotiation of the Grain Futures Act at an inopportune time, the Board also had to ensure that, behind the scenes in Washington, no new legislation was enacted counter to its interests.

That it succeeded in doing both these things for almost the entire inter-war period evidences the strength of the futures lobby. Maintaining the status quo in the futures markets was not enough for the CBOT executive, however, and the collective action problem highlighted here resulted in an unacceptable sclerosis. Thus it took an otherwise toothless GFA to bring about the changes that the CBOT needed to ensure its evolution as the dominant futures exchange of the twentieth century.

This chapter will (i) explain why the government could not innovate legislatively after 1922, in order to set the stage for the co-construction of 1926, (ii) explore the role of the GFA in information gathering and the legacy of these actions, (iii) cover the infamous Cutten Corner and the subsequent crash and price volatility of 1924–1926, (iv) explain how the CBOT membership was forced to adopt modern clearing in 1926, (v) describe the creation of the BCC in the same year, and (vi) show how the weakness in governance at the CBOT combined with weaknesses in the formal regulatory regime contributed to the successful evolution of the futures markets. Specifically, I show that the co-constructed changes in 1926 were a direct result of knowing that the GFA and the USDA were unlikely to receive any new powers from Congress in the foreseeable future.

4.2 EXPLAINING THE GAP IN REGULATION BETWEEN 1924 AND 1935

It had been clear to the USDA from the earliest days of drafting the Act, and to the GFA by 1923, that it could not prevent manipulation and that all it was capable of was obtaining the latest and most accurate information regarding prices, volumes and open interest, right down to the individual account level for ‘Special Accounts’ above 500,000 bushels.³ Yet between 1922 and 1935 no new regulative legislation passed Congress for four main reasons. Firstly, there was a focus on the part of key Congressmen on the cooperative movement and the wider problem of wheat prices falling far below ‘parity’. Many solutions to the farmers’ dilemma of low grain prices were proposed, some going as far as advocating a fixed (high) price for wheat, as had been the case during the war. Instead, throughout the 1920s, legislators focused largely unsuccessfully

³Letter, W.M. Jardine to Arthur Capper, 31 March 1925. NARA/KC, 12, 14-6.

on rent-seeking bills such as McNary-Haugen. Secondly, there was a very strong feeling in Washington that the GFA would need time to accumulate enough information about the functioning of markets.⁴ Thirdly, the CBOT remained vigilant in Washington and elsewhere for signs of new legislation. Finally, the ideological biases of the Coolidge and Hoover administrations resulted in no legislative interest in amending the Act.

4.2.1 *Cooperatives and Parity Pricing*

One of the main agitators for more efficient commodity markets became significantly less focused on futures markets by the time the 1922 Act was passed, removing a key interest group from post-1923 policy debates. The Farm Bloc and other interventionists were predominantly concerned with achieving higher farm prices. The Bloc had already over-extended itself, so had little appetite to fight for futures regulation.⁵ As a result, by December 1923, the Congressional Bloc leaders had agreed that the 1922 Act would be the last word on regulation for some time, given that it met the needs of its constituents.⁶ Therefore, the ascension of the Bloc to power precluded, rather than encouraged, additional regulation.⁷

By 1923 many proposed schemes were devised to help farmers with their surpluses. The International Farm Congress in Kansas City, which developed a plan to involve the government in marketing the wheat surplus internationally while fixing a price for domestic use,⁸ received support from many Congressmen.⁹ Wallace and Coolidge, however, were listening rather than doing, i.e. 'securing the best of advice and information, as well as listening to opinions and ideas of a wide range of persons'.¹⁰ Supply management at the farm level was considered to be the better option.¹¹ Wallace had Dr. H.C. Taylor of the Bureau of

⁴Letter, MacMillan to Fones, 22 December 1923. CME III.667.2.

⁵Letter, MacMillan to Fones, 4 October 1923. CME III.666.10.

⁶Letter, Fones to MacMillan, 19 December 1923. CME III.667.2; Letter, MacMillan to Fones, 18 December 1923. CME III.667.2.

⁷Letter, MacMillan to Fones, 22 December 1923. CME III.667.2.

⁸Letter, MacMillan to Fones, 11 October 1923. CME III.666.10.

⁹Ibid.

¹⁰Letter, MacMillan to Fones, 19 September 1923. CME III.660.10.

¹¹Ibid.

Agricultural Economics lead a study of the farm relief problems to report back by autumn 1923.¹² However, his *Report to the President of the Wheat Situation* was seen by the Board to be ‘colorless’, recommending the setting up of a commission as well as an export corporation.¹³ In the event, Coolidge did not put any export plan before Congress.¹⁴ However, the issue of cooperatives being denied access to the Chicago Board’s membership remained important to legislators, such as Capper and USDA Secretary Jardine, who were unhappy with the lack of progress, if unsure how to proceed.¹⁵

The legislative solution finally proposed was to help farmers help themselves, hence the Capper-Volstead Act. Indeed many pro-business actors, including Coolidge himself, felt that empowering farmers in the marketing chain would be more than adequate support. Indeed, Wallace had stated in late 1923 that ‘the farmers are to blame for their troubles’, while on 10 October 1923 even Capper said ‘the troubles of the farmers - all of them – cannot be straightened out by legislation. There is too much legislation by congress’.¹⁶ At the same time, by way of mergers and evolving their business models, cooperatives were gaining strength. In October 1923, for example, the US Grain Growers of Minneapolis and the American Wheat Growers merged with a promise to encourage cooperative marketing.¹⁷

4.2.2 *Taking the Time to Investigate the Markets*

After the Grain Futures Act passed in 1922, neither the USDA nor Congress was interested in any regulatory changes until more information accumulated, and new regulation was unlikely without the USDA’s support. It was obvious at the time that ‘the intention of Congress as understood by this department has been to dispel the mystery which has always beset the public mind with reference to trading in grain futures’.¹⁸

¹²Letter, MacMillan to Fones, 25 August 1923. CME III.666.10.

¹³Letter, MacMillan to Fones, 1 October 1923. CME III.666.10.

¹⁴Letter, MacMillan to Fones, 8 December 1923. CME III.667.2.

¹⁵Telegram, Jardine to Carey, 24 August 1925. CME III.11.5.

¹⁶Letter, MacMillan to Fones, 11 October 1923. CME III.666.10.

¹⁷Ibid.

¹⁸US Department of Agriculture, *Annual Report of the Secretary of Agriculture for the Year Ended June 30, 1924* (Washington, DC: Government Printing Office, 1924), p. 60.

The Farm Bloc and the GFA felt the same way. Brand, of the GFA, wrote to Capper, 'It seems to me that all of the avenues of correction and restraint presented by the Capper-Tincher Futures Act as it stands should be exhausted before any additional legislation is undertaken'.¹⁹ Capper believed that 'Congress will not seriously consider anything in the way of amendments to this law, unless they are proposed by the Secretary of Agriculture who is responsible for the administration of the law'.²⁰ However, this did not stop Capper from suggesting to GFA staff-ers in 1925 that perhaps some amendment to the Act would have prevented the 'Cutten Corner' problem.²¹

That the USDA was disinclined to consider new legislation was made clear from the response by Wallace and Duvel to Senate Bill S 454, which tried to ban futures after egregious manipulations in 1925. Although the public record was full of damning testimony, there was aggressive private opposition to any such legislation from both the USDA and the GFA, in support of the exchanges.²² Even though the GFA wanted new controlling legislation in principle, it knew it would be unlikely to be successful until after a full investigation of the markets was complete. This did not stop Duvel and others from frequently petitioning the Agriculture Secretary for more powers to punish manipulators after 1926.

4.2.3 *The CBOT Lobby*

An overwhelming body of archival evidence reveals that the CBOT was a very powerful lobby group. Its Washington representatives remained hyper-vigilant throughout the Coolidge years as it enjoyed practically unlimited access to many top legislators. Lobbyists and the executive maintained good relations with its supposed enemies, such as by lunching with Senator Capper. Lobbyists, especially, were insiders in

¹⁹Letter, Charles Brand, Consulting Specialist in Marketing, GFA, to Arthur Capper, 1 June 1925. NARA/KC, 12, 14-6.

²⁰Letter, Capper to Carey, 15 January 1924. CME III.ss1.9; Letter, Capper to Brand, 4 June 1925. NARA/KC, 12, 14-6. Capper agreed with GFA's Brand's suggestion that no new legislation is necessary.

²¹Letter, Capper to Brand, 27 May 1925. NARA/KC, 12, 14-6.

²²Letters between Carey and Gates, 12 May-22 May 1924. CME III.11.10.

Washington, often relaying gossip back to Chicago.²³ An example of such behind the scenes power appears in a letter on 12 May 1924 reporting on the progress of one anti-futures bill. Gates wrote to Carey, ‘In spite of [...] unfavorable factors, we are, confidentially, rather inclined to agree with Congressman Rainey who [believes] that there is still a “splendid majority against [the Bill] in both the House and the Senate”’.²⁴ Legislators were wary of the power of the exchange lobby to the extent that GFA head Duvel noticed in 1929 ‘a hesitancy on the part of the senatorial leaders to incorporate proposed amendments to the Grain Futures Act in the so-called farm relief bill, as to do so [...] would bring down on them the entire forces of the Grain Exchanges in opposition to the [...] bill’.²⁵ While the GFA wanted to make changes to increase their power to fight manipulation, they were regularly thwarted.²⁶ However, due to extensive lobbying the legislators were less likely to press for changes to the regulatory regime. As will be shown in Chapter 5, this lobby remained dominant until 1936. In fact, the CBOT was so prominent in Washington that it even managed to roll back the 1923 Rules on occasion. Besides in D.C., the lobby also defended the Board’s interests at other levels,²⁷ including keeping a close eye on the State legislatures. The CBOT carefully followed the hearings at the various State capitols, especially Springfield, Illinois, to the point of hiring a stenographer to keep their own records of the debates and testimony.²⁸

At the local level, the failure of bills in Illinois in 1921 did not discourage a new attempt by Senator Lantz, with similar bills pending in other States, such as Ohio. However, few bills truly threatened. In a letter to the membership encouraging better self-governance, CBOT President Stream reported that bills to control exchanges were ever in their early stages, writing that ‘on December 11th the *Chicago Tribune* reported that fifteen bills had already been introduced in Congress to regulate Grain

²³Letter, Carey to Arnot, 29 February 1924. CME III.ss1.9; Letter, P.P. Campbell, Washington Lawyer, to L.F. Gates, sent on to J. Stream, president, CBOT, 13 December 1923. CME III.ss1.9.

²⁴Second letter, L.F. Gates to Carey, 12 May 1924. CME III.11.10.

²⁵Letter, Chester Gray, AFBF to Duvel, 16 April 1929. NARA/KC, Box 3, 2-2.

²⁶Letter, Duvel to Morrill, undated. NARA/KC, Box 12, 14-6.

²⁷Letter, J. Mauff to F.W. Upham, 21 June 1922. CME III.ss2.663.4.

²⁸Letter, J. Mauff to Stream, 17 March 1923. CME III.660.8.

exchanges, some of them to stop speculation in Grain altogether'.²⁹ The CBOT did not focus much attention on bills that were unlikely to pass. Bringing necessary firepower to oppose frivolous bills could draw unwanted attention. As one lobbyist observed, 'the situation is [...] almost impossible and hopeless, and it is my opinion that if we come out in the open and oppose the Bill either as a whole or by amendment, that it will simply have the effect of creating later interest in the measure on the part of the state farm bloc'.³⁰ Indeed, there was a sense that support for the cooperative movements, and sentiment against futures trading and grain middlemen in general, was sweeping the Midwest, and the Farm Bloc was assumed to have the votes to 'do what they like. We must be careful'.³¹ As the Secretary of the Grain Dealers National Association wrote on 21 March 1923:

You will see just what the situation is. The country is going through a veritable legislative fever and the situation must be handled carefully. We are in the unfortunate position where open opposition from us may only be playing into the hands of our enemy.³²

His advice was to 'lie low publicly and lobby privately until the fever burns itself out'.³³ Carey, Gates and Barnes had all agreed that the CBOT and the Grain Exchange Legislative Committee should not publicly comment on any bill that had a passing connection to the grain trade unless such a bill was truly a threat—i.e. that it had passed the House—and there was good formal support from the grain trade in the form of, for example, a conference.³⁴ On 21 May 1924, in response to

²⁹Open letter, to the Members of the Board of Trade of the City of Chicago, 18 December 1923. CME III.643.7.

³⁰Letter, Charles Quinn, secretary of Grain Dealers National Association to J. Mauff, 21 March 1923. CME III.2.650.4,

³¹Letter, Charles Quinn to J. Mauff, 21 March 1923. CME III.2.650.4.

³²Ibid.

³³Ibid. CME III.2.650.4; Letter, P.W. MacMillan to CBOT Secretary, 22 December 1923. CME Archives III.667.2; Memorandum, Dies to Carey and Bunnell, 9 January 1926 with attached article: "Farming Bill Wins Support of President," *Chicago Tribune*, 9 January 1926. CME III.15.14.

³⁴Letter, Gates to Carey, 20 May 1924. CME III.11.10.

Gates' letter a day earlier, Carey replied very informatively stating that a certain piece of legislation 'can [not] possibly pass [... and therefore] we can afford to remain silent'.³⁵ But even if direct opposition was rarely needed, the CBOT continued to operate behind the scenes. The CBOT executive was aware enough to be wary of trade-offs in the legislative process, such as logrolling. Gates, on behalf of Carey, would often contact key Congressmen to ascertain the level of threat of any new or proposed bills. In at least one instance, Gates performed an extensive analysis of the potential for a favourable vote in the House after obtaining inside knowledge of the intentions of the key Congressmen. He then proposed that the Midwestern representatives should be more heavily lobbied to ensure 'a comfortable margin'.³⁶

Goings-on in Washington and in state capitals were discussed at the highest level—among the CBOT directorate and also at Legislative Committee meetings. For the first half of the 1920s, there was no chance that futures regulation would be rolled back in the same way that Dodd-Frank is under threat as the memories of the 2008 financial crisis faded. While CBOT President Carey not only did not believe that any anti-futures legislation would be passed, neither could he foresee any pro-futures laws either: 'If we come out and father such a bill [to correct the Act], I cannot think we will get very far with it'.³⁷ Gates confidently added that 'I am quite sure that the Secretary of Agriculture will put nothing of this kind unless it is approved by us'.³⁸ Futures markets had indeed fallen off the Farm Bloc's radar after 1922 and hardly reappeared on the agrarian agendas until the Great Depression. Yet, equally there was no opportunity for the CBOT to propose even more benign legislation in the form of industry-led amendments.³⁹ Capper regularly met with CBOT executives, including President Carey⁴⁰ and soon after an exchange of letters with Capper, Carey wrote to Arnot from his Florida convalescence that he was 'very strong of the opinion that we should let matters rest in Washington this year [...] I am not willing to get behind

³⁵ Letter, L.F. Gates to Carey, 20 May 1924. CME III.11.10.

³⁶ Letter, L.F. Gates to Carey, 12 May 1924. CME III.11.10.

³⁷ Letter, L.F. Carey to Gates, 21 May 1924. CME III.11.10.

³⁸ Letter, Gates to Carey, 5 November 1925. CME III.11.9.

³⁹ Letter, Capper to Carey, 15 January 1924. CME III.ss1.9.

⁴⁰ Ibid.

any move that asks for any radical change in the Capper-Tincher Bill at this time'.⁴¹ Gates was in full agreement.⁴²

In any event, the key representatives of the CBOT believed that they had an act they could work with, with rules that mandated little more than information disclosure of a few 'Special Accounts', together with a legitimised and supported product. As such, there was no reason to engage Congress. CBOT representatives regularly met with the US President and the Secretary of Agriculture, even to the point where politicians found the lobbying egregious. When the Secretary of Agriculture met with CBOT lobbyist Barnes and his grain men, Barnes was hauled before a Senate committee for it.⁴³ Nevertheless, the CBOT was able to successfully influence the 1922 Act, many of the 1923 Rules and the staff responsible for administering it.

Public silence on policy matters was hard to achieve. Even though the CBOT executive wanted to limit the amount of pressure it put on the legislative process, if only because 'it would be a waste of good ammunition',⁴⁴ there was always a risk of rogue interests in the membership advocating a suicidal idea. It is very clear from the Carey-Gates correspondence in 1924 that the membership as a whole rarely agreed on anything—i.e. 'I am sure this market is not a unit and there is considerable argument'.⁴⁵ In 1924, a minority of powerful members led by a director, Mr. Brosseau, had formed a committee that made arrangements with a lobbyist in Washington to establish their own parallel lobby group. Even if there would have been a window for legislative change, the Board's membership could not agree on what changes to propose: 'such suggestions [...] for modifications have been in the most general terms. What is needed is a well worked out program [...] Simple general statements are not sufficient'.⁴⁶

In this, as on many other issues, a united front never materialised during the interwar years. The CBOT remained on the lookout for an

⁴¹ Letter, Carey to Arnot, 29 February 1924. CME III.ss1.9.

⁴² Ibid.

⁴³ Memorandum to the Exchanges from P.W. MacMillan, republishing Senator Caraway's open letter to Julius Barnes, 23 December 1929. CME III.16.15.

⁴⁴ Letter, Gates to Carey, 22 November 1924. CME III.11.9.

⁴⁵ Letter, Carey to Gates in Washington, 12 May 1924. CME III.11.9.

⁴⁶ Letter, Gates to Carey, 9 May 1924. CME III.11.9.

opportune time to introduce amendments to the Act, or push through new legislation, but the Cutten corner of 1925 and the general support for farmers' cooperative marketing efforts meant that there was never a good moment.⁴⁷ As Carey wrote to Gates on 12 May 1924, 'There has been no time [...] up to now when I thought it would be advisable to propose any changes to the Act'.⁴⁸ For example in 1924 and 1925, there was the presidential election to worry about, as well as an attempt to solve the farm problem with such bills as McNary-Haugen.⁴⁹

4.2.4 *Ideological Bias Against New Legislation*

In the mid- to the late 1920s, the White House was at least as anti-regulation as Congress. The story of the GFA's early years, beginning in 1923, the 1924–1925 Cutten Corner and the innovations that followed in 1926 spans two US Presidents and three Agricultural Secretaries. Henry C. Wallace remained the Secretary of Agriculture since his appointment by President Harding on 5 March 1921, and it was under him that the GFA and the Rules came into being. The developments in modern futures markets that are the subject of this chapter occurred during the early years of William M. Jardine's tenure at the USDA from 5 March 1925 to 4 March 1929 under Calvin Coolidge. Harding, Coolidge, Wallace, Gore and Jardine were all Republicans, as were their successors on 6 March 1929, Secretary Arthur Hyde and President Herbert Hoover. Coolidge was generally against economic regulation, even as he was sceptical of Hoover's pro-business initiatives.⁵⁰

One example of Coolidge's biases occurred when CBOT member C.W. Lonsdale had a conference with Secretary Jardine in early 1926. It was clear that the Dickinson Bill that would set a tariff-protected domestic price floor for wheat would not pass due to the president's fundamental ideological objections: 'The administration at Washington has gained

⁴⁷Letter, Carey to Gates, 12 May 1924. CME III.11.9.

⁴⁸Letter, Carey to Gates, 12 May 1924. CME III.11.9; see also Letter, MacMillan to Carey, 9 May 1924. CME III.11.9.

⁴⁹Letter, Gates to Carey, 9 May 1924. CME III.11.9.

⁵⁰Marc Winerman and William E. Kovacic, "Outpost Years for a Start up Agency: The FTC from 1921–1925," *Antitrust Law Journal* 77 (2010): 145–203.

considerable reputation by standing firm for sound business methods and frankly telling the public it would not stand for any wildcat law which directly or indirectly puts the government into business'.⁵¹ The USDA was seen by the president to be the source of expertise in legislative issues concerning the futures markets; however, Jardine did not hold any overriding power at the White House. Outside pressure—whether from Capper, the Board or other interests—for change had no hope of succeeding.

4.3 INFORMATION GATHERING AT THE GRAIN FUTURES ADMINISTRATION

Chester Morrill, before becoming Secretary of the Federal Reserve Board, was a young solicitor and cotton expert when he was placed in charge of cotton and warehouse divisions in 1913 by the head of the USDA's Bureau of Markets. Henry C. Taylor became Bureau of Markets chief soon after, and eventually headed the Bureau of Agricultural Economics that was to have a huge influence on the 1930s legislation.⁵² By 5 May 1923, it was clear that Morrill would be in charge of both the GFA and the Packers and Stockyards Administration, with Duvel and Mathewson as field supervisors.⁵³ Rollin E. Smith, 'well known to the trade in Minnesota', would be assistant to Morrill, who would be the day-to-day administrator.⁵⁴ Smith had been a floor trader who wrote a long study *Hedging in the Futures Market*, published by the Board around 1919. Dr. J.W.T. Duvel, formerly the Grain Exchange Supervisor in Chicago for three years, replaced Morrill in Washington in 1925, with L.A. Fitz replacing Duvel in Chicago. As such, the first three key regulators were acknowledged experts, with one coming from the industry about to be supervised.

⁵¹Letter, Carey to C.W. Lonsdale, Simonds-Shields-Lonsdale Co., Kansas City, 13 January 1926. CME III.ss1.9; Memorandum, Dies to Carey and Bunnell, 8 January 1926. CME III.15.14; Memorandum from Dies to Carey and Bunnell, 7 January 1926. CME III.15.14; Memorandum, Dies to Bunnell, 11 January 1926. CME III.15.14.

⁵²C. Clyde Jones, "Henry C. Taylor: Father of Agricultural Economics (1873–)," *Agricultural History* 32 (1958): 196–197.

⁵³Letter, MacMillan to Fones, 5 May 1923. CME III.667.2.

⁵⁴Letter, MacMillan to Fones, 20 April 1923. CME III.667.3.

The CBOT was asked to fill the remaining supervisory roles in June 1923, a chance that should not have been passed up.⁵⁵ However, after experienced directors Robert McDougal, Sam Arnot and Hiram Sager had all declined to join Duvel, the GFA hired Paul Mehl, who had struggled against the Board as a leader of one of the early cooperatives.⁵⁶ As a result, though the CBOT had the opportunity to stack the deck in its favour using the ‘revolving door’, the GFA remained solidly independent and technocratic for the time being. That the GFA remained neutral and not captured was perhaps an accident, but it may have been the most important result of the 1923 establishment of the GFA.

In fact, the revolving door between government, industry and academia was more open in the other direction. When the CBOT was considering a cotton futures contract, it took an employee from Herbert Hoover’s Commerce Department on secondment and then full-time and another grain industry expert went from the GFA to Continental Grain and then back to the GFA in 1931.⁵⁷ Herbert Hoover had responded to Carey on 20 September 1924, ‘it is some consolation to know that the experience to be gained in a Government Department may increase rather than lessen a man’s usefulness in private business’.⁵⁸

4.3.1 *The 1923 Rules and Regulations*

On 16 April 1923, the Supreme Court ruled in favour of the government and upheld the constitutionality of the Grain Futures Act.⁵⁹ As the law was to go into effect immediately, it became necessary to revisit the draft Rules that Duvel and Morrill had drafted in 1921.⁶⁰ The CBOT, which conformed to the 1922 Act as accurately, diligently and quickly as possible, pressured other exchanges to follow suit, reporting

⁵⁵Letter, Mauff to Stream, 21 June 1923. CME III.660.7; Telegram, Mauff to Hiram N. Sager, 21 June 1923. CME III.660.1.

⁵⁶Letter, Mauff to Stream, 22 June 1923. CME III.660.7; Letter, Mauff to Stream, 21 June 1923. CME III.660.7.

⁵⁷Letter, F. Carey to Herbert Hoover, Secretary of Commerce, 17 September 1924. CME III.ss1.9. Note, Duvel. NARA KC, 19-1.

⁵⁸Letter, Hoover to Carey, 20 September 1924. CME III.ss1.9.

⁵⁹*Board of Trade of City of Chicago v. Olsen* 262 U.S. 1 (1923). Decided 16 April, Argued 26 February 1923.

⁶⁰Letter, MacMillan to Fones, 16 April 1923. CME III.667.3.

transgressions by other exchanges to the Secretary of Agriculture.⁶¹ As is generally the case, in rewriting the Rules to conform to the 1922 Act, there was room for significant interpretation of the Act itself.⁶²

Some new rules were simple and uncontroversial, such as having those found guilty of corners or other manipulation expelled by the Board rather than just suspended, even if the information demands would be resisted by much of the membership.⁶³ Yet, when some CBOT members complained bitterly in public about the informational requirements, Wallace castigated the exchanges, saying:

Violent opponents of the law have always claimed that [it...] affected legitimate operations, [but that was because of ...] persistent misrepresentation by men who ought to know better. The quicker the law and the rules and regulations are accepted in good faith [...] the better it will be for every legitimate interest.⁶⁴

The exchanges up to this point viewed the Rules as another opportunity to water down the legislation indirectly through appointing exchange-friendly staffers at the new regulatory agency or by rendering the Rules harmless. However, the new Rules required more from exchange members than they had anticipated, since daily reports were now expected that had to include detailed information about all the positions of clearing members and those of certain large Special Accounts.⁶⁵ The membership thought that they were both impossible to produce and irrelevant, given the weak oversight that was mandated by the Act. Before this, members' data were their own, and there was no possibility of compelling members to provide it to the directorate, the executive or any committee, let alone the government. Prices were of course reported by floor reporters in real time, but that was the extent of the transparency at the Board. Concern also focused on the potential uses of such

⁶¹L.F. Gates wrote to the Secretary of Agriculture reporting a violation by the KBOT in letter, Stream to Mauff, 21 March 1923. CME III.660.8.

⁶²Letter, Stream to Mauff, 21 April 1923. CME III.660.7.

⁶³Letter, Stream to Mauff, 24 March 1923. CME III.660.7.

⁶⁴Letter, MacMillan to Fones, 2 June 1923. CME III.667.2; Letter, Mauff to Stream, 23 June 1923. CME III.660.7; Telegram, MacMillan to Fones, 27 June 1923. CME III.667.1. Quote from Future Trading Regulations Report, 22 June 1923. CME III.667.4.

⁶⁵Ibid.

confidential information should it fall into the ‘wrong’ hand—that is, other traders. Nevertheless, Morrill concluded ‘that we cannot get along without daily reports’.⁶⁶

The final Rules and Regulations of the Act signed by Secretary Wallace in Des Moines required reports to include the following information for each clearing member of the market:

1. The net position [number of contracts long or short] at the beginning of the period covered by the report.
2. The quantity of grain purchased and the quantity of grain sold on contracts.
3. The quantity of grain delivered and received.
4. The net position at the end of the day.
5. The aggregate of all long and short accounts.
6. The net position at the end of the day of each separate account carried by the firm making the report, if the net position equals or exceeds such amount as may be specified by the administration [a ‘Special Account’]. It is understood that this amount may vary according to the size of the different markets.⁶⁷

The underlying records and their sources were to be kept and furnished to the GFA when requested.⁶⁸ The Special Account hurdle was initially set at 500,000 bushels long or short.

The CBOT directorate, though not the executive, was livid that the 1922 Act had actually made some substantive demands on the membership, rather than simply protecting and encouraging the Board’s activities. By 1924, the Exchange Legislative Committee was of the opinion that:

Our trouble under the Act has come from regulations of the Department of Agriculture rather than the Act itself. A more friendly attitude on the part of the secretary of agriculture would obviate much of present

⁶⁶Letter, Morrill to C.W. Lonsdale, KBOT, 26 May 1923. CME III.667.2.

⁶⁷Letter, F.B. Wells to Mauff, 13 June 1923. CME III.667.1; Future Trading Regulations Report, 22 June 1923. CME III.667.4.

⁶⁸Ibid.

troubles, and such friendly attitude can hardly be expected of the present incumbent. The officials representing the Trade should canvass the field for a desirable successor to be suggested at such time as a change is indicated.⁶⁹

The above report had two important implications. Firstly, as shown previously, the exchanges did not view the Act itself as particularly problematic and were surprised when some power was exercised by the USDA, even if purely in a supervisory and not controlling role. Secondly, as theory predicted, many command and control elements—or lack thereof—were often written into the formal and informal rules applied by the agency responsible for the day-to-day administration of the original Act, and this appears to have been the case here.⁷⁰ As such, it is necessary to study not just the Acts but also the Rules in order to assess the effectiveness of the regulation. While the Act was captured by lobbying, the Rules were designed to give the GFA the most power it could glean from the Act, as both the USDA and Congress, never mind the White House, believed that transparency and analysis were in fact the key elements of the regulatory regime. The CBOT should not have been surprised, therefore, that it had to ‘pay’ the government in information for receiving its legitimacy and protected monopoly. The CBOT would not have given this information up freely, and who knows what the impact would have been on the present-day futures markets if such data had never been collected, distributed or analysed.

The CBOT membership displayed strong opinions and obvious disunity upon hearing that Wallace had ignored at least one major concern when he approved the Rules. While the directorate did not threaten to close the Board, some vocal members felt that it was a legitimate form of protest, and were quoted by the press as threatening such action.⁷¹ The grain trade was said to be ‘furious’ and set up a group ‘with the

⁶⁹Memorandum to the Members of the Exchange Legislative Committee, mid-1924. CME III.15.8.iii.

⁷⁰Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation* (Oxford: Oxford University Press, 2011).

⁷¹Letter, Duvel to Morrill, 2 August 1923. NARA/KC, 101-1

thought expressed to give the ninety-days' notice of the termination of this association as a contract market in wheat'.⁷² A few days later, exchange members were spreading rumours that the enforcement of any reporting requirements would 'be construed as the dead line for speculation'.⁷³ Duvel, however, was confident that the Board would never make good on any of its threats. Consequently, he and Morrill ignored the often-hysterical concerns that daily reports could not be produced at all, never mind by next morning, and stuck to their demands for timely position reporting.⁷⁴

We know that the directorate made many attempts to calm the membership, knowing full well that the legislation was toothless (Section 3.3.4). The CBOT executive found it necessary to remind members, often half-heartedly as it had to balance its relationship between reactionary members and the GFA, that the GFA had the right to inspect books.⁷⁵ Not only were many members regularly late in filing, but many others protested the GFA's very existence.⁷⁶ Pushback on reporting requirements came from almost all members, who could not easily cope with the increased workload.⁷⁷

But the information demands benefitted more than just the GFA. The truth was that most firms did not keep adequate records, even for themselves.⁷⁸ The Rules offered firms a chance to improve their internal systems. Yet at the same time, there were genuine concerns. As mentioned earlier, a big concern was the security of confidential information. One firm complained that the inspections 'will substantiate no facts, and give no basis for clear determination, so far as we can see, of any of the objects which might bear upon business'.⁷⁹ The committee

⁷²Letter, Mauff to Stream, 23 June 1923. CME III.660.7.

⁷³Letter, Mauff to Stream, 25 June 1923. CME III.660.7.

⁷⁴Letter, Duvel to Morrill, 2 August 1923. NARA/KC, 101-1; Letter, F.B. Wells to Mauff, 13 June 1923. CME III.667.1.

⁷⁵Letter, Lewis Alsberg from Secretary of CBOT, 31 October 1923. CME III.642.1.

⁷⁶Ibid.

⁷⁷Letter, member representing Seaverns & Co. to Duvel, complaining that "it will increase the cost of doing business inasmuch as the more voluminous the reports are made, the larger the office force necessary to compile them," 19 May 1923. CME III.667.4.

⁷⁸Joseph Martin Mehl, *Hedging in Grain Futures* (Circular No. 151) (Washington, DC: Government Printing Office, 1931).

⁷⁹Letter, member representing Pope & Eckhardt Co. to Duvel, 17 May 1923. CME III.667.4.

speaking for Chicago, Minneapolis, Kansas City, St. Louis, Duluth and Milwaukee wrote to Morrill and Wallace that ‘no good purpose will be served by collecting the data’.⁸⁰ Even Mauff was a little bit miffed that the lobbying effort in Washington turned out to be ‘an awful waste of time and effort on the part of the committee’.⁸¹ Nevertheless, he did feel that convincing the Agricultural Secretary to have the committee suggest supervisors, having the CBOT benefit from the ‘revolving door’, was a significant success.⁸²

The CBOT directorate, unlike the membership, were nonplussed by the GFA’s demands. Not only did Mauff and Stream believe that the reporting would have no impact on futures trading, they felt it incumbent on themselves to ‘refute allegations to the contrary with considerable publicity’.⁸³ In an article in the *Chicago Tribune* in March 1924, an ‘official of the Board’ was very clear in the article that neither the Act nor the Rules had unduly affected futures volume.⁸⁴ Although the CBOT executive was supportive of the Rules privately, the biased public record often erroneously stated otherwise. For example, another *Chicago Tribune* article about the Rules ‘carried the impression that [the executive] had recommended closing the Exchange as a result of the regulations under the Grain Futures Act’.⁸⁵ But of course it was rather only certain elements of the membership that leaked such a possibility. The executive of the CBOT was in fact cognisant of the information deficit and mostly agreed with the government that such transparency was good for the markets.

L.C. Brosseau was chairman of the CBOT’s Legal Advice and Rules Committee in 1923 when the Board had to conform to the Rules.⁸⁶ Rewriting the CBOT’s own rules was not a trivial exercise, and there often existed a significant disagreement on what conforming entailed

⁸⁰Letter, Exchange Committee to Morrill, 18 May 1923. CME III.667.4.

⁸¹Letter, Mauff to Stream, 23 June 1923. CME III.660.7.

⁸²Ibid.

⁸³Letter, Mauff to Stream, 25 June 1923. CME III.660.7.

⁸⁴“US Eyes Undue Drop in Grains,” *Chicago Tribune*, 30 March 1924.

⁸⁵Letter, Duvel to Morrill, 2 August 1923. NARA/KC, 101-1.

⁸⁶Letter, Fones to L.C. Brosseau, Chairman of legal advice and rules committee, 15 June 1923. CME III.659.1.

among the membership, with the executive, Board counsel and the GFA often all in disagreement.⁸⁷ At one point an exasperated Mauff demanded counsel to accept the GFA proposal, whereas, at times he expressed frustration with the GFA's views and on 2 May 1923 he sent them to counsel with a note:

Comment is unnecessary because you will readily perceive that what is contained therein is not practical and workable and would completely ruin the futures market [...] We would like to have your views and also any suggestions as to just how much of this we could eliminate and still have the rules and regulations consistent with the Grain Futures Act.⁸⁸

If the membership and the executive were at odds on the desirability of certain rules, it was worse across the exchanges. The CBOT's interests and those of the smaller exchanges often diverged. For example, one rule vilified by the CBOT was welcomed by Baltimore.⁸⁹

4.3.2 Inspections

Even before the Rules were put into effect in 1923, the GFA was given the right to inspect the books of CBOT members as part of the 1922 Act. Even if the GFA had no enforcement powers, the theme of transparency carried over into detailed investigations into member conduct. Duvel reported to Rollin Smith on 13 August 1923 the results of his investigation of a potential corner of July oats and corn. After examining all transactions at the end of the July 1923 delivery month, Duvel was able to ascertain that 'I do not think [certain operators] undertook to force the price too high' by cornering the market, even though there was an extra 205,000 bushels of oats that they were defaulted on and had to be satisfied with a settlement price set by a CBOT committee.⁹⁰ Reports like these were useful to the Agricultural Secretary in responding to the many inquiries he received from Congress, the administration, industry

⁸⁷Ibid.

⁸⁸Letter, Robbins to Mauff, 29 May 1923. CME III.659.2; Letter, Mauff to Robbins, 2 May 1923. CME III.659.2.

⁸⁹Letter, Secretary of the Baltimore Chamber of Commerce to Fones, 10 July 1923. CME III.642.7.

⁹⁰Letter, Duvel to Rollin Smith, 13 August 1923. NARA/KC, 101-1-1.

leaders and lobbyists. In another case, on 2 May 1922, Duvel verified intelligence received through the secretary that speculators were fighting on both the long and the short side to the point that hedgers ‘are afraid to hedge in May owing to the tight condition and do not like to hedge in July or September because the latter two are at a considerable discount under May’.⁹¹

One of the first truly significant reports concerned the famous New York speculator, Jesse L. Livermore, a frequenter of bucket shops as a boy and a famous personality of twentieth-century stock market lore.⁹² In October 1922, after attempting to get the CBOT to fight an inquiry, Livermore told the Federal Trade Commission that in 1921 he bought 7 million bushels of wheat futures in Chicago in twenty minutes without moving the market.⁹³ Duvel immediately investigated this far-fetched claim by obtaining records of any trades by Livermore or his known associates. Referring to his source by code number, Duvel reported that a ‘Mr (3)’ said the orders reached Chicago via Ware and Leland, where the other famous speculator of the age, Arthur Cutten, had an office.⁹⁴ Apparently Cutten was shown Livermore’s orders before they were sent to the pit, thus the orders were ‘crossed’ between the two parties off the exchange floor, as is quite common today in stock trading.⁹⁵ Duvel had identified a particularly large bucketing trade, but the conclusion was reached that Livermore’s trades were not illegal or unethical at the time.⁹⁶ That is, they would not pass muster today. Such conclusions impacted future policy. As I document in Chapter 5, such investigations eventually resulted in further anti-bucketing legislation in 1936.

GFA operations did not always run smoothly, and there were many misunderstandings between the grain men and Duvel. A casual comment by the GFA could move markets as easily as a spurious rumour. This occurred on 29 March 1924, when Duvel put up a notice under clause 7 of the 1922 Act asking members for information about why markets

⁹¹Letter, Duvel to Morrill, 2 May 1922. NARA/KC, 101-1-1.

⁹²For example, see Tom Rubython, *Jesse Livermore—Boy Plunger: The Man Who Sold America Short in 1929* (Croydon, UK: Myrtle Press, 2014).

⁹³Telegram, ‘TJB’ to John Mauff, 15 June 1922. CME III.ss2.653.4.

⁹⁴Memorandum for Files, USDA Administration of the Grain Future Trading Act, by Dr. J.W.T. Duvel, 13 October 1922. NARA/KC, 101-1-1.

⁹⁵Ibid.

⁹⁶Ibid.

appeared ‘unduly depressed’, especially in corn but also in wheat. Traders wondered if Duvel had inside information about the position of certain large traders, and so the Board members sought a hearing with the grain supervisor. They argued that Duvel had no right to interfere in the markets. The *Chicago Tribune* reported that ‘members were disposed to put their own construction of what Clause 7 [...] means’.⁹⁷ Duvel also wanted to ‘publish the net positions of the Chicago market’, which Carey thought dangerous and not in any spirit of cooperation.⁹⁸

It is hard to believe, given how widespread and useful such information is today, but even simple price and volume data were only grudgingly distributed, even after 1923. One CBOT member complained to Fones that there was not any good reason to require the public dissemination of futures volume data.⁹⁹ He argued that, as the information was privately and confidentially furnished to the USDA, there was no reason to distribute it further. Unlike today, the lack of transparency was not felt to be an impediment to free markets.

The CBOT membership was generally against the release of any data to users or the public, even when its executive accepted there was no obvious reason to oppose it. Occasionally the directorate had to acquiesce—or at least be seen to be acquiescing—to the membership. Carey mirrored the public opinion of the Board on 26 December 1924 when, in a conference, he ‘condemned the position taken by the department in releasing any of these figures – even the daily volume of trade’.¹⁰⁰ Carey wrote that ‘it [was] harmful to the Institution and that the government had no right to do so and that it is very unfair’.¹⁰¹ However, he admitted in private that ‘so far as he knew [the release of the figures] had worked no hardship and had not done any harm’.¹⁰² In his official letter to the secretary, Carey more circumspectly asked the secretary for warning if data were to be released, and also to be consulted before any action was taken. If they had been consulted, he wrote, ‘we might have shown you that such statement[s] should be approached with the utmost care [as] the protective service of the Exchange Trading might be greatly

⁹⁷“US Eyes Undue Drop in Grains,” *Chicago Tribune*, 30 March 1924.

⁹⁸Letter, Carey to Gates, 29 December 1924. CME III.11.9.

⁹⁹Letter, T. Cunningham, Hathrop & Co., to Fones, 30 August 1923. CME III.16.6.

¹⁰⁰Letter, Duvel to Morrill, 27 December 1924. NARA/KC, 101-1.

¹⁰¹Ibid.

¹⁰²Ibid.

undermined to the express disadvantage of the American farm'.¹⁰³ However, Duvel saw the demand to be warned and consulted as effective censorship, given that the Board was opposed to the release of any data on a timely basis.

While there are many examples after 1925 in the archives of cases where the GFA and CBOT worked together to address manipulation after the bureaucrats brought suspicious activity to the Board's attention, there was a good deal of pushback at this time from a membership affronted by the enthusiasm and persistence of the GFA Chicago office. The CBOT favoured the Act, of course, but members continued to complain to the directorate and to the executive about the amount of information demanded. Carey in a letter to Gates suggested appealing to Secretary Gore to tone down the information requests.¹⁰⁴

But any worries that the GFA was going to somehow police the markets and control the membership were extremely unfounded. For one thing, the Act was toothless, and the Rules not much less so. And the GFA, especially Duval, was sympathetic to many issues at the Board. In fact, despite the pushback on the reporting requirements and information dissemination, in the early years of the Act's administration the GFA was often on the side of the Board, especially in legislative hearings. For example, when Senate Bill S 454 tried to ban futures after egregious manipulation in 1925, although the public record was full of damning testimony, there was opposition to any such legislation by Secretary Wallace and Duvel. The GFA wanted free markets as long as they were fair and efficient. Even so, Wallace and his team at the USDA were not viewed as friends to the industry. Carey argued that:

The best move we can make in the interest of the entire grain trade is to lay the ground for a new Secretary of Agriculture, getting a man in there who understands the grain interests and then we can probably shape [new] legislation, with the endorsement of the Agriculture Department.¹⁰⁵

The membership often complained of 'socialistic people in the Agricultural Department', recommending that the CBOT should work

¹⁰³Letter, F. Carey to the Secretary of Agriculture, 26 December 1924. NARA/KC, 101-1.

¹⁰⁴Letter, Carey to Gates, 29 December 1924. CME III.11.9.

¹⁰⁵Letter, Carey to Gates, 21 May 1924. CME III.11.10.

to ‘get them out’.¹⁰⁶ In one classic example, Siebel Harris, a powerful CBOT member from Cross, Roy & Saunders Inc. in Chicago, complained that:

Dr. Duval is inclined to favour [...] prohibit[ing] brokers [...] doing a brokerage or commission business in futures for customers from speculating in great futures for their own account. [His contact] calls attention to the fact that this would put them out of business, as well as nearly all of the leading houses. He states that no firm there could live on its commissions.¹⁰⁷

What is interesting about the specific case is that Siebel was obviously unaware that the CBOT’s rules already prohibited a member from acting as agent and principal in the same transaction. In fact, it is likely that the CBOT did not enforce many of its own rules at this time because of pushback from powerful elements of the membership. Ironically, CBOT members resented the GFA’s attempts to enforce—or have enforced—the rules the Board itself had developed over the previous sixty or so years.

In theory, it is often difficult for associations to enforce rules on its membership, since all actors are part of the same club and have to deal with each other on a day-to-day basis.¹⁰⁸ But the executive was interested in enforcing rules that would give the impression of an efficient and fair marketplace, even if such enforcement was difficult to effect. In 1926, however, the inspections and the BCC were the solutions to this additional collective action problem.

4.3.3 *Governance by Threats Rather Than Laws*

Regardless of the GFA’s lack of power, the CBOT executive, along with progressive elements of the membership wanted markets that, at the very least, *appeared* fair and efficient, and often encouraged the GFA to bring

¹⁰⁶Letter, Carey to Gates, 29 December 1924. CME III.11.9.

¹⁰⁷Letter, Siebel Harris to the Board of Directors of the CBOT, 20 August 1923. CME III.16.6.

¹⁰⁸For example, see Richard L. Abel, *The Legal Profession in England and Wales* (Oxford: Blackwell, 1988), pp. 250–258. For a summary, see Anthony Ogus, “Rethinking Self-Regulation,” *Oxford Journal of Legal Studies* 15 (1995): 98–99.

the committees evidence of wrongdoing. Alone, the GFA or the USDA had limited powers. As such, when the government felt the need to step in on some important issue, their tools of control were limited to moral suasion, threats of future legislation and negative public relations.¹⁰⁹

According to Chester Morrill, the GFA was intended to mirror the philosophy of the rest of the USDA. In his 1952 oral history Morrill stated that:

Secretary Wallace personally laid down the view that [...] the elimination of an undesirable practice or the institution of a desirable practice by informal methods [...] would be [...] in the public interest [and that ...] formal procedures should be resorted only when it was apparent that the interested parties were unable or unwilling to agree with the administration without formal proceedings.¹¹⁰

In 1925 and 1926, the GFA and the secretary were able to significantly influence the evolution of the most dominant futures markets in the world. The goal was more important than the method.

4.3.4 Information as Goal and Outcome

One of the key themes throughout this study is that the US Federal Government—the powerful agriculture committees as well as the USDA—was not interested in controlling the futures markets, but focused instead on having a regulatory agency gather information in order to ascertain whether or not control was actually necessary. There is hard and circumstantial evidence for this up to 1925. For instance, both private correspondence and public reports are littered with references to the main function of the GFA being one of information gathering.

Both the USDA and the GFA had now opined both publicly and privately that the Rules were intended to gather information as well as in order to market the benefits of the futures market to the public. On 21 October 1924, Morrill wrote to USDA economist H.C. Taylor that the

¹⁰⁹Telegram, Barnes to Gates, 12 May 1919. CME III.s1.6.

¹¹⁰Chester Morrill with Dean Albertson, *Oral History* (New York: Transcript from Columbia University, 1952), p. 88.

Grain Futures Act of 1922 was intended to gather information for legislators and the general public.¹¹¹

In the Agriculture Secretary's 1923 *Annual Report*, he was non-committal with respect to the potential advantages for farmers under the Act: 'The law which brings the grain future trading markets under Government supervision has afforded an opportunity for an investigation and study of these markets which in time should lead to beneficial results'.¹¹² In the 1924 *Annual Report of the Department of Agriculture*, Secretary Gore wrote that:

An opportunity was given the Government for the first time under the Future Trading Act to supervise and study the operations of grain exchanges [...] In time systematic studies now being made should enable us to form a reliable opinion as to the value and function of grain exchanges. Heretofore these institutions have been regarded in some quarters as wholly good and in other quarters as wholly bad. These conflicting opinions were not based on adequate knowledge. No one had the necessary information to form a trustworthy opinion as to the merits and demerits of grain exchanges. It is now possible to learn what takes place on grain exchanges [...] and to form an idea of the effect of grain-exchange trading on prices.¹¹³

The *Report* added that:

A discriminating public opinion is beginning to grow up on the basis of facts ascertained and published by the grain futures administration [...] The intention of Congress as understood by this department has been to dispel the mystery which has always beset the public mind with reference to trading in grain futures [...] for both the seasons during which the grain futures act has been in effect.¹¹⁴

¹¹¹Memorandum, Morrill to Dr. H.C. Taylor, 21 October 1924. NARA/KC, Box 12, 14-15.

¹¹²US Department of Agriculture, *Annual Reports of the Department of Agriculture for the Year Ended June 30, 1923* (Washington, DC: Government Printing Office, 1923), p. 57.

¹¹³US Department of Agriculture, *Annual Reports of the Department of Agriculture for the Year Ended June 30, 1924* (Washington, DC: Government Printing Office, 1924), p. 26.

¹¹⁴US Department of Agriculture, *Annual Reports of the Department of Agriculture for the Year Ended June 30, 1924* (Washington, DC: Government Printing Office, 1924), pp. 59-61.

Nowhere in the *Annual Reports* is control mentioned, neither does it show up in the private record.

This information—that turned out to be difficult to obtain—gathered by the GFA immediately allowed it to understand markets better, and helped the USDA respond to criticisms of market behaviour. That is, the information helped government defend futures markets from any outside *and* inside criticism. In one example, in late 1923, Senator Capper had reported some Illinois farmers complaining of a ‘bear’ raid by large speculators. Secretary Wallace ascertained from his Chicago office that many of the largest accounts were likely hedgers and, anyway, short interest was not concentrated in so few hands.¹¹⁵ Equally, Chester Morrill at the USDA was able to reassure Senator Capper that ‘Your letter of the 3rd with reference to the administration of the Grain Futures Act in connection with the possibility of a “May squeeze” in the wheat futures market has been received [...] A copy [...] is being sent to our Chicago office, with the suggestion that the market be watched with more than usual care’.¹¹⁶

The GFA and the USDA pressed hard for the timely release of key data and in 1924 the GFA began to provide open interest information for each future on the following day. Duvel issued a press release countering rumours in the Chicago press that Arthur Cutten was ‘holding the biggest line of [grain futures] that probably one individual ever carried in the history of the Board of Trade’.¹¹⁷ The previous day’s ‘open interest’ showed that this size of holding was not possible, thus dispelling the rumours. CBOT members were furious; the executive called Duvel in for a conference and asked him how dare the GFA release open interest data from the day before, especially without consulting the Board?¹¹⁸

There was also a disagreement over whether or not the CBOT should have access to the GFA’s data. On 9 October 1925, Gates circulated a letter from Senator Capper responding to a query from the CBOT on the details of the interaction between the government regulators on the ground and CBOT committees. Contrary to the CBOT view, Duvel did

¹¹⁵Letter, H.C. Wallace to Capper, 27 December 1923. NARA/KC, Box 12, 14-6.

¹¹⁶Letter, Rollin Smith to Capper, 7 May 1923. NARA/KC, Box 12, 14-6. Response to earlier letter, Capper to Morrill, 3 May 1923. NARA/KC, Box 12, 14-6.

¹¹⁷Copy of US Department of Agriculture Press Release, authored by J.W.T. Duvel, 17 December 1924. NARA/KC, 101-1.

¹¹⁸Ibid.

not feel compelled to share data from his reports with CBOT officials. Capper, however, as the primary legislative sponsor of the 1922 Act relayed to the secretary that it was his opinion that the GFA should share its data with the CBOT.¹¹⁹ In the end, though, as a result of the inspections and Special Account reports, the most prosecutable cases, together with all the relevant accumulated information, were turned over to the CBOT.

In December 1925, Duvel and the GFA were able to easily ascertain that a false rumour broadcast by Armour Grain Co was unlikely to have been a malicious attempt to profit from positions. The GFA was able to examine the positions of Armour through the daily reports, and Duvel was able to quickly conclude that, ‘reports do not suggest any motive for releasing the contents of the cable except the common practice of passing out trade gossip’.¹²⁰ Duvel added that, in the three years he was in Chicago, he found it unusual if a member spreading rumours was actually pre-positioned by ‘front-running’ to take monetary advantage. It is worth noting that, again, this conclusion was reached without the need for a full audit, putting paid to the trope, proposed by Jerry Markham, for example, that lack of resources held the GFA back from taking advantage of their access to information.¹²¹ In fact, accurate information was gathered on a regular basis, and specific details were gathered on special situations, often by the supervisor himself. The GFA, therefore, was able to examine the books of all members and their clients, including overseas investors and brokers, in search of anomalies. On 12 October 1925, Duvel provided the secretary with a detailed breakdown of the positions of the London, England branch of one of the board members: 63 accounts, net short 4.5 million bushels, mostly from London and Liverpool clients.¹²²

As was shown earlier, Capper was pro-futures but definitely anti-manipulation. Senator Capper remained a bee in the GFA’s bonnet throughout the interwar years by consistently writing to the Agricultural Secretary, Duvel and even junior employees of both the USDA proper

¹¹⁹Letter, Capper to Gates, 6 October 1925. CME III.11.9.

¹²⁰Memorandum for the Secretary on Argentine Crop Report, by Duvel, 22 December 1925. NARA/KC, 305-1.

¹²¹Ibid.; Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987).

¹²²Memorandum, Duvel to the Secretary of Agriculture, 12 October 1925. NARA/KC, 305-1.

and the regulatory agency. He had a question and/or demand for every situation that occurred in the grain markets, often based on letters he received from constituents or interested parties and the GFA and the secretary received such inquiries or complaints directly. Once, Capper asked why the Chicago wheat price was lower than the Winnipeg price and, on 28 July 1924, Duvel responded with the justification that Chicago July represented the new crop being harvested and Winnipeg July represented the old crop that had very little carry-over.¹²³ He added that Canada was experiencing drought conditions, and was faced with ‘the wildest and most demoralising bull market in its history’, so Canada’s crop wouldn’t be available until the autumn, whereas the US crop was bountiful and was moving freely. This kind of analysis was performed by the GFA on a regular basis, resulting in an accumulation of useful knowledge by the regulators, which was then often passed on to academics, the press, politicians, other bureaucrats and, indeed, even the grain trade for its own use and to inform others. Answering Capper’s questions was just another part of the essential tasks that the GFA was using information to accomplish: To understand the markets.

The GFA had pressured the exchanges to release other information for some time, as they and powerful users could see how important such data were to understanding market movements. For example, the Millers National Federation adopted a resolution in the spring of 1927 to request that the GFA publish daily volumes of trading and open interest for each delivery month.¹²⁴ Capper added pressure to this movement in a letter to Jardine on 19 July 1928.¹²⁵ Even though the 1922 Act could not compel the exchanges to provide such information, the GFA eventually succeeded in wresting the data out of the hands of the membership, and in August 1928 such figures that all traders take for granted now were finally compiled and released on a daily basis.¹²⁶ Information was finally beginning to flow freely to those who needed it to make key buying and selling decisions.

¹²³Letter, Duvel to Capper, 28 July 1924. NARA/KC, 14-61.

¹²⁴Resolution adopted by the National Millers Foundation in May 1927 at its annual meeting, as quoted in letter, Capper to W.M. Jardine, 19 July 1928. NARA/KC, 14-6.

¹²⁵Ibid.

¹²⁶Letter, R.R. Kauffman, GFA, to William E. Banks, 26 June 1934, with clipping, “Daily Reports on Grain Commitments Issued,” *New York Journal of Commerce*, 5 July 1928. NARA/KC, 14-6.

Scientific management, and even industry self-regulation, required data, and this is what the Grain Futures Act provided, with two major implications. Firstly, information was disclosed and disseminated to interested parties, including traders, hedgers, academics and government investigators. As a result, from 1923, government and exchange officials could explain otherwise confusing aspects of this previously opaque market to the public, powerful constituents, the administration and government leaders, either to allay their fears or to highlight limitations of the system to encourage voluntary or legislative change. Secondly, measures of speculative interests were now available and it became possible to evaluate the consequences of the actions of the largest market participants.

4.4 THE CUTTEN CORNER, 1924–1925

Price volatility between the wars was comparatively high, with wheat prices falling from a wartime high of \$2.45 a bushel just after the markets reopened in 1920 down to \$1, languishing at the lower end of the range into 1924. This wide range was especially noticeable, coming so soon after the fixed prices during World War I. This depression continued into early 1924, with the CBOT directorate stirred up by the announcement of a new government investigation of the depressing wheat situation.¹²⁷ Prices rallied hard again in 1925 back up to over \$2, before crashing in 1925. Prices fell again beginning in 1928, eventually bottoming at 43 cents per bushel during the depths of the Great Depression (Fig. 4.1).¹²⁸

The key trigger in 1924–1925 however was the move in the May 1925 wheat contract, referencing 1924 wheat in storage from \$1.20 per bushel on 8 July 1924 to \$2.06 by the end of January 1925. It was the 75% increase in prices in 1924 that turned the public's attention away from the plight of the farmer towards the potential of a shortage. This rise in prices held the attention of the entire nation, frequently appearing on the front pages of major newspapers. The USDA wrote on 6 January 1925 that:

¹²⁷Letter, Arnot to Carey, c/o New Willard Hotel, Washington, DC, 2 April 1924. CME III.ss1.9. The CBOT had an emergency meeting of the directors.

¹²⁸Holbrook Working, "Prices of Cash Wheat and Futures at Chicago Since 1883," *Wheat Studies of the Stanford Food Institute II* (1934).

For four years the wheat grower has been staggering under a load of distress. Depression and deflation have driven hundreds of thousands of wheat growers from the land. The complaints, generally speaking, rest upon the misapprehension that speculation has driven the price up unduly in the United States and hence that the United States price must be above a parity with the rest of the world [...] The charges are now in circulation that the grower is receiving no benefit for the high price of wheat and that the consumer is being unduly mulcted as a result of them. Furthermore, the grain exchanges are held responsible for existing conditions which those unfamiliar with the facts call very bad. Certainly complaint against wheat prices being too high is unwarranted when they have merely attained a parity of purchasing power with all commodities and when the index number of wheat prices is still far below the index number of wages.¹²⁹

The rumour at the time, later verified by the GFA, was that Canadian-born speculator Arthur Cutten had entered the market on the long side, driving wheat futures prices up. But artificial price rises cannot last forever, and bearish news from Europe forced prices down in very short order (Fig. 4.1).

However, the farmer was not to gain from the explosive rise because, by the early winter, very few producers had wheat left to sell, and prices rose 55 cents per bushel after early October. Long before the coming harvest, after holding above \$1.75 for about a month, a crash sent prices down to \$1.35 in early April. Cutten was in Florida on 3 April 1925 when the wheat price broke.

In 1924, Charles Brand wrote to Capper that:

Extensive “come along” tactics were followed by the commission houses in soliciting buying orders during the rise that culminated on January 28. World shortage warranted higher prices. Propaganda attracted the public into the market in a wild buying orgy. Once the public is a heavy participant in the market it is technically weak because participation is based upon shoe string margins combined with ignorance of the true value of the commodity. [Prices then fell] due to extensive short selling [...] Money and credit, together with almost uncanny knowledge of the use of the future markets, have become concentrated in a relatively small group of

¹²⁹US Department of Agriculture, Office of the Secretary Press Service, *Is the Wheat Price Too High?* Press Release, 6 January 1925. CME III.667.6.

powerful hands. This group was ready to take advantage of the technical weakness of the market, selling it short and buying it in again on the way down for heavy profits.¹³⁰

Recently, history has disputed the corner argument and concludes that fundamentals drove prices up and then down.¹³¹ Regardless of the actual driving forces behind the volatile moves in wheat prices, it was clear that the CBOT was embarrassed by the press coverage and the eventual findings of the GFA. The Cutten Corner period was recognised, especially by the CBOT executive, as a public relations disaster. The CBOT president wrote in 1925 that ‘unfair tactics [...] were nevertheless very disconcerting to the trade in general [and ...] prevented legitimate grain interests carrying on their hedging and speculative business in a normal way’. May 1925 wheat futures trading ‘developed into an emergency for which the exchange [...] was not fully prepared to meet in a wholly satisfactory manner’.¹³² The CBOT executive, in effect, was admitting it had mismanaged the issue.

The millers were outraged that the CBOT and the GFA appeared powerless to stop large speculators who were driving up the prices of their future purchases, even after the farmer had been paid for his harvest. Soon after the collapse, on 9 May 1925, R.G. Winter of Quaker Oats, a major miller, reported to Carey, ‘considerable dissatisfaction was expressed by many of the members because the wide swings and rapid changes did not permit of satisfactory hedging operations’.¹³³ During a meeting of the Illinois Grain Dealers’ Association, a resolution passed to work with the CBOT to find ways to eliminate such price swings. Duvel informed them that price limitations worked well in the cotton market, and that he was about to undertake a study of the extent of hedging in the grain markets.¹³⁴ There had been violent reversals, with a four day period in March having greater than ten cent ranges, ‘paralysing the

¹³⁰Letter, Brand to Capper, 1 June 1925. NARA/KC, Box 12, 14-6.

¹³¹Todd E. Petzel, “A New Look at Some Old Evidence: The Wheat Market Scandal of 1925,” *Food Research Institute Studies* 1 (1981).

¹³²Chicago Board of Trade, *Annual Report of the Board of Trade of Chicago for the Year Ended December 31, 1924* (Chicago: Chicago Board of Trade, 1925), p. xx.

¹³³Letter, F.G. Winter, CBOT director, to Carey, 9 May 1925. CME III.18.2.

¹³⁴Ibid.

grain and milling businesses’, according to the GFA investigation, which was to come.¹³⁵

The answer, at least in the short term, was clear in the minds of the GFA and the USDA. In a 31 March 1925 letter to Senator Capper, Secretary Jardine wrote:

I [...] acknowledge your letter [...] transmitting one from the Clyde Milling and Elevator Company of Clyde, Kansas. I realise how disastrous these violent fluctuations are to millers and other legitimate interests in the cash grain trade. My purpose in having the Grain Futures Administration conduct an immediate investigation of the causes of the recent situation is to determine if possible what steps can be taken to obviate future occurrences of this kind... The apparent remedy, if investigation should disclose unlawful manipulation, would be to cancel and revoke the designation as a “contract market” of any exchange that was found not to have enforced its rules for the prevention of abuse of its facilities as evidenced by the sudden and apparently unreasonable fluctuations that have recently occurred. This, of course, would be an exceedingly serious step and one that could only be considered if there was absolute proof of wrong doing. Nevertheless I want you to know we are going the limit of our power under the law and that we are not passing any opportunity to ascertain the influences that have been at work.¹³⁶

Without a knowledgeable, experienced and fully informed GFA, the ability to analyse, understand and report to Congress and the public would have been extremely limited. The importance of the intellectual power of the government cannot be overemphasised. Ignorance at any level might have resulted in a much less successful future market down the road, especially if regulation had been increased due to misunderstandings of how the markets operated.

4.4.1 *Fluctuations in Wheat Futures*

Congressional reactions to the fluctuations of 1924–1925 are prominent in the interwar record of the futures market through hearings on Capitol

¹³⁵US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, p. 2.

¹³⁶Letter, Jardine to Capper, 31 March 1925, NARA/KC, Box 12, 14-6.

Hill and the reactions of various actors in the press.¹³⁷ What has been less clear is how the perceived market abuses during this period impacted on private decision-making and relations between government and the CBOT. Under normal circumstances, a policy window might have been opened. But there was no hope for new legislation for reasons given earlier, and the GFA was powerless to act to prevent manipulation or to prosecute the culprits under the laws then in existence.

The Senate tasked the USDA and therefore the GFA with investigating the 1924–1925 volatility, resulting in Senate Document No. 135 *Fluctuations in Wheat Futures (Fluctuations)*.¹³⁸ But even before this formal command, the GFA began investigating the situation due to the public and private outcry, and this did not sit well with certain elements of the membership of the CBOT. Members and other grain men privately threatened a boycott of speculative buying on account of the uncertainty surrounding the inquiry. Brand wired Duvel from Washington on 1 April 1925 that a rumour was widespread that ‘dealers have practically gone on strike as a result of the investigation into the grain trade being conducted by your department’.¹³⁹ Given that prices were unaccountably depressed at this time, Brand felt that there may be some grounds to the rumour. In the meantime, the GFA was not having much success in tracing the causes of the volatility.

On 9 February 1925, Duvel wrote to Morrill that they had made significant progress towards reviewing the books of all the commission houses, but that the completed examinations had revealed nothing new.¹⁴⁰ Nevertheless, Duvel pressed on to audit houses outside Chicago, requesting more staff.¹⁴¹ George Wright Hoffman, assistant professor of insurance at University of Pennsylvania, had played a key role in the analysis to such an extent that he was brought in as co-author on the next two investigations and remained a consultant through World War II. The investigation was further supported by others in the GFA, such as Paul

¹³⁷For example, see Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956).

¹³⁸US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926.

¹³⁹Telegram, Brand to Duvel, 1 April 1925, NARA/KC 19-18.

¹⁴⁰Letter, Duvel to Morrill, 9 February 1925. NARA/KC, 19-18. The GFA reviewed J.E. Bennett and Company, Bartlett Frazier Company and Thompson and McKinnon.

¹⁴¹Letter, Duvel to Chester Morrill, 9 February 1925. NARA/KC, 19-18.

Mehl, the Department of Commerce and the Bureau of Investigation of the Department of Justice.¹⁴² The amount of resources dedicated to the task of analysing this market anomaly was therefore truly impressive. This contradicts previous arguments that the GFA's investigations were poorly executed due to the presence of one sole official auditor.¹⁴³

While a good proportion of the membership cooperated with the GFA, members trading over a fifth of the total number of Special Accounts caused serious delay.¹⁴⁴ *Fluctuations* covered approximately 70% of May futures volume from 2 January to 18 April 1925, with 627 accounts in the 'above 100,000' class.¹⁴⁵ Reports were obtained from 89 CBOT clearing members, with extra investigations elsewhere.¹⁴⁶ *Fluctuations* further made reference to the CBOT's own annual report, agreeing with its president's analysis that some tactics were unfair.¹⁴⁷

Fluctuations revealed a crucial flaw in the daily reports. Specifically, single positions were split into different accounts just under the reporting limit of 500,000 bushels—in some instances apparently for the sole purpose of avoiding having to make a daily report—as to render conclusions based on the reports data alone unsatisfactory.¹⁴⁸ This was a huge surprise to many members and also the government, since manipulators could still operate in large size without the CBOT or the GFA being aware. Additionally, it was found that large speculative long accounts became net sellers just as the market itself turned lower.¹⁴⁹ The final report came too late to influence any public decision regarding further regulation of the futures markets, as described below,¹⁵⁰ but Duvel used the preliminary findings to defend two suggestions made at

¹⁴²US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926.

¹⁴³As argued by Jerry W. Markham, *The History of Commodity Futures Trading and Its Regulation* (Westport, CT: Praeger, 1987), p. 16.

¹⁴⁴US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926.

¹⁴⁵*Ibid.*, p. 2.

¹⁴⁶*Ibid.*

¹⁴⁷*Ibid.*, p. 6.

¹⁴⁸*Ibid.*, p. x.

¹⁴⁹US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, p. 5.

¹⁵⁰Letter, Carey to Gates, 20 June 1925. CME III.11.9.

an earlier conference, namely (i) modern clearing adoption at the CBOT and (ii) the creation of a BCC.¹⁵¹ Importantly, these ideas were not initially Duvel's, even if both institutions would make monitoring of the markets easier. In fact, these ideas originated with the CBOT executive, itself. That is, modern clearing, especially, did not come about as a result of GFA or USDA concerns. The next section reveals that the Secretary of Agriculture effectively lowered the CBOTs 'coordination costs' at the latter's request, resulting in a more efficient and robust futures market.

4.5 THE FIGHT FOR MODERN CLEARING

Throughout 1920–1926 the Board executive felt strongly that certain innovations were needed to enforce the CBOT's dominance but did not have the power to force change. It was feared that continued manipulation—now easier to observe thanks to GFA monitoring—could lead to outrage among the powerful users of the futures markets, such as the millers and their representatives in Congress. At the very least, such revelations could jeopardise the Chicago futures monopoly in that less use would be made of a market that acted irrationally. The CBOT 'boxed' itself into adopting two important features of modern derivatives markets, (i) the clearing house and (ii) the BCC (next section). Even though toothless, in 1925 the 1922 Act was useful as it revealed more manipulation at the CBOT, while the threat of new bad publicity and the potential for new restrictions influenced the CBOT executive to attempt to change the ways of the membership. This was because the clearing house assures users that they are not taking counterparty credit risk while the BCC tends to ensure that manipulation is punished when identified, hopefully resulting in more efficient markets with rational pricing. The system of large trader reporting, also an innovation of this period, provided further transparency, which still exists to this day. No derivatives market in the present age functions without these key innovations.

4.5.1 *A Collective Action Problem at the CBOT*

Besides the fight for modern clearing, described below, the debate over how much information to release under the 1923 Rules, and the private

¹⁵¹ US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, p. 7.

wire controversy discussed in Chapter 3, there are many more examples of infighting at the Board. For example, members felt that the 1922 Act's requirements should be fought in Washington, but these concerns were dismissed by Carey and others at the Board for the reasons explained in Chapter 2. In fact, members were generally kept in the dark about confidential negotiations in Washington.¹⁵²

There is one very illustrative example of the infighting at the Board at the highest level, and how it adversely affected governance improvements. In early 1924, a plan was conceived by CBOT director Brosseau, with the backing of the directorship, but crucially not of the executive, to have a new committee seek Congressional support for a bill amending the Grain Futures Act in the CBOT's favour. When they found out, Arnot and Carey wanted the committee discontinued immediately.¹⁵³ Committee member and Board chairman, J. Simons, though, was undeterred.¹⁵⁴ Arnot told Carey that even though the rest of the committee was in support of ceasing attempts to amend the Act, 'I don't believe we will ever be able to do much constructive work until he [Brosseau] is sat upon, if that is possible'.¹⁵⁵ The Brosseau committee failed, but 'rebellion' did not end. At CBOT Board meetings, discord was a given. That same year, 'the same general element' had begun campaigning to 'secure a modification of the Grain Futures Act', but Gates and Carey agreed that 'it appears to those most familiar with the situation in Washington the present session in Congress is an extremely inopportune time to ask for a modification'.¹⁵⁶

As further evidence of the divergence between private and public opinions, executive vice-president Mauff publicly argued for the repeal of the 1922 Act, simply to placate the reactionary members. Indeed, Mauff was privately in favour of the Act and actively fought his own

¹⁵²Letter, Carey to J.M. Adams, Rosenbaum Brothers, 1 February 1924. CME III.ss1.9.

¹⁵³Letter, Arnot to Carey, Clarendon Hotel, Florida, 28 February 1924. CME III.ss1.9; Letter, Carey to Arnot from, 25 January 1924. CME III.ss1.9; Letter, Arnot to Carey, 26 February 1924. CME III.ss1.9; Highly confidential letter, Arnot to Carey, 21 February 1924. CME III.ss1.9; Letter, Arnot to Carey in Florida, 22 February 1924. CME III.ss1.9; Letter, Carey to Arnot, 25 January 1924. CME III.ss1.9.

¹⁵⁴Letter, Arnot to Carey, 26 February 1924. CME III.ss1.9.

¹⁵⁵Letter, Arnot to Carey, 11 March 1924. CME III.ss1.9; Telegram, Gates to Carey, 30 April 1924. CME III.11.10.

¹⁵⁶Letter, Gates to Carey, 22 November 1924. CME III.11.9; Letter, Carey to Gates in Washington, DC, 12 May 1924. CME III.11.9.

membership to cease any challenge.¹⁵⁷ Yet on 7 May 1924, at one such meeting, an argument ensued over asking for modifications to the Act. Yet again Carey was clear that ‘it would be unwise to attempt any change’.¹⁵⁸

Meanwhile, differences emerged within the directorate and the close-knit group of powerful directors. Not long after his arrival in Washington, as Secretary of the Legislative Committee, Sam Arnot fell out with the Committee, especially Lonsdale. Yet, on 23 May 1924, Gates refused to intervene.¹⁵⁹ Arnot saw the committee as being unfairly ‘exceedingly hostile to Chicago’.¹⁶⁰ The committee, resenting Arnot’s inroads into confidential matters, demanded that they ‘be consulted before any one was permitted to visit the Capitol or an office of the Senate or House of Representatives’.¹⁶¹ However, Arnot stated he was unable to reveal all his information because ‘a portion of my work, and the most effective portion, was political and confidential’.¹⁶² Behind the scenes lobbying was still crucial to the success of the Board, and it was fortuitous that pragmatic and progressive elements of the directorate were best represented in Washington by the likes of Arnot and Barnes. As a result, despite all this infighting, the CBOT mostly refrained from agitating for legislative changes. As regards institutional change, the CBOT was equally far from homogenous. Indeed, in many instances, key market improvements were contested at every level, modern clearing included.

4.5.2 *Modern Clearing*

The most obvious example of an innovation co-constructed by both government and industry was the adoption of the CBOT’s modern clearing house. By 1925, the CBOT was the last remaining major exchange to

¹⁵⁷ Letter, Duvel to Fones, 27 December 1923. CME III.667.4.

¹⁵⁸ Letter, Carey to Gates, 7 May 1924. CME III.11.9.

¹⁵⁹ Letter, Arnot in Washington, to Carey, 24 May 1924. CME III.ss1.9; Letter, Arnot to Carey, 23 May 1924. CME III.ss1.9; Arnot was made Secretary of the Exchange Legislative Committee and personal representative of the CBOT. Memorandum to the Members of the Exchange Legislative Committee, 1924. CME III.15.8.

¹⁶⁰ Letter, Arnot in Washington to Carey, 24 May 1924. CME III.ss1.9.

¹⁶¹ Letter, Arnot to Carey, 23 May 1924. CME III.ss1.9.

¹⁶² Letter, Arnot to Carey, 24 May 1924. CME III.ss1.9.

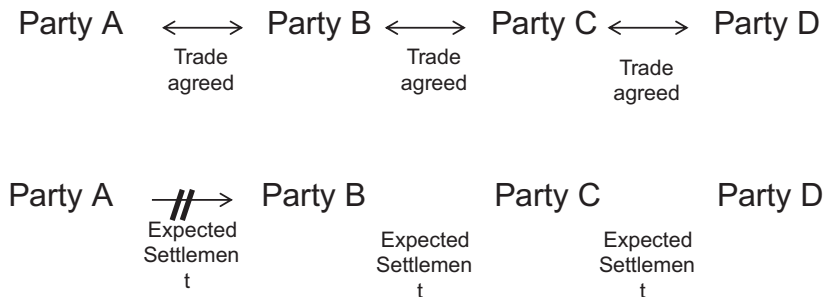


Fig. 4.2 Breaking the settlement chain in ring clearing

use an antiquated, resource-intensive and credit risky method of settling trades called ‘ring settlement’ or ‘ring clearing’. In such a system, the default of any one counterparty could cascade down a series of often off-set trades to affect a large number of traders (Fig. 4.2). This meant that traders would always prefer to trade with those they trusted from a credit perspective. Even so, they were still exposed to the poor choices of other counterparties. Thus, in the pits, the bigger, more respected and most highly capitalised traders were always the preferred counterparties, which gave them an enormous competitive advantage, thereby reducing market efficiency. This was especially true at the time, as members did not generally call margins on each other and were thus fully exposed to the credit reputation of their counterparty. The traders with better credit and more capital could afford to offer clients bigger positions with less (often zero) margins. Thus the average broker was at a huge disadvantage. The most powerful traders benefitted the most from this legacy system.

In ring clearing, unsettled trades were linked to one another if not paired off in the ring. Without modern clearing, therefore, ‘many times a single delivery will clear up many contracts as it passes from one to another’.¹⁶³ Thus a single failure could lead to a system collapse. For instance, Jackson Brothers notified the CBOT executive that it had defaulted to Updike and Rosenbaum on 15,000 bushels of July oats because Armour and Norris had defaulted to Jackson.¹⁶⁴ In 1902,

¹⁶³Letter, Carey to W.A. Starr, 10 June 1925. CME III.11.4.

¹⁶⁴Letter, Jackson Bros & Co. to Fones, 31 July 1923. CME III.665.9.

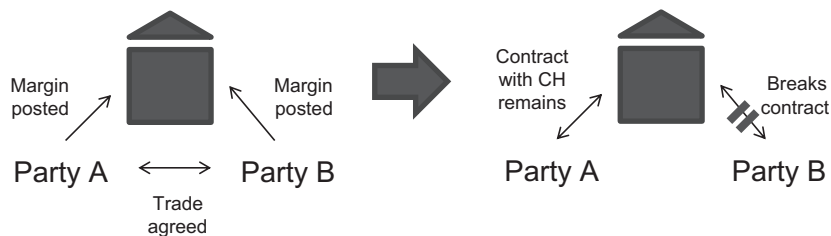


Fig. 4.3 Modern clearing basics

George Phillips' bankruptcy caused losses for more than 42% of Board members.¹⁶⁵ Because traders in a ring are taking counterparty risk to unrelated entities, a default results in catastrophe.

Other exchanges resolved this problem by inserting a well-funded central counterparty—the modern clearing house, which stands between every trade and becomes the counterparty to every open trade. If one party defaults, then the other is unaffected (Fig. 4.3).

Modern clearing has a long history as a robust method of credit risk mitigation. Since its inception in the late nineteenth century, clearing houses have survived the Great Depression and every other crisis, including the 2008–2010 Global Financial Crisis, with only one single default documented in the literature.¹⁶⁶ In fact, the lack of central clearing in the OTC derivatives markets, as opposed to exchange-traded futures exchanges, may have caused, or at least worsened, the effect of that crisis.¹⁶⁷ But modern clearing accomplishes far more than simply reducing credit risk for trading counterparties. Modern clearing anonymises transactions, unlike in over the counter trading where the true buyer and seller are revealed to each other, usually well before the trade is consummated.¹⁶⁸ Because traders in a ring are taking counterparty risk to

¹⁶⁵James T. Moser, *Origins of the Modern Exchange Clearinghouse: A History of Early Clearing and Settlement Mechanisms at Futures Exchanges* (Chicago: Federal Reserve Bank of Chicago, 1994), p. 28.

¹⁶⁶Vincent Bignon and Guillaume Vuillemy, “The Failure of a Clearinghouse: Empirical Evidence,” *Banque de France Working Paper* 638 (2017).

¹⁶⁷See Gary Gorton and Andrew Metrick, “Securitized Banking and the Run on Repo,” *Journal of Financial Economics* 104 (2012): 425–451.

¹⁶⁸Ralph Janvey, *Regulation of the Securities and Commodities Markets* (New York: Warren Gorham Lamont, 1992).

unrelated entities, a default results in catastrophe. Also, modern clearing marked the end of ‘ungentlemanly’ capitalism, where each trading counterparty knew, but perhaps disliked, each other. Such financial engineering is anonymous, a key ingredient in modern financial capitalism.¹⁶⁹

From 1900 the CBOT executive had made several unsuccessful attempts to establish modern clearing, but many powerful members were against it. Given what transpired in the early 1920s, it is very informative that modern clearing was not installed during such a period of instability. In 1922, many powerful members, who were at best indifferent to the Board’s overall potential loss of competitiveness and fearing that their own personal positions would be affected, intensely defended the clearing *status quo*. Even the basic legality of modern clearing was challenged in committee, and the executive had to obtain an opinion from counsel that the concept was legally sound.¹⁷⁰ But there were very good reasons why its competitors had modern clearing, and it did not escape the notice of certain CBOT members that the Minneapolis Chamber of Commerce and the KBOT had employed it since the end of the nineteenth century. It was simply the better system. The executive and many members who relied on commissions for their revenue recognised the competitive threat. On 27 October 1919, a petition signed by over 100 members, including two future CBOT presidents, was submitted in its support:

[Modern clearing] is used and approved in every exchange of the importance in the world, except the Chicago Board of Trade. A very considerable number of our members feel that we should be sufficiently progressive to at least try out this system which is in successful operation everywhere else.¹⁷¹

However, on 27 January 1920, even after investigation, no doubt reflecting the interests of powerful members who benefitted from the then-current system and who had little interest in simply increasing volumes,

¹⁶⁹Kenneth D. Garbade and William Silber, “Structural Organization of Secondary Markets: Clearing Frequency, Dealer Activity and Liquidity Risk,” *Journal of Finance* 34 (1979): 577–593.

¹⁷⁰Letter, H. Robbins to J. Mauff, 28 January 1922. CME III.2.641.2.

¹⁷¹Petition to CBOT Board, 27 October 1919. CME II.90.5.

it was rejected ‘with disapproval, on the grounds that a change in the Clearing House System is not necessary or warranted’.¹⁷²

The directorate was furious, yet continued to push for reform. In the CBOT’s 1921 *Annual Report*, Griffin, one of the original petitioners, urged:

For the third time I respectfully submit the urgency of a modern method of clearing our transactions. Millers and grain merchants everywhere are protesting bitterly because of the inability of our members to make advances on unclosed trades. As a result, a large volume of hedging business is being lost to this market and executed elsewhere at such points operating a modern clearing house and where hedgers as a consequence are not obliged to employ so much capital in carrying insurance contracts.¹⁷³

Indeed, the CBOT leadership had been trying for years to adopt a modern clearing house, with much of the membership in support, when it was put to yet another unsuccessful vote on 22 March 1922.¹⁷⁴ However, the issue was ‘neither pigeonholed nor forgotten, having had such thought and attention as to insure impetus and direction in 1923 with only a little more clearing up of hitherto insurmountable obstacles’.¹⁷⁵ Yet, in spite of its popularity with the executive and a large percentage of the membership, modern clearing did not arrive either in 1923, 1924 or 1925. This was not for lack of trying. Opponent James E. Bennett, indeed, was furious at the executive that a clearing house vote remained on the agenda over the 1923 Christmas holidays, even though over half the membership was not so informed. Worse, clearing house proponents were aware that the proposal was still in play while opponents and the local press believed it was dead.¹⁷⁶ But even such clandestine attempts failed at this time.

¹⁷²Notice from Secretary J. Mauff, January 1920. CME II.90.5.

¹⁷³Chicago Board of Trade, *Annual Report of the Board of Trade of Chicago for the Year Ended December 31, 1921* (Chicago: Chicago Board of Trade, 1922), p. xx.

¹⁷⁴Amendments for a Ballot Vote as ‘Section 9 ½, Rule XXII – New Clearing House System’. Undated. CME III.2.655.1.

¹⁷⁵Report of the President Robert McDougal addressed to members of the Board of Trade of the City of Chicago, 12 January 1923. CME III.665.9.

¹⁷⁶Letter, J.E. Bennet to J. Stream, 26 December 1923. CME III.643.7.

By 1924, the membership was still divided on modern clearing and it was Sam Arnot who was tasked with advancing the proposal. Several high profile executives were still opposed, including Fred S. Lewis of the eponymous FS Lewis & Co. and first vice-president of the CBOT at the time.¹⁷⁷ Lewis accused Arnot of:

Forgetting in his enthusiasm his present official position, which without question calls for a neutral attitude at least on all amendments to our rules [...] He simply does not control his enthusiasm when there is what seems to him even a small chance of changing our Clearing House [...] Naturally I strenuously object to having to try to reconvert those whom Arnot, in his official capacity, has convinced a change is necessary.¹⁷⁸

Lewis was adamant that modern clearing should never come to Chicago. He added, ‘The more I go into the matter the more convinced I become that [it is] all impracticable in a gigantic market like Chicago’.¹⁷⁹

Because it is more expensive to replace a defaulted contract if the market has moved substantially in a trader’s favour, highly volatile markets increase potential counterparty risks to futures users, such as millers. As a result, after the Cutten Corner volatility the pressure from industry customers on the Board for credit mitigation was even greater than in 1921. On 8 May 1925, CBOT President Carey promised the Millers National Federation, which was in favour of modern clearing, to resolve the matter soon. Shortly after sending a resolution dated 29 May 1925 demanding modern clearing, representatives of the Millers Federation met the CBOT Executive Committee, again requesting the establishment of a clearing house along the lines of the clearing houses in use at Minneapolis.¹⁸⁰ The CBOT executive acknowledged the competitive pressures, but was powerless at the time.

Neither the agitating members nor the CBOT executive viewed modern clearing as a response to Cutten Corner magnitudes of volatility through manipulation. Rather, the executive understood that clients

¹⁷⁷Letter, Carey to Fred Lewis, 21 October 1924. CME III.16.4.

¹⁷⁸Letter, Fred Lewis to Carey, 19 October 1924. CME III.16.4.

¹⁷⁹Ibid.

¹⁸⁰Letter, Carey to Sidney Anderson, Millers National Federation, 8 May 1925. CME III.ss1.9; Memorandum to the Members of the Exchange Legislative Committee, 29 May 1925. CME III.15.8.

wanted price efficiency above all, and that commission houses needed to trade on the best price rather than with the ‘best’ counterparty to achieve that level of efficiency. A modern clearing house was also a tool to place the smaller trading members on equal footing with their better-capitalised counterparts, while putting the CBOT on equal footing with its competitors for hedging and speculating business. Commission houses, especially, being often both less well capitalised and dependent on outside customer orders, would benefit the most, while the better-capitalised large speculators would lose some of their competitive advantage. Floor brokers would be able to trade solely on the basis of the best price rather than guess who was the best counterparty from a credit risk standpoint. Of course, reducing such risk should be a benefit to all. Settling daily with a sophisticated counterparty, such as the clearing house, injects a high degree of discipline on traders to properly account for all trades, a point that had been made in the committee by CBOT counsel Robbins in 1920.¹⁸¹ Importantly, neither the GFA nor the USDA pushed a modern clearing agenda. As the USDA’s Brand informed Capper, modern clearing would do nothing to curb speculation:

No clearing house can prevent manipulation, nor even curb it. The Minneapolis Chamber of Commerce and the Kansas City Board of Trade Kansas City Board of Trade have perfect clearing houses; but while they are of direct benefit to the commission houses on those exchanges, that benefit does not extend to the public nor in any way and to decrease nor “purify” speculation. I hope Secretary Jardine will not have anything “put over on him” by the shifty Board of Trade men.¹⁸²

That is, modern clearing was not seen by government as being an important institution. Knowing that futures markets were useful for the marketing of grain and that there was no chance of obtaining any amendments to the Act in 1925, Capper contented himself with letting the CBOT self-regulate in terms of the clearing house and BCC issues, stating, ‘If the boards of trade will inaugurate in good faith the

¹⁸¹Letter from Legal Advice and Rules Committee Chairman to the Board of Directors of the Board of Trade of the City of Chicago, 13 February 1920. CME II.90.5.

¹⁸²Letter, Administrative Assistant, GFA, to Arthur Capper, 23 June 1925. NARA/KC, Box 12, 14-6.

suggestions made a few months ago by Secretary Jardine, I am confident that [...] beyond question, the wheat growers of the country will profit'.¹⁸³

Nevertheless, the USDA was more than happy to cajole and even threaten the CBOT membership into accepting modern clearing, even though the biggest beneficiaries would be the CBOT, itself. Why then did Jardine end up publicly demanding such a change? I answer that question below.

4.5.3 *The Road to Modern Clearing*

The private record shows that the CBOT executive entered into an agreement with the GFA and the USDA to force modern clearing on the Board's membership. The Cutten Corner became the policy window: modern clearing was back in play. On 17 June 1925, Gates reported to Carey that 'the present may be an opportune time to get through a clearing house proposition'.¹⁸⁴ Two days later Carey appointed a committee of five members, including Joseph Griffin as chairman, to handle the clearing proposition.¹⁸⁵ The reactionaries were still opposed, however, Carey lamented that 'there is going to be a real contest on here over the clearing house, as Fred Lewis is very actively working against it'.¹⁸⁶

In June, a new Committee followed up on a request from Gates and Carey for suggestions on how to improve the functioning of the market. It was especially important as there was a large participation by 'the public', i.e. the small speculator, at the time of the Cutten Corner, who had been the biggest losers. The committee asked the membership: 'Could a modern clearing house, similar to those in operation at Minneapolis, Kansas City and other markets, help prevent a recurrence of conditions prevailing in recent months? And are you in favour of a modern clearing house?'.¹⁸⁷ Even if the directorate (and many others) knew that a clearing house would not dampen volatility or even speculation, there were some gains to be had by continuing to frame the question in such terms.

¹⁸³Letter, Capper to Paul Mehl, 29 December 1925. NARA/KC, Box 12, 14-6.

¹⁸⁴Letter, Gates to Carey, 17 June 1925. CME III.11.9.

¹⁸⁵Letter, Carey to Edward Westbrook, 19 June 1925. CME III.16.8.

¹⁸⁶Letter, Gates to Carey, 17 June 1925. CME III.11.9.

¹⁸⁷Letter, Carey to Gates 22 June 1925. CME III.11.9.

On 25 June, Carey, in response to a letter from Wells, who had stated that Jardine had confidence in Carey, still believed that ‘we have made considerable progress here toward the establishment of a modern clearing house’.¹⁸⁸ In an attempt to look as if he was pre-empting government intervention through self-regulation, Carey wrote, ‘I would rather put the rule on our own books than to have such a rule passed by Congress’.¹⁸⁹ In fact, the CBOT did enact modern clearing precisely due to the government threat. But, the threat did not actually emanate from the government. Additionally, there is an important difference between self-regulation under credible threat of outside control (quite common in modern regulation studies) versus under a far from serious threat by an otherwise powerless and possibly captured government department.

The Board executive tried to persuade the membership by having other exchanges apply pressure. In July 1925, Carey sent a petition to the exchange directorates at Duluth, Minneapolis, Omaha, Kansas City and St. Louis to be signed by CBOT members in those centres and returned to Griffin at Bache & Company.¹⁹⁰ Carey further asked for a resolution from each exchange ‘commending the Chicago Board of Trade on their efforts towards establishing a modern clearing house’.¹⁹¹ The plan was a success. On 15 July 1925 Griffin received from Lonsdale in Kansas City a petition signed by all Kansas City members of the CBOT as requested by Carey.¹⁹² Lonsdale also had a resolution adopted by the KBOT board of directors favouring the clearing house proposal at the CBOT and wrote to Carey that he assumed that all CBOT members from Kansas City would have to appear in person to vote on the clearing house sometime in the future, but needed time to ensure that as many as possible could attend.¹⁹³ There is no evidence in the archive for a farmer-driven lobbying effort of Jardine or Duvel at this time, contrary to what has been written in some of the literature.¹⁹⁴ Certainly, the rhetoric

¹⁸⁸ Letter, Carey to Wells, 25 June 1925. CME III.14.2.

¹⁸⁹ Ibid.

¹⁹⁰ Letter, Carey to Chas W. Lonsdale, Kansas City, 3 July 1925. CME III.ss1.9.

¹⁹¹ Ibid.

¹⁹² Letter, Lonsdale to Carey, 15 July 1925. CME III.ss1.9.

¹⁹³ Ibid.

¹⁹⁴ See William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998), p. 159; they state, for

in the press calling for reform on behalf of the farmer is ubiquitous, but it is hardly convincing.¹⁹⁵

4.5.4 *The Private Arrangement*

A letter on 3 June from Gates to CBOT President Carey referred to the troubles with Lewis and others.¹⁹⁶ Carey then proposed to the CBOT executive that he request Secretary of Agriculture Jardine to ‘order’ the CBOT to start a modern clearing house for its own good. Carey replied to Gates on 20 July:

I feel Lewis and Rumsey both will do whatever they can to defeat [the clearing house] measure, and they don’t care whose feelings they hurt, or what accusations they make [...] As I see it, those who are inclined to extend credit and be very lenient with margin calls [...] are opposed to a new clearing house. I am quite sure the Secretary would be perfectly willing to write a letter definitely advising the Board to establish a clearing house.¹⁹⁷

This above letter is but one piece of evidence linking the idea for modern clearing to the executive, rather than the government. Gates then ‘wired Lonsdale in Washington to find out if the Secretary would be willing to advise the adoption of a clearing house as this would satisfy the opposition, which believes that the Secretary has not made any such recommendation’.¹⁹⁸

The appeal was clearly successful. On 23 July, the *Herald & Examiner* published an obvious and direct threat from Secretary Jardine ‘promising federal action Jan. 1 if steps [to ‘clean house’] fail’.¹⁹⁹ But this was

example: “even more pressure came from farmers cooperatives and other organizations.” See also Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406.

¹⁹⁵See, for example, William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998); William M. Jardine, “Farmers’ Distribution Problem and Co-operatives,” *The American Grain Elevator and Grain Trade* (15 July 1925), p. 46.

¹⁹⁶Letter, Gates to Carey, 3 June 1925. CME III.11.9.

¹⁹⁷Letter from Carey to Gates, 20 July 1925. CME III.11.9.

¹⁹⁸Letter, Gates to Carey, 17 July 1925. CME III.11.9.

¹⁹⁹Clipping, “Grain Board Warned to Clean House,” *Herald & Examiner*, 23 July 1925. CME III.12.2.

not considered direct enough by the Board executive. While Jardine was critical of the CBOT, he stopped short of ordering the establishment of modern clearing. Targeting the bigger members, Jardine wrote that ‘the Chicago Board of Trade is in control of “little men and scalpers”, who are resisting efforts to clean it up. If the board does not set its own house in order by 1 January, the government will step in and do it for them’.²⁰⁰ The letter went on to state that ‘the department’s agents found a “lot of gambling going on”’. Many CBOT members were livid, and on 28 July passed a Director’s resolution to have Carey take up the matter with Secretary of Agriculture.²⁰¹ Carey was now in an uncomfortable position, caught between powerful yet reactionary members and a generally friendly yet now exasperated USDA.

On 30 July, Carey wrote to the Secretary of Agriculture Jardine in a personal manner requesting that he endorse the clearing house reform more vociferously: He stated privately, ‘I have brought down upon myself the animosity of those opposed to the measure [...] They are secretly creating the impression on the trading floor [...] that this is a personal matter of mine’.²⁰² Presumably he was referring to Armour & Co, who were his vocal opponents.²⁰³ Carey up to this point could not use the big stick of USDA threats as Jardine hadn’t played along. Carey wrote to Jardine that ‘My statement to the membership [...] has been that you have not ordered a modern clearing house [...] but that you felt a clearing house would be in the right direction’.²⁰⁴ Carey did not think this would be enough to push recalcitrant members to vote against their initial interests, and asked Jardine to reiterate his request, wondering ‘how strong a letter would you care to write us, if any, endorsing this plan?’²⁰⁵ Carey further suggested that a public threat would be stronger than a private letter to the membership and directorate.²⁰⁶

²⁰⁰Ibid.

²⁰¹Letter, Fones to Carey, 28 July 1925. CME III.12.2.

²⁰²Letter, Carey to Jardine, 30 July 1925. CME III.11.3.

²⁰³Ibid.

²⁰⁴Ibid.

²⁰⁵Ibid.

²⁰⁶Ibid. Carey proposed that Jardine ‘put out a public statement to the press from Washington.’

By August, the clearing house plan was still not guaranteed to pass, and Carey was still waiting for a letter to come from Washington as Mrs. MacMillan had promised.²⁰⁷ However, Secretary Jardine had been taken ill around this time. In early August, a petition signed by 464 members supporting modern clearing was rejected by the CBOT Board by a vote of 10-4. While the membership now was in favour, the reactionaries still held control of the Board. Soon after, Carey assured interested parties, such as Sidney Anderson of the Millers National Federation, that, if the petitioners re-submitted, then the directors must hold a vote.²⁰⁸ Carey was optimistic that the vote would support the clearing house, as he expected soon to allow non-Chicago-based members to vote by proxy.²⁰⁹

Meanwhile, in addition to Jardine's public comments, Jardine and President Hoover both made private threats to the Board. A letter from Morris Townley to Carey reads, 'Mr Hoover told Mr Strawn [who told Townley's partner, Mr Wild] that he and Mr Jardine were in absolute accord [...] that unless the Chicago Board of Trade cleaned up its own house in the near future, Congress would do the house cleaning at its next session'.²¹⁰ A few days later, on 11 August, member Harry Lobdell of Lamson Brothers [Gates' firm] tabled the proposition and discussed both the strengths and the weaknesses of the plan.²¹¹

The critical private threat came on 15 August, when President Carey received a copy of a telegram addressed to Gates quoting a Ray Roberts that Secretary 'Jardine told me [...] that he regarded it as very essential that Chicago Board of Trade set up clearing house system'.²¹² The telegram stated further that, even though the directors had just rejected a modern clearing house in a vote, Jardine was expecting a full membership vote to get it through.²¹³ The author of the telegram quotes a key Jardine aid as arguing that 'there certainly will be legislation if Congress ever lets loose on the subject. If Chicago cleans up, [it would not be]

²⁰⁷ Letter, Carey to Lonsdale, 4 August 1925. CME III.ss1.9.

²⁰⁸ Letter, Carey to Sidney Anderson, 6 August 1925. CME III.ss1.9.

²⁰⁹ Ibid.

²¹⁰ Letter, Townley to Carey, 7 August 1925. CME III.16.7.

²¹¹ Letter, Carey to Lonsdale, 10 August 1925. CME III.ss1.9.

²¹² Telegram, B.L. Hargis, KBOT, to Gates, 15 August 1925. CME III.11.9.

²¹³ Ibid.

necessary'.²¹⁴ Jardine followed up with an official threat to the CBOT Washington delegation with legislation if it was not enacted.²¹⁵ Gates and Murray wrote from Washington that Congressional committees were in support of Jardine's threat if modern clearing and the BCC were not implemented.²¹⁶ This letter was circulated to the membership and included reference to previous public and private admonishments by the USDA Secretary. While there is no evidence that the threat was the only driver of change, the clearing house amendment passed by a huge margin on 3 September 1925.

The new clearing house was announced to great fanfare and began operating on 4 January 1926 with \$1.7 million in paid up capital, represented by stock in the corporation held by the members of the CBOT clearing association. The clearing house could also call for margins as further credit enhancement from the clearing members. The positions were marked to the market price daily and all payments to the clearing house needed to be settled by the close of the business day in which they were demanded. Payments out were to be netted and also paid on the close of business.

In an editorial in the *Country Gentleman*, President Carey crowed:

Of its own initiative the exchange took other steps which are calculated to meet and prevent future emergencies [...] The incorporated Clearing House, which began to function in January [...] is an important part of the improved machinery. This modern incorporated Clearing House will succeed an antiquated system installed 40 years ago.²¹⁷

Yet the clearing house was not at all solely a result of the Board's 'own initiative'. Tellingly, in this same editorial, Carey commented in a rare turn of understatement that the clearing house, 'had considerable opposition from members of the exchange, but we believe now is that the whole market will be safer and sounder for it'.²¹⁸

²¹⁴Ibid.

²¹⁵Ibid.

²¹⁶William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998), pp. 169–170.

²¹⁷Frank Leighton Carey, "The Wheat Pit Reforms" (editorial), *Country Gentleman*, 1926. CME III.16.13.

²¹⁸Ibid.

This section has demonstrated that neither of the two common myths about modern clearing is true. Modern clearing was not a precondition for futures trading—in this, the largest exchange had been a laggard. Secondly, the adoption of such a major innovation at the CBOT as the modern clearing house was not a result of successful self-regulation. In fact, the CBOT executive did not appear capable of implementing key changes on its own, and modern clearing was rather the result of threat, if not entirely credible, of more government regulation. The government effectively forced changes favoured by the CBOT executive on its membership. Hence, the Federal Government played a major role in dragging the CBOT's membership and directorate kicking and screaming into the very late nineteenth century, catching up with the other exchanges in forming a modern clearing house.

A second major innovation, the BCC, was also announced by Carey in an editorial in the *Country Gentleman*:

The creation of [this] committee by the Board is regarded as a matter of equal importance with the incorporated Clearing House. It may be said that the Chicago Board of Trade has put its house in order [...] If the exchange is left alone and encouraged the way will be smooth and the road easy.²¹⁹

But, again, the BCC, like modern clearing, was not a result of the Board's 'own initiative'.

4.6 BUSINESS CONDUCT COMMITTEES

4.6.1 *Towards Co-regulation*

Before 1925, enforcement of the CBOT's own long-standing rules, the anti-corner rule of 1876 pertaining to reducing manipulation for example, was lax and random, or at worst subject to power relations. For example, when the Board executive attempted to fine two traders for an attempted corner, an emergency board meeting was held and it was the executives who were censured rather than the perpetrators.²²⁰ If the CBOT committees were unlikely to enforce their own rules,

²¹⁹Ibid.

²²⁰Charles H. Taylor, *History of the Board of Trade of the City of Chicago* (Chicago: Robert O. Law, 1917).

new tougher rules alone would not actually reduce manipulation. As the GFA's Brand observed in a letter to Capper, 'The exchanges have it in their power at all times by the relatively simple expedient – though unwilling resorted to – of correcting conditions by changing the rules that make up the contract'.²²¹ Prosecutions required proof, with such proof almost impossible to obtain. Position and trading data were the property of the member, and, though now provided to the GFA in aggregate form, was unavailable to the CBOT's own committees. Additionally, rules were not easily interpreted and applied, or the original purpose of a rule may have disappeared over time. For example, Rule 16 Section 3 might, or might not, require that a broker act in the best interest of his client.²²² CBOT committees often sought outside counsel on interpretations of rules, and for suggested changes to rules, in order that they would work in the way intended. Additionally, it was unclear what powers and obligations the Board's committees had to prosecute even obvious transgressions such as trading in banned privileges.²²³ The solution, according to both Board executives and the GFA, was to implement an institution that continues to this day, the BCC.

The CBOT executive changed between 1922 and 1926, but the strategy to support the 'harmless' 1922 Act, to self-regulate the worst excesses of the market and to establish modern clearing had not. John J Stream was elected president in 1923, supported by executive vice-president John Mauff.²²⁴ The report of outgoing President Robert McDougal summarised the two issues of the day as (i) the elimination of the most egregious manipulation and (ii) the clearing house proposal. He further noted that 'the extraordinary number of expulsions and suspensions necessary during the year indicate that the requirements of membership need stiffening and ought to be raised'.²²⁵ Newly elected President Stream's welcoming address mirrored McDougal's farewell report, cautioning that:

²²¹ Letter, Brand to Capper, 1 June 1925. NARA/KC, Box 12, 14-6.

²²² Letter, Carey to Morris Townley, ca. 15 April 1925. CME III.16.7.

²²³ Letter, Mauff to Robbins, 8 December 1921. CME III.2.641.3.

²²⁴ John Stream, Speech in the *Saturday Evening Post*, undated. CME III.660.8. For an example of his troubles, see "Seek Curbs on Elevators," *Chicago Tribune*, 30 October 1906.

²²⁵ Report of the President Robert McDougal addressed to members of the Board of Trade of the City of Chicago, 12 January 1923. CME III.665.9.

The Board must remove from within, the causes that have been the source of all our antagonism; and until these evils are eradicated, it will avail us little to shout our virtues from the housetops or damn the agitator or reformer. We must have clean hands if we are successfully to plead our cause and hold public confidence.²²⁶

The 1922 Act did not curb manipulation: The CBOT had not become a better policeman. Even the Grain Exchange National Committee, the exchange lobbyist, admitted that the exchanges were powerless to stop most manipulations.²²⁷ Squeezes still occurred on a regular basis, as did defaults by members, yet this did not motivate members to lobby for modern clearing, or a limit to speculative operations. For some, the markets were functioning just fine under pure self-regulation. For example, in March 1923, members felt the need to petition the Board to intervene in the oats market and set a settlement price for the March contract to negate a suspected corner.²²⁸ As described earlier, in early 1922, Arthur Cutten had attempted a corner of May 1922 wheat, but had been foiled by a ruling of the CBOT directorate to allow delivery by rail cars in addition to that evidenced by elevator receipts.²²⁹

Generally, the CBOT executive, if not the entire membership, sought to curb abuses in the markets rather than have the government do it for them. Unfortunately, due to collective action problems, especially as regarded some of the more powerful members, Stream did not reduce manipulation and was not able to establish modern clearing.²³⁰ Those tasks were left to the president of the CBOT in 1924 and 1925, Frank Leighton Carey, a partner at grain trader Hallet & Carey Co. with offices in Minneapolis and Duluth. During World War I, Carey served as vice-president of the US Grain Corporation and was involved in the US Food Administration, and from 1919 he was a Special Agent of the US Wheat Director Julius Barnes, tasked to investigate wheat trading and

²²⁶John Stream, Speech in the *Saturday Evening Post*, undated. CME III.660.8.

²²⁷Letter, Mauff to Robbins, 28 February 1923. CME III.659.3; Memorandum from Executives of the Grain Exchange National Committee to the Boards of each of the exchanges, undated. CME III.2.650.5.

²²⁸Petition, 19 March 1923. CME III.665.9.

²²⁹William G. Ferris, *The Grain Traders* (East Lansing: Michigan State University Press, 1988), p. 167.

²³⁰Letter, Barnes to Mauff, 28 April 1923. CME III.642.5.

storage.²³¹ In order to keep Mauff within the executive of the CBOT, even though he was replaced by James J. Fones as secretary in 1923, the CBOT created the new position in early 1923 of executive vice-president at \$17,000 per year, more than double the secretary's wages.²³² Clearly the Board realised Mauff's value if he was to be paid more than twice as much as the secretary. It was Fones, Mauff and Carey, working with LF Gates and Sam Arnot from Chicago and FB Wells in Minneapolis, who oversaw the transformations of 1925–1926. Carey and Julius Barnes remained close confidantes during this period, especially important as the latter was President (1921–1924) and then Chairman (1929–1931) of the US Chamber of Commerce.

The CBOT executive, and even former executive committee members such as Joseph Griffin, now at Bache & Co, were fully cognisant of the problems with the self-regulatory *status quo*. These experienced leaders at the CBOT had not only developed a firm understanding of regulatory tools and both open and behind the scenes lobbying, they were aware of the benefits of co-construction and co-regulation beginning in the mid-1920s. Frank Carey wrote to Griffin on 29 July 1925 bemoaning an accusatory letter from a former Illinois Congressman—close to the US President—to another about the need of the CBOT to clean up its act. Carey had added, 'What evils may exist must be eradicated by us. If we fail so to do then the task will be accomplished by others who are neither friendly nor competent'. Carey was also planning 'to have the Clearing House matter in full swing before the end of the week'.²³³

CBOT President Carey, who died in 1933, went through a period of ill health in early 1924. A set of letters over Carey's six weeks' convalescence, together with telegrams and records of phone calls, offer significant insight into the functioning of a self-regulatory business association, such as the CBOT, in times of unprecedented change.²³⁴ The letters reveal the internal political strategy of the CBOT executive

²³¹Letter, Julius Barnes, United States Wheat Director, to Carey, 24 July 1919. CME III.ss1.9.

²³²Memorandum to the President and Board of Directors of the Board of Trade of the City of Chicago, 17 February 1923. CME III.ss1.9.

²³³Letter, Joseph Griffin, Bache & Co. to Frank Carey, CBOT president, 29 June 1925. CME III.ss1.9.

²³⁴Letter, J. Simons, first vice president, CBOT, to Carey, Florida, 28 February 1924. CME III.ss1.9. Carey was in Florida for almost six weeks from 21 February to 1 April,

between members and Board committees, between lobby groups and the directorate and between the CBOT and other exchanges. The executive was mostly in agreement on the reform agenda, yet Gates and others disagreed on some issues. Arnot wrote to Carey on 10 March 1924 that ‘everything will be done that is possible to carry out your policies, because they coincide thoroughly with my own and the Inter-Exchange Committee’.²³⁵

Although the Secretary of Agriculture in 1925 was threatening to punish manipulators albeit generally unsuccessfully, the GFA was no better a police force.²³⁶ While information gathering and report making were the most visible of works done by the GFA, enforcement proved problematic. The GFA was constantly complaining to the Commission, the Congressional committee on Agriculture and the Secretary of Agriculture about their lack of power to enforce proper market discipline.²³⁷ Attempts at on-the-ground regulation by the GFA were thwarted by the CBOT, the Supreme Court, the Grain Futures Commission and also by the poor wording of the Act itself. For example, two lawsuits seeking to ban known market manipulators failed because it was ruled that the Act only applied to those in the *actual* process of manipulating the markets as opposed to those who had manipulated markets in the past.²³⁸

As a result of its lack of direct power and influence on the markets, when the GFA noticed manipulation or fraud, its only recourse was to report it to the exchanges.²³⁹ As such, the exchanges remained in control of the enforcement, even if, legally, they were not obliged to enforce their own rules under the obviously weak 1922 Act. Prosecuting

1924. Others, including J. Simons, Board director and for a time acting chairman of the directorate, also corresponded with Carey during this time.

²³⁵Letter, Arnot to Carey, 10 March 1924. CME III.ss1.9.

²³⁶Letter, Brand to Capper, 1 June 1925. NARA/KC, Box 12, 14-6.

²³⁷See, for example, US Congress, Hearings Before the House Committee on Agriculture on HR 3009, 74th Cong. 1st Sess., 7 February 1935.

²³⁸Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), pp. 285–287.

²³⁹Jerry. W. Markham, “Manipulation of Commodity Futures Prices—The Unprosecutable Crime,” *Yale Journal on Regulation* 8 (1991): 281–305, p. 303.

manipulators or bucketers was difficult, as such activities needed to be proven in a court of law. The CBOT's own counsel advised the executive that 'If the charge is that the member has generally engaged in [...] irregular practices, it would still be necessary to prove enough specific instances to sustain the general charge'.²⁴⁰ Under the current system, therefore, manipulation was rampant and immune to prosecution.

By 4 August 1925, it was likely that a significant increase in wheat futures prices constituted a corner on the exchange. The committee fixing a price for defaulted July 1925 futures contracts had reported that the July price 'was run up too high and it penalised the short seller for defaulting'.²⁴¹ However, the Board's directorate did not consider it a corner, did not cite any members who were withholding grain and did not punish a single trader.²⁴²

Although the CBOT had many committees, they lacked authority and were sometimes caught up in trivial minutiae. Two of the hundreds of trivial petitions in the archives that needed to be handled by one or more of the applicable committees include: 'I am directed by the president to inform you that you have been suspended from the privileges of the Board of Trade for one day, on complaint of the Room committee for boisterous conduct'.²⁴³ 'I wish to file charges against Samuel Mincer for uncommercial conduct. He called me a tout in the Smoking Room yesterday afternoon'.²⁴⁴ Of course, much worse behaviour than is reported here was a regular occurrence on the trading floor then and throughout the twentieth century.²⁴⁵ The CBOT admitted internally that it had troubles with members conducting business without adequate funds, and even sometimes when insolvent. In one letter to Mrs. MacMillan, the CBOT secretary admitted that he should be glad to support any regulation that helped in expelling such members.²⁴⁶ But on its own, the CBOT executive did not have the power nor the support to have new

²⁴⁰ Letter, Mauff to H.S. Robbins, CBOT Counsel, 28 January 1922. CME III.ss2.653.1.

²⁴¹ Letter, Carey to Lonsdale, 4 August 1925. CME III.ss1.9.

²⁴² Ibid.

²⁴³ Letter, Fones to Ludwig B. Armerding, 28 May 1923. CME III.642.1; Letter, Fones to Stream, 25 May 1923. CME III.660.7.

²⁴⁴ Letter, Anonymous to Stream, 2 February 1923. CME III.660.8.

²⁴⁵ See, for example, the altercations in the film *Floored: Into the Pit* (2009).

²⁴⁶ Letter, Secretary of CBOT to MacMillan, 17 January 1923. CME III.667.4.

laws passed and, anyway, the Board always defaulted to a self-regulatory mindset.

The enforcement provisions under the 1922 Act were weak, while allowing industries to self-regulate introduces a range of problems. For example, non-members in a members club cannot be prosecuted by the club for violations of club rules.²⁴⁷ Additionally, members clubs tend to be more focused on public relations than on creating and enforcing club rules. In the case of the bankruptcy of the Grain Marketing Co., a Special Investigating Committee of Gates (chairman), Griffin, Patten, Hoyt and a Frank G. Coe,

[...] carefully examined the voluminous records, held almost daily sessions for nine weeks and examined many witnesses concerning all phases of the organisation, operation and dissolution of the Grain Marketing Co. As a result of the investigation, certain members were charged in connection with the investigation. Wrongdoers [...] were impossible to prosecute, as (1) it was thought the company would be able shift the guilt to non-member employees, while at the same time (2) the private arbitration testimony was privileged and would not be available for trial purposes.²⁴⁸

The Board's executive and its membership could read complaints in the press, and they received many letters that criticised the Board for allowing egregious manipulation. The Secretary of Agriculture, as per a CBOT letter, had already blamed the large rally and increased price volatility in 1924 to early 1925 on 'the heavy trading of a limited number of professional speculators'.²⁴⁹ As such, the CBOT executive formed a Members Program Committee, with Gates as chair and Siebel Harris on the committee, to 'prevent the recurrence of such wide price swings'.²⁵⁰ In an undated 1925 memo from the Committee to the CBOT board of directors, the committee observed that 'the Board [...] is not so well

²⁴⁷Michael Lenox and Jennifer Nash, "Industry Self-Regulation and Adverse Selection: A Comparison Across Four Trade Association Programs," *Business Strategy and the Environment* 12 (2003): 343–356.

²⁴⁸Letter, Special Investigations Committee to the President and the Board of Directors, CBOT, undated. NARA/KC, 101-1.

²⁴⁹Communication from the Members Program Committee to All Members, 7 July 1925. CME III.16.8.

²⁵⁰Ibid.

equipped to handle special emergencies or prepare for them [...] and there is a traditional reluctance on the part of our Boards of Directors to take preventative steps against, or special action during, emergencies, except [...] as specifically authorised by the rule'.²⁵¹

The committee concluded that the participation of the GFA was crucial to reduce manipulation as well as enact voting by proxy in that the GFA would not be easily swayed by social or political pressures that were rampant at the exchange. As such, the above documents the realisation that it would take the uniting of the two forces, government and market, to make a controlling regime function. The committee suggested:

1. A reorganised clearing house [already acted upon].
2. Proxy vote by mail.
3. No daily price limits, but that the Board should have the power to implement such if deemed appropriate in an emergency.
4. Restore the trading of privileges.
5. New crop estimate releases may only be made after trading day ends.
6. The creation of a BCC to work with information supplied by the GFA.²⁵²

The Cutten Corner provided a window allowing the Board's executive to establish the last of the key committee proposals listed above, the BCC. As with modern clearing, adopted by the CBOT's membership in behind the scenes collusion with the USDA, the BCC offers an obvious and undeniable example of co-construction, here with more equal partners. Pressure was already being put on the Board's directorate by the GFA to form a new committee to enforce proper market conduct. The archive shows that both the Board executive and the USDA were in favour of establishing a joint operation where the GFA head in Chicago would sit on the committee and the GFA would provide information and aid in the investigation. In fact, it turned out that it was the GFA that brought most of the cases to the BCC, and the GFA expected the kind of action that would have occurred had it the power to prosecute.

²⁵¹Memorandum from the Members Program Committee [undated but 1925]. CME III.18.2.

²⁵²List is a quotation from Memorandum from the Members Program Committee [undated but 1925]. CME III.18.2.

There was a precedent for joint operations with such actions taken based on the detailed and often confidential information. In 1925, when the GFA found that reports of unusual trading coming from the floor were often error ridden, the CBOT added a rule prohibiting such ‘flashes’ unless based on provable fact. Also in 1925, the GFA concluded that unusually large trades had the potential to cause debilitating price volatility, with the result that the CBOT adopted a rule limiting daily price ranges in emergency situations. The Cutten Corner of 1925 appeared to have been stopped by what the *New York Times* deemed a public threat to the CBOT from Secretary Jardine, but was actually a product of some behind the scenes pressure.²⁵³ In an interview with the *Saturday Evening Post*, speculator Arthur Cutten recalled that the CBOT, working with the GFA, pushed him to end the Corner by stating, ‘You ought to sell some wheat for the sake of the Board of Trade. You know, this committee is the device we settled upon to keep the government from taking fuller control of the trading in futures’.²⁵⁴ This cooperation was announced more formally on 7 July 1925, where the Board authorised the president, Carey, to appoint a Grain Futures Committee to work with Duvel of the GFA.²⁵⁵

It was important that the CBOT’s BCC be seen in Washington to be a success. Gates wrote to outgoing President Frank Carey on 26 January 1926 that he should write to Secretary Hoover as to what a success the BCC has been. The GFA’s representative, Theo. Hammatt, was especially keen that the state-industry cooperation be acknowledged in Washington at the highest level.²⁵⁶ Capper was pleased with the adoption of the BCC, stating, ‘I believe no one can fail to appreciate the fine spirit in which your governing body has approached the problem [and, if the BCC is properly tasked] long steps will have been taken towards the elimination of evils which brought forth the enactment of the grain futures act’.²⁵⁷ Capper, clearly a believer in free markets and

²⁵³ *New York Times*, 19 March 1925.

²⁵⁴ Arthur Cutten with Boyden Sparkes, “The Story of a Speculator,” *Saturday Evening Post*, 19, 26 November 1932.

²⁵⁵ Letter, Fones to Carey, 8 July 1925. CME III.16.8.

²⁵⁶ Letter, Gates to Carey, 20 January 1926. CME III.11.9.

²⁵⁷ Letter, Gates to Wells, 17 October 1925. CME III.11.9.

self-regulation, added, ‘I have no desire to impose ruinous restrictions upon the proper activity of the Board of Trade’.²⁵⁸

The BCC remains a key component of financial self-regulation, even if was not a result of pure self-regulatory intent. In fact, without government intervention, such an institution might never have been adopted by the membership at large, and perhaps would not exist today. The National Futures Association, a consolidated regulator of all futures markets, together with individual exchanges such as the Chicago Mercantile Exchange, all have such committees. Disciplinary action remains quite common at both levels, as can be seen from the public record on exchange websites. In terms of the BCC solving the CBOT’s collective action problem, Duvel himself commented that ‘[i]t is only fair to say that the majority of board-of-trade members were more or less disgusted with the conditions that existed, but fear of reprisals and ruin of their own business rendered them helpless to do anything’.²⁵⁹ Duvel observed the same phenomenon as is argued in this study; the BCC, like modern clearing, came as a result of co-construction by government and markets.

4.6.2 *Cooperation in Committee*

The BCC, which comprised five members who agreed not to speculate while serving, was tasked with supervising the business conduct of members and their relation to the non-member customers, the public, the state and the Federal Government. It could examine books and other records and its conclusions would be final. Because members were reluctant to reveal information to potential competitors, the GFA would be the initial investigator, and consider the information to be confidential. Neither results nor the data would be widely exposed to the membership, the directorate or other CBOT committees. That is, the CBOT relied on the GFA to be an *independent* gatherer of facts as well as the initial arbiter, another useful contribution of government to markets. This is true co-regulation. But the GFA needed the support of the

²⁵⁸Ibid.

²⁵⁹J.W.T. Duvel, *The Grain Futures Act—What Is It?* (Statement by the Chief of Grain Futures Administration), United States Department of Agriculture (Washington, DC: Government Printing Office, 1933).

CBOT to permit the release of data, as well as monitoring for potential manipulative or fraudulent behaviour.

By the end of 1925, Duvel and the GFA had agreed an agenda to be presented to the CBOT's BCC. Duvel wanted the BCC to obtain reports from clearing and non-clearing members of the exchanges, fix speculative position limits, take closer notice of rumours and gossip and amend delivery rules to stop opening new trades by the middle of delivery months.²⁶⁰ Even though the GFA could alter the reporting levels for Special Accounts unilaterally, it wanted the BCC to agree that the limit should be lowered from 500,000 bushels to 200,000 bushels.²⁶¹ The goal was to be able to identify possible manipulation before it became egregious or even dangerous to the proper functioning of markets.

At the behest, but importantly not the demand, of the GFA another committee was formed to properly codify the rules of the CBOT with the help of its counsel, Townley.²⁶² The new Board rules also empowered the Board of Directors, on a two-thirds majority, to set a percentage limit above or below which no trading could occur. Carey was against limits, but on 25 June 1925 he wrote to Wells that 'I think if [Jardine] insists upon it that the Board itself should put a rule through'.²⁶³

In the early days, the BCC was seen to be allied with the interests of the GFA in preventing manipulation, even if this situation was to deteriorate over the years leading up to 1936. According to Duvel, 'during the delivery months of December and May [1926] the BCC rendered excellent service. They undoubtedly prevented what probably would have been two of the most successful corners ever staged on the Chicago Board of Trade'.²⁶⁴ The GFA brought many such potential corner situations, such as the manipulation attempts by Cutten in 1926, to the attention of the BCC for their investigation and action. The CBOT brought the firepower, backed by the—usually implicit—threat of government control or criminal punishment. Thus the executive, directorate and committees were able to use government threats to force powerful

²⁶⁰Memorandum, Summary of Points for Consideration at the Proposed Conference with the Business Conduct Committees (written by Duvel), 31 December 1925. NARA/KC, 101-1.

²⁶¹Ibid.

²⁶²Letter, Fones to Carey, 24 June 1925. CME III.16.8.

²⁶³Letter, Carey to Wells, 25 June 1925. CME III.14.2.

²⁶⁴Memorandum, Duvel to the Secretary, 25 June 1926. NARA/KC, 305-1.

interests to follow the rules and support the new institutions. The GFA analysed detailed confidential information obtained directly from clearing members, then provided the CBOT with evidence if they believed further investigation was warranted. On the whole, members were happier to give the information to the GFA than directly to their friends, enemies and competitors on the various committees. This system functioned well for a time and is still utilised in many regulatory regimes.

4.7 VOTING BY PROXY

The executive had another fight on their hands when it came to voting for amendments that had the potential to modernise futures markets. In order to maintain the status quo, powerful interests consolidated power in the locale of Chicago by disallowing voting by proxy. This nearly cost the Board dearly in 1921 when the Federal Government had planned to ban private wire houses in the Midwest hinterland (Chapter 3). Locals were in favour of a ban while of course members depending on the small speculator and the country elevator hedger were against such a restraint of trade. The directorate, as in the clearing house matter, sided with the powerful reactionary interests, and on 21 January 1920 rejected a petition allowing vote by proxy, even after Board counsel admitted there were no legal reasons to disallow it.²⁶⁵ The Board's executive were in favour of proxy voting as out of town members provided much needed support against the powerful interests in Chicago who only wanted to increase their own monopoly and profitable trading (including manipulation). As a result, proxy voting was put through by the CBOT in 1926 after significant pressure from the GFA and the USDA.

4.8 STRAINED RELATIONS BEGIN

One of the biggest issues with the BCC remained that, while prosecution for manipulation was easier to effect, easier to identify, and now up to the BCC to rule upon, the punishment was limited to censure, suspension or expulsion. While admittedly this was a sufficient threat

²⁶⁵Letter to the Board of Directors of the Board of Trade of the City of Chicago from the Legal Advice and Rules Committee, 19 January 1920. CME SII.90.1.—The directorate rejected the petition as ‘such amendment would not be for the best interest for the capital Association.’

for some grain men, the larger speculators, who were really the target of the GFA's ire, were likely to be unmoved by such threats. The powerful could easily push back, and expulsion was a nuclear option rarely resorted. More serious punishment, though, was beyond the scope of the 1922 Act and clearly the CBOT was unwilling and unable to prosecute members in the courts.

Although the GFA and the CBOT cooperated at the BCC during this period, relations between the GFA in Chicago and the Board and its membership in general were strained. In fact, cooperation at the Board executive level did not last long after 1926. Carey did not think much of Duvel, especially due to the latter's insistence on proper reporting. A letter from Carey to Dies dated 21 January 1926 states, 'I guess the Washington meeting turned out to be of very little importance on a meeting of the various committees with Jardine and a few fool suggestions made by Duvel, which were quite characteristic of his suggestions'.²⁶⁶ Earlier, Carey observed that Duvel's recent speech 'shows the trend of his mind and danger hangs over our market if his suggested limitation of daily fluctuations was put upon us'.²⁶⁷ The CBOT considered GFA staffer and ex-insider Rollin Smith to be a bigger threat. Carey wrote to Gates on 12 December 1924 that Smith's testimony was overly adversarial and ill-informed. Carey had 'already taken steps to have [Smith's criticism ...] brought before higher officials' and he asked Gates to have his Committee 'lay [it] before Mr Dean [in Washington] and I think [it] should be laid before the President. If the grain trade is to receive such attacks from employees of a government department, it is high time we at least called the President's attention to same and let him know that we strongly resent it'.²⁶⁸

Even the CBOT executive and its friends were aware that the BCC had failed by 1930. Barnes complained to Carey on 2 January 1930 that,

I wish we could study some way to get the Business Conduct Committee [to proceed] with backbone and conviction, having in mind the greater objective of preserving public confidence in future trading, rather than playing anybody's interest, buyer or seller.²⁶⁹

²⁶⁶ Letter, Carey to Dies, 21 January 1926. CME IIII15.14.

²⁶⁷ Letter, Carey to Gates, 13 November 1924. CME III.11.10.

²⁶⁸ Letter, Carey to Gates, 12 December 1924. CME III.11.10.

²⁶⁹ Letter, Barnes to Carey, 2 January 1930. CME III.14.13.

That is, Barnes and Carey, CBOT insiders and generally in favour of self-regulation, could both easily see that the BCC could no longer adjudicate in the public interest, but was rather captured by powerful member interests. The fracture in relations between the BCC and the GFA that occurred after 1927 was to be a major catalyst for the legislation of 1936.

4.9 CONCLUSION

Between 1923 and 1926 the GFA, as information gatherer, mostly cooperated with the CBOT and the USDA to provide for three now-ubiquitous key elements of modern futures markets, (i) large trader position reporting, (ii) modern clearing, and (iii) the BCC. The requirement for reports from clearing members, analyses provided by the GFA and the use of the information as evidence in manipulation cases, all stemmed from an otherwise mostly powerless 1922 Act, where the CBOT was provided with legitimacy and protection in return for allowing ever increasing transparency in the markets. Today, both modern clearing, considered one of ‘two critical elements’ of futures markets in markets literature, and the BCC are considered essential to the functioning of futures markets.²⁷⁰

The Rules based on the 1922 Act can be seen as a logical technocratic response to the 1921 Depression, focused as they were on information gathering in advance of any decision to control futures markets. Such information based goals were consistent with similar strategies of this and an earlier era, such as the use of information disclosure to inform on subsequent railroad regulation by Charles Francis Adams in the second half of the nineteenth century.²⁷¹ However, the Federal Government went beyond simple information processing by cajoling otherwise recalcitrant CBOT members who had rejected self-regulation into finally adopting both modern clearing and the BCC. Additionally, the government and

²⁷⁰Anne E. Peck, “The Economic Role of Traditional Commodity Futures Markets,” in *Futures Markets: Their Economic Role*, ed. Anne E. Peck (Washington, DC: AEI Press, 1985), pp. 12, 73; Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 234.

²⁷¹Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis and Alfred E. Kahn* (Cambridge: Harvard University Press, 1984).

the futures industry worked together to prosecute manipulation in the markets, as neither the CBOT executive nor the GFA had the power to do it alone. Such co-construction was not unusual during this period.

The risks of misunderstanding the origins of modern clearing, in particular, are ever present in the current discussions over effective systemic risk management tools in the present day. Randall Kroszner, an academic and Governor of the Federal Reserve System, interprets the historical record as illustrating ‘how market forces led to the evolution of organisational and contractual features that have created strong incentives for effective private regulation that addressed both market participants’ and public policymakers’ concerns about risk control’.²⁷² If this is to be believed, self-regulation rather than government interference would be the answer to many regulatory problems.

But the Board as a whole, at least in the 1920s, would not and did not adopt clearing of its own accord, had little incentive to end manipulative practices and were not interested in transparency in the markets. Modern clearing and the BCC can be seen as relevant examples of government and industry co-construction in the face of a weak regulatory regime and otherwise-insurmountable collective action problems in industry. As such, neither are parables of effective self-regulation but examples of effective polycentric and co-regulation, where many interests benefited from the cooperation between governments and markets.

Popular literature is also wide of the mark in this regard. In Emily Lambert’s work on futures market speculation she writes that the Secretary of Agriculture demanded that Board of Trade members oust the clique of ‘gamblers and scalpers in control of the exchange. And members in the 1920s had no choice but to adopt something they had resisted [...] central clearing’.²⁷³ Yet the fight for modern clearing and

²⁷²Randall Kroszner, *Central Counterparty Clearing: History, Innovation, and Regulation*. Speech at the European Central Bank and Federal Reserve Bank of Chicago Joint Conference on Issues Related to Central Counterparty Clearing, Frankfurt, Germany, 3 April 2006. <https://www.federalreserve.gov/newsevents/speech/kroszner20060403a.htm>. Accessed 1 March 2017.

²⁷³Emily Lambert, *The Futures: The Rise of the Speculator and the Origins of the World’s Biggest Markets* (New York: Basic books, 2012), p. 15.

the BCC cannot be said to have been won by an ideologue in the form of Jardine, as has also been claimed by William Falloon.²⁷⁴

Errors in interpreting the actions of the USDA were not limited to modern accounts. Contemporary sources were equally misled by the public record. In late 1925, Secretary Jardine was said by the *Wall Street Journal* to be ‘entitled to credit for making issue and forcing rules for good government and better conduct in the business of grain speculation and without sensationalism or popular or political agitation’.²⁷⁵ Ironically, though, the *Journal* went even further and suggested that the New York Stock Exchange could learn from the CBOT how to establish its own good conduct rules.²⁷⁶ However, as this chapter showed, this innovation was not a result solely of CBOT self-regulation.

The CBOT executive, directorate and membership fought internally as regards the value of, (i) the 1922 Act and the 1923 Rules, (ii) modern clearing, (iii) a reduction in manipulation and (iv) market transparency. It is often believed that markets are more ‘efficient’—that is, immediately reflecting fundamental value or at least unbiased—the more transparent they are, the less manipulation is allowed to distort prices and the more confident the counterparties are that other risks—such as counterparty credit risk—have been mitigated. Transparency, improved efficiency and a reduction in counterparty risk were only possible through a concerted strategic effort by the GFA and the CBOT executive. In the 1920s elements of the regulatory regime were ‘captured’, as is predicted in the economic theory of regulation, resulting in the futures industry being supported by government regulation. Kolko has argued such capture was endemic to industry economic regulation during the Progressive Era. However, unlike other cases where excess rents appeared to have been captured by industry or other special interests, alone, the result of the interwar futures regulation was that the markets were made more efficient and less exposed to idiosyncratic and systematic credit risk.

²⁷⁴See, for example, William Falloon and Patrick Arbor, *Market Maker: A Sesquicentennial Look at the Chicago Board of Trade* (Chicago: Chicago Board of Trade, 1998), pp. 157–158.

²⁷⁵Clipping, C.W. Barron, *Wall Street Journal*, 20 October 1925. CME III.12.5.

²⁷⁶Ibid.

Additionally, the information gathered during the same period resulted in a huge increase in the understanding of how markets functioned or failed. Consequently, the ‘captured’ 1922 Act can be said to have actually been in the public interest, inasmuch as the innovations effected are now incorporated into all exchange-traded derivative product markets. The regulations, the rules and the form the markets currently take are based heavily on the actions taken by the Federal Government in that centralised clearing, which is now ubiquitous, was adopted, post-GFC, in the larger OTC markets. Furthermore, the futures exchanges continue to self-regulate and are monitored by the latest iteration of the GFA. Exchanges still have BCCs and provide public daily trader reports. The CFTC (originally the GFA) continues to authorise ‘contract markets’.

The Grain Futures Act empowered a bureaucratic elite to obtain and process vast amounts of expensive-to-obtain information about the functioning of the grain markets. Even though the 1922 Act and the Rules were mostly ‘captured’, the information gatherers and analysts were not, since Duvel, Smith, Mehl and Fitz pushed the limits of their power. The 1925 fluctuations embarrassed the exchanges, the grain men and their regulators, but there was no possibility of new legislation between 1922 and 1935, no matter how many bills were put through Congress. In the meantime, the CBOT, capitalising on the light touch regulatory environment, worked with the government to introduce key institutions and norms into the market. In 1926, the information gathered was not only relied upon to cajole the Board, but it also played a key role in the drafting of the 1936 regulations. Most importantly, however, was the degree of policing of the previously rampant manipulation, which was accomplished as a result of this information, instead of a strongly enforced legal mandate by the GFA. Consequently, even while public victories over the manipulators in the courts were rare (Chapter 5), the GFA was successful in ending some abuses of market function and the ill-treatment of customers.

In summary, the GFA and the USDA spurred improvements and important new institutional features, such as modern clearing and BCC, but not necessarily for the reasons given in the literature. Self-regulation cannot be said to have caused the spurt of innovation between 1923 and 1926. As a result, the framework described in this chapter, which existed on the eve of the 1929 Crash, should be described rather as ‘market co-construction’ by government and industry in an albeit strange arrangement that did not survive the Great Depression.

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Legitimising the Grain Gambler and the Commodity Exchange Act of 1936

5.1 FROM GAMBLING DEN TO ‘NECESSARY’ INSTITUTION IN THE PUBLIC INTEREST

During the Great Depression, a significant change in the direction and philosophy of Federal Government intervention took hold for most areas of US business.¹ From the Crash of 1929 to the declaration of the Agricultural Adjustment Act (AAA) and the National Industrial Recovery Act (NIRA) as unconstitutional in 1935, there were greater priorities than the evolution of futures market regulation. To the extent that the futures markets were targeted at all, federal policy-makers and their agents were keen to use regulation to stabilise grain prices. George Peek, chief of the AAA, informed the exchanges in a private conference in 1933 that ‘we are charged by Congress under the Agricultural Adjustment Act [with the ...] raising of farm prices to parity’.² Yet using self-regulation, or indeed any traditional command and control regulation, to boost prices was always going to be a pipe dream.

¹There is a deep and contested literature about the New Deal. The traditional approach is best exemplified by William E. Leuchtenburg, *Franklin D. Roosevelt and the New Deal, 1932–1940* (New York: Harper, 1963); Arthur M. Schlesinger, *The Age of Roosevelt* (Boston: Houghton Mifflin, 1957).

²Transcript, Informal Conference with Chicago Board of Trade, other Exchanges and the Federal Government, 10am, Reporter Mr. Sharkey, 24 July 1933. CME. III.850.1.

The failure of all efforts to negotiate a voluntary code of conduct for the futures markets set the stage for an unlikely coalition of the GFA and the American Farm Bureau Federation (AFBF), the powerful farm lobby group. This chapter shows that the AFBF, in sponsoring futures regulation at least, was not interested in raising grain prices for the American farmers, as is claimed by Roberta Romano, but was more interested in punishing the CBOT and weakening its resistance to the farmer's cooperative movement. Market efficiency—less manipulation, less fraud and more confidence in the markets in general—was always the goal of the eventual 1936 legislation, which focused almost exclusively on protecting the small and numerous 'grain gamblers' from fraud and manipulation. Previously vilified by state legislators and academics, the small speculator by the 1930s was considered by the GFA and the AFBF to be the critical participant in the efficient functioning of futures markets during the marketing cycle.

Although the GFA was unable to gain the attention of an increasingly distracted and pro-business Secretary of Agriculture in the very early 1930s, soon after it was able to join with the AFBF to co-author a new bill that passed into law as the 1936 Commodity Exchange Act (CEA), which amended the 1922 Act. The GFA allowed the AFBF to dictate terms surrounding the cooperatives but otherwise had key clauses inserted that protected and encouraged speculators to enter the market. Here, as in 1921, the law did not curb futures trading in any meaningful way. This time it was the powerful idea of the futures market as an efficient price setter and space for risk management that dominated any rent-seeking motivations. The CEA protected speculators from fraud and unethical activities. There was no chance of a blanket ban or any heavy control. Such protections included segregating client margin monies from a firm's general accounts and the requirement that a firm could not act as both principal and agent in a client transaction, effectively banning bucketing as well as limiting front-running and other conflicts of interest. These have become, like the earlier innovations of 1923 and 1926, required and routine practices in futures markets.³

³However, CBOT members could still flaunt the rules, as the FBI raids of the 1990s demonstrate. For a fulsome explanation of criminal activity discovered in 1989–1991, see Davis Greising and Laurie Morse, *Brokers, Bagmen, and Moles: Fraud and Corruption in the Chicago Futures Markets* (New York: Wiley, 1991).

The CBOT directorate was privately in favour of these changes, even if publicly many in the membership protested any additional government involvement.

In the final analysis, a non-rent-seeking special interest was able to work with a semi-autonomous government agency in the public interest, where that interest also benefited the industry itself. Once again, it is clear that the government versus markets debate is a false dichotomy since it is shown here that all participants in a regulatory regime can function together to create stable and long-lasting institutions that are seen to be essential to modern business and finance. While the 1922 Act can be explained by a compromise between the ideas and actions of government and markets and the 1926 innovations are best considered as co-construction of a regime by both government and industry, the 1936 Act's history is much more complex. Three key questions need to be answered when analysing the 1936 CEA; (i) Who was responsible for the successful legislative push in the mid-1930s? (ii) Why did the CEA come into being? and (iii) What is the explanation for the substance of the CEA? The answers to the first two questions require an understanding of the multiplicity of interests within both government and industry and, of course, between the futures industry, different levels of the Federal Government and producer organisations. Without support, the GFA could not adequately advance its case for better regulation in the public interest due to political constraints, as well as it not wanting to alienate the industry that it relied upon for the information necessary to supervise the markets.⁴

This chapter shows that the CEA of 1936 was born out of a marriage between a powerful private interest and a knowledgeable yet mostly powerless government agency. The failure of the voluntary Codes in 1935 in the midst of a worsening depression finally opened a policy window whereby the GFA, working with and through the AFBF, seized control of the process to produce legislation for grain

⁴This latter conundrum is well understood in regulation studies. See, for example, Julia Black, "Critical Reflections on Regulation," *London School of Economics/Centre for the Analysis of Risk and Regulation Working Paper*, 2002, pp. 3, 18; Christine Parker, "The 'Compliance' Trap: The Moral Message in Responsive Regulatory Enforcement," *Law & Society Review* 40 (2006): 591–622.

futures that was in the interest of almost all market participants, thereby placing it in the ‘public interest’ and as far from rent-seeking as was possible.

The third question, regarding the substance of the Act, can be answered by understanding the outcome of the previous thirteen years of study. Government analysis indicated that futures markets were a key contributor to efficient grain marketing, in spite of the recent depression in futures prices, and the data and analysis together provided a knowledge base from which an entire field of study was launched. As in 1926, the information gathered and analysed by the GFA informed the government about the changes that needed to be made in 1936. Such policy learning is common today, yet also existed in interwar regulatory policy.⁵ Hoover, for example, considered the AMA and the Federal Farm Board intervention to be a grand policy experiment.⁶ Similarly, the CEA broke new ground as regarded a new form of enforced self-regulation for markets. The 1936 Commodity Exchange Act established a key new concept in financial market regulation in the USA, encouraging and also protecting the small speculator. While New Deal economics dominated FDR’s war on depression, the CEA, like the Securities Act of 1933, was completely free from the socialism attributed to farm relief programmes.

This chapter first explains who was involved in the creation of the Commodities Exchange Act of 1936 as well as why and how the stage was set for the further institutional changes that survive into the present day. Secondly, the groundbreaking analysis of the GFA between 1923 and 1935 will be studied, especially with regard to its effect on the legitimacy of the markets, how it informed those interested in amending the 1922 Act and how it influenced a new generation of financial markets scholars. Thirdly, it will cover the political economy in terms of the fight for the 1936 Commodity Exchange Act, and fourthly, it will explain the changes that were made to the 1922 Act. The chapter concludes with a detailed analysis of the legacy of the Act by discussing the significant social turn, away from futures speculation as ‘gambling to be restricted’ and towards being considered necessary for the functioning of markets.

⁵Paul A. Sabatier, “An Advocacy Coalition Framework of Policy Change and the Role of Policy-Oriented Learning Therein,” *Policy Sciences* 21 (1988): 129–168.

⁶Letter, F.G. Fisher to Carey, 28 March 1931. CME III.16.16.

5.2 CONFLICTING INTERESTS: THE CBOT, THE GFA AND THE AFBF

As documented in earlier chapters, any change to the formal regulatory framework was virtually impossible before 1936, even though the GFA regularly announced the 1922 Act's failings on Capitol Hill and at the USDA. Futures regulation was far from at the front of the minds of most of the powerful interest groups, even—and perhaps especially—throughout the Great Depression years. Immediately after the Crash of 1929, the interests that eventually forced change in 1936 were powerless to intervene; therefore, the response to the crisis in the futures markets was not immediately legislative. Previously, in 1925–1926, the government worked with the futures industry rather than against it. In 1930 and early 1931, the Federal Government, through the Federal Farm Board, failed in its use of futures markets to prop up farm prices.⁷ Nevertheless, such government intervention legitimised futures trading by acknowledging the effectiveness of the futures market. In fact, it was Duvel's idea to allow the Federal Farm Board to use futures to hedge their cash positions, facilitate marketing and, possibly, aid in any government price support activities.⁸

By the time of the 1929 Crash, the CBOT had become less cooperative with the USDA and its regulatory agency, the GFA. The Board's BCC was less enthusiastic in punishing accused market manipulators, and, even though the CBOT was in favour of being legitimised and protected by the Federal Government, it fought further half-hearted Congressional interference. In 1927 and again in 1933, it also succeeding in having earlier reporting requirements rolled back. Yet the Board's executive could not agree even with its own membership or other exchanges during much of this period. Equally, the CBOT and the GFA rarely saw eye-to-eye. Hence, the GFA was becoming more aware that flaws remained in the futures trading framework and that the Board membership had little interest in improving its institutions.

In 1933, a highly contested election resulted in getting the Democrats back into the administration, with FDR as President and

⁷See Anne E. Peck, "The Futures Trading Experience of the Federal Farm Board," *Futures Trading Seminar Proceedings*, Vol. iv (Chicago: Chicago Board of Trade, 1976): pp. 23–56.

⁸Letter, Duvel to Chester Gray, 6 April 1929. NARA/KC, Box 3, 2-2.

Henry C Wallace's son Henry A. Wallace as Secretary of Agriculture. Interestingly, it was the father that was heavily involved in the founding of the AFBF in 1919⁹ (son Henry Agard Wallace followed as Secretary of Agriculture during the Great Depression and was vice-president of the US in 1941, see Chapter 5). Henry Agard Wallace developed the concept of the 'ever normal granary' in 1933. Harding, Coolidge and also Hoover were reasonably laissez-faire. For example, the rent-seeking McNary-Haugen Bill was vetoed twice by Coolidge with Hoover's support.¹⁰

While factions in Congress dithered on bills that had no support from the key legislators, neither US President Hoover's office, nor the powerful Agricultural Committees were going to endorse any legislation without the full support of Hoover's Secretary of Agriculture, Hyde. Yet the Secretary was pro-business and unsupportive of any of the GFA's proposals. As such, the GFA could no longer work with the CBOT executive to move modern futures trading closer to the market-efficient ideal; therefore it turned to a new partner, the American Farm Bureau Federation, to push for needed changes. The following section will explain how and why the GFA began to focus less on working with the CBOT and more on co-opting powerful groups to introduce new legislation in order to make markets safer for all participants—especially small speculators.

The AFBF, the dominant farmers' organisation, sought to punish the CBOT for not providing adequate exchange and clearing house membership to farm cooperative marketing companies and the GFA provided evidence that the Board was failing to protect market participants, especially the small speculator. Together, in the 'public interest', these organisations sought to alter the futures markets. In designing and lobbying for the Act, interests outside the futures industry were not proposing rent-seeking alternatives, focusing more on cleaning up the markets and making them safe for speculators and hedgers.

The ABFB actually favoured free grain markets, much as did the millers and other industry interests in 1926, and Capper and the CBOT itself in 1921. And few actors, other than fraudsters and manipulators, would be against any of the 1936 amendments that were proposed by the AFBF and the GFA. The regulatory regime innovations of 1936

⁹Donald L. Winters, "The Persistence of Progressivism: Henry Cantwell Wallace and the Movement for Agricultural Economics," *Agricultural History* 41 (1967): 109–120, p. 113.

¹⁰Dan Morgan, *Merchants of Grain* (New York: Viking, 1979), p. 78.

were constructed by government and a special interest acting in the public interest, fighting the entrenched monopoly of the Board and the *status quo*. Rather than vilifying the grain gambler, as individual States had attempted to do in the previous century, the Act was designed to protect small speculators' interests in the future markets based on information gathered and analysed by the GFA. The transition from speculation as illegal gambling, extant in State law from the nineteenth century, into speculation as an important yet fragile contributor to efficient markets was complete. This differed from the securities laws which viewed the speculator as an unnecessary participant. While some legislators wanted the public to stay out of speculation in grains, the GFA's support of speculation actually provides another example of the Federal Government supporting and defending the interwar futures industry.

5.2.1 *A Coalition Formed*

The AFBF's articles were formally ratified in 1920 and it became the dominant US farm organisation, immediately contributing to the forming of the Farm Bloc in Congress.¹¹ The AFBF has a long history in policy-making, taking credit for the Packers and Stockyards Act, the Grain Futures Act and the Capper-Volstead Act, all in 1922. It has also admitted to notable policy failures, such as McNary-Haugenism and a suboptimal construction of the Federal Farm Board under the AMA of 1929.¹² It is important to note that the AFBF is not necessarily an organisation that agitates for change. In fact, in its current form, the AFBF mostly represents large agribusinesses, and even in the interwar years it 'was cool, if not hostile, toward all radical agrarian groups'.¹³

¹¹John Mark Hansen, *Gaining Access: Congress and the Farm Lobby 1919–1981* (Chicago: University of Chicago Press, 1991), pp. 26–33; Arthur Capper, *The Agricultural Bloc* (New York: Harcourt, Brace, 1922).

¹²American Farm Bureau Federation, *History of the Farm Bureau*. Accessible at <http://www.fb.org/about/history>. Accessed 1 March 2017. See also John Mark Hansen, *Gaining Access: Congress and the Farm Lobby 1919–1981* (Chicago: University of Chicago Press, 1991), p. 87; and Letter to Duvel from Chester Gray, 20 January 1932. NARA/KC, Box 3, 2-2.

¹³Carol/Trevelyan Strategy Group, *Farm Bureau Summary of Findings*, 30 April 1998. Available at <http://www.documentcloud.org/documents/1303873-americanfarmbureau01813.html>. Accessed 1 March 2017. Quote sourced from John Mark Hansen, "The Political Economy of Group Membership," *The American Political Science Review* 79 (1985): 79–96, p. 84.

Following the 1922 Act, the cooperatives' frustration with the CBOT did not diminish. Furthermore, the cooperatives began to turn on the GFA after they too, appeared unable or unwilling to intervene. On 22 December 1925, the Minnesota Wheat Growers Cooperative Marketing Association complained to Secretary Jardine of 'a long and very unsatisfactory correspondence with Mr Duvel', as the Minneapolis Chamber of Commerce had filed charges 'with a view of expelling us from the Minneapolis market for criticising grain speculators'.¹⁴ Additionally, the AFBF had been informed by the GFA that manipulation was still common in the grain markets, and this was not in the farmers' interests. As a grain man and chair of the US Chamber of Commerce, Julius Barnes admitted, 'I feel it would be great reassurance if the Board of Trade authorities just had the courage now to see that the legitimate hedger was not to be made the victim of manipulative tactics by concentrated ownership of contracts'.¹⁵ By 1930, AFBF officials were angry over the handling of the cooperative issue, with their affiliate the Farmers National Grain Corporation (FNG) fighting hard for acceptance as a CBOT clearing member.¹⁶

As a result of discussions with the GFA, the AFBF lobbied Congressional leaders for new futures regulation. In fact, the GFA and the AFBF had a long history of working together in legislative circles and even before the 1929 Crash, the GFA gave recommendations to the AFBF regarding futures trading amendments to go into 1929 farm relief bills.

This time, Duvel had the AFBF propose new legislation directly to Congress, with the AFBF justifying the proposed amendments as reducing manipulation or protecting Board clients.¹⁷ Even though he acted as a policy entrepreneur in that he identified the need for, conceived and drafted the proposed legislation, Duvel could not take the lead on any legislation. Firstly, the USDA and the GFA had already shown themselves to be against new legislation. Secondly, Duvel did not want to be seen by the grain trade, many of whom he had to work with on a regular basis, to be encouraging government support. Duvel wrote

¹⁴Letter, Minnesota Wheat Growers Cooperative Marketing Association to W.M. Jardine, 22 December 1925. NARA/KC, 19-0.

¹⁵Letter, Barnes to Fred Uhlmann, 24 December 1929. CME III.13.34.

¹⁶Leon Kendall, "The Chicago Board of Trade and the Federal Government" (PhD diss., Indiana University, 1956), p. 259.

¹⁷Letter, Duvel to Chester Gray, 6 April 1929. NARA/KC, Box 3, 2-2.

to the AFBF in his covering letter to the amendment proposal that, 'I have not been anxious to appear before the committee on this matter at any of their public hearings, knowing that the ideas presented would not appeal to the grain trade'.¹⁸ Duvel did not want to intervene directly. He was interested in improving relationships and didn't necessarily want to be seen by the CBOT as in favour of additional controlling regulation, even if he privately was so. Nevertheless, when futures regulation was not included in the Agricultural Marketing Act, Chester Gray of the AFBF informed the GFA, on 16 April 1929 that a new bill needed to be introduced to meet the needs of the cooperatives. These amendments to the 1922 Act would need to be considered in a new Capper Bill by the Senate Committee on Agriculture and Forestry.¹⁹

Duvel and the others at the GFA, with support from certain legislators, had earlier been lobbying internally for more power, especially after the recurring frustrations with the CBOT's BCC reverting to protecting powerful interests rather than reducing manipulation. But it was to be an advocacy coalition with the AFBF that finally got the attention of the Secretary of Agriculture and the White House. At the same time, Capper, too, had renewed his efforts in cleaning up manipulation. While, he was far from anti-futures, he remained clearly anti-manipulation, though he now understood that speculators were being victimised by many traders, and were on desperate need of protection. Most such protection, it turned out, could only be achieved through a new set of laws.

GFA head Duvel, who was aware that he needed allies in order to be heard by his own bosses at the USDA, encouraged and supported both Capper and the AFBF to progress legislation independently, though with full private support from the GFA. As Duvel wrote confidentially to the AFBF president:

I hope the bills, when they shall be introduced by Senator Capper and Congressmen Dickinson, will at least in general form agree with your wishes, and I am hopeful that the Department of Agriculture can be helpful to us in giving official support at the proper time to the measures'.²⁰

¹⁸Ibid.

¹⁹Letter, Chester Gray to Duvel, 16 April 1929. NARA/KC, Box 3, 2-2.

²⁰Letter, Chester Gray to Duvel Re: HR 151618, S. 5542, 6 January 1931. NARA/KC, Box 3, 2-2.

The AFBF originated, introduced and supported legislation that mirrored the thinking at the GFA, including a Capper-Dickinson Bill (HR 193) that limited short selling and licensing brokers.²¹ Other key requirements agreed by both parties included giving the Secretary of Agriculture powers to set exchange rules.²² All the Federation's proposals originated with GFA, yet Duvel clearly didn't want attribution for, nor to be seen as pushing, the legislation.²³ While the GFA wanted to be seen as neutral, it was in fact the most important influence on the new bills. A private letter from Duvel to Chester Gray on 5 January 1931, reveals that the AFBF had to drive any legislation forward by itself for it to be successful. Duvel and his team would draft clauses that were then sent to the AFBF for incorporation into draft legislation.²⁴ Duvel stated that:

I have felt some reluctance in complying with your request for assistance in the preparation of a suggested bill for the reason that such assistance can so easily be interpreted to mean Departmental approval of the bill and may indeed give the appearance of the bill itself being a Departmental measure. This Department does not wish to express its view relative to proposed legislation until requested to do so in the regular way [...] In any use which you may make of the enclosed material, may I request that you please make clear that this Department does not at this time take any position as concerns the merits of any of the proposed amendments.²⁵

While the AFBF was the dominant advocate for new futures regulation, it must be stressed the legislative push was not intended to provide any sort of farm relief. The organisation's stated goal of 'curbing of speculation that affected adversely the price of farm commodities' was only the fifth and last resolution from its key report of 1932, and nowhere does

²¹Letter, Fisher to Carey, 3 January 1931. CME III.18.5.

²²Letter, Duvel to Chester Gray, 5 January 1931. NARA/KC, Box 3, 2-2.

²³Letter, Chester Gray to Duvel, Re: HR151618, S. 5542, 6 January 1931. NARA/KC, Box 3, 2-2; Letter, J.M. Mehl, assistant chief, GFA, to Capper, 4 August 1931. NARA/KC, Box 12, 14-6.

²⁴Letter, Duvel to Chester Gray, 5 January 1931. NARA/KC, Box 3, 2-2.

²⁵Letter, Duvel to Chester Gray, 5 January 1931. NARA/KC, Box 3, 2-2. See also 'Markup of a Bill, to amend the Grain Futures Act,' 1931, by Duvel. NARA/KC, Box 3, 2-2.

rent-seeking enter into the justification for futures regulation, unlike in the other farm relief efforts.²⁶

The AFBF was driven both by its disgust with the CBOT for harming cooperative interests and by its desire to have markets function efficiently during the grain marketing cycle. Even though the Grain Futures Committee had found for the FNG and required the CBOT to include the FNG in the clearing corporation, the CBOT fought the ruling in court.²⁷ This seriously angered the AFBF as well as powerful Midwestern legislators. At the same time, the CBOT's recalcitrant BCC had angered the GFA. The GFA aggressively supported position limits to be set by the USDA and it also justified new bills in terms of the previous difficulties in attempting to enforce the 1922 Act.²⁸ Alternative sanctions to the 'bazooka' authorised in the 1922 Act were clearly necessary. Price and basis volatility had angered millers and even some of the grain men who relied on efficient markets in order to set and remove hedges for cash grain purchases and sales. But still the USDA had not felt the need to demand new legislation, and lobbyists had experienced little success on Capitol Hill.

5.2.2 *The CBOT and the GFA, 1926–1936*

Throughout the 1920s, the CBOT had grown in institutional stature. On the eve of the Crash of 1929, the CBOT planned on opening a securities exchange which would rival New York and become 'the most comprehensive marketing exchange in commercial history'.²⁹ Additionally, it was contemplating a takeover of the Chicago Securities Exchange.³⁰ In October 1929, a CBOT seat sold for \$58,000, 30% higher than in January of the same year. The exchange was on top of the world, or at least the Midwest, installed as it was in its new forty-four storey building

²⁶Report of the condition of the organisation and its activities during the period from 1 December 1931 to 30 November 1932, American Farm Bureau Federation, 1 December 1932. NARA/KC, Box 3, 2-2; Resolution, Regulatory Legislation, AFBF, 10 December 1930. NARA/KC, Box 3, 2-2.

²⁷Letter, Duvel to Capper, 29 July 1932. NARA/KC, Box 3, 2-2.

²⁸Summary of Commodity Exchange Act Activities to Senator Mead, including 1934 Hearing Statement by Duvel, 20 April 1939. NARA/KC, Box 3, 1-3-1.

²⁹Clipping, *Chicago Journal of Commerce*, 24 July 1929. CME III.12.5.

³⁰Letter, MacMillan to Carey, 14 September 1929. CME III.16.15.

with the Roman god Ceres at its peak.³¹ Speculation had become part of the American cultural, business and social fabric, even as agricultural markets continued their long-term descent from Great War levels towards 1929.

Throughout the later interwar years, though, the CBOT continued to experience governance problems of its own, with collective action issues and high coordination costs very much in evidence. As shown in previous chapters, its interests were not always aligned with the majority of its grain market participants since the Board, its directorate and its executive each acted in its own interest. Many Board members, especially the large brokers who executed trades for non-members, were under pressure from their clients to reform. Carey's firms, for example, handled many of the large cash and futures trades as well as storage businesses of then and current grain giants Louis Dreyfus and Archer Daniel Midland (ADM) in both the USA and Canada, and Carey was great friends with Ed Stuhr of ADM.³² It was clear to many such clients and the GFA that the CBOT could not police itself. In 1934 and 1935, the GFA made Congress aware of at least twenty-four CBOT members suspected of bucketing. Indeed, the GFA had brought charges against several of these previously.³³ The GFA, however, was powerless to stop such activities, and the CBOT's BCC was not interested in helping. The far from objective BCC could be easily swayed or pressured by fellow members. As such the BCC did not eliminate manipulation, and relations rapidly worsened between the BCC and the GFA after 1927. As a result of both attempted and successful speculative operations, hedging was sometimes as risky as outright speculating, which both the GFA and the Board executive recognised as early as 1923, hence the development of the Business

³¹Charles R. Geisst, *Wheels of Fortune: The History of Speculation from Scandal to Respectability* (Hoboken: Wiley, 2002), p. 95. A seat sold for \$45,000 in January 1929.

³²Telegram, Archer Daniels Midland to Frank L. Carey, 22 April 1926. CME III.14.9. Archer Daniels Midland and Louis Dreyfus are the 'A' and the 'D' of the famous ABCD grain trading monopoly, controlling up to 90% of the global grain trade. See Sophia Murphy, David Burch, and Jennifer Clapp, *Cereal Secrets* (London: Oxfam Research Reports, August 2012).

³³US Congress, Hearings Before the House Committee on Agriculture on HR 3009, 74th Cong. 1st Sess., 7 February 1935, p. 71; US Department of Agriculture, *Annual Report of the Chief of the Grain Futures Administration 1934* (Washington, DC: Government Printing Office, 1934), pp. 4–6.

Conduct Committee (BCC) in 1926.³⁴ In 1926, the government felt it could work with the CBOT to eliminate abuses. In those early days of the BCC the Board welcomed the GFA's contributions, hence the GFA and the USDA were not immediately willing to make changes to the formal regulations; also, amendments were unlikely to succeed for reasons given earlier. For example, Secretary Wallace and Duvel were both opposed to Caraway's 1926 attempts to further regulate futures, with the latter finally dropping the attempt in 1929 after one final flourish to ban futures outright.³⁵

Although manipulation and fraud were still considered by the GFA to be serious shortcomings of the futures markets, and the BCC was increasingly obviously failing, the CBOT lobby and membership continued to fight against any additional controls. In fact, the CBOT was able to go on the offensive in 1929, with Hoover in the White House and speculation becoming an accepted part of American business life. The CBOT executive was rarely caught out by legislative intentions, and there are many examples of just how plugged in to Washington it was during the interwar period. In one instance in 1933, the CBOT's legal counsel was able to ascertain during an off the record lunch that a lawyer was called in to draft investor protection laws for both securities and commodities, and that this lawyer was aware of certain of the President's off the record discussions with certain industry representatives.³⁶ The CBOT's counsel agreed to 'help' with the draft, thereby allowing the regulated industry early and anonymous influence into what were possibly going to be tough new regulations. All of this was of course highly confidential.³⁷ Duvel wrote to Capper that:

Our Board of Trade friends [...] are determined to get rid of the Grain Futures Administration. Apparently they believe the best way to do this is to try to hook up our organisation with the Federal Farm Board and to press for the elimination of both as a form of farm relief that has not

³⁴US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, pp. 1, 6–7; Letter, Barnes to Carey, 2 January 1930. CME III.14.13.

³⁵Cedric B. Cowing, *Populists, Plungers and Progressives* (Princeton: Princeton University Press, 1965), p. 130.

³⁶Memorandum, legal counsel to P. Carey, president, CBOT, 17 November 1933. CME III.830.1.

³⁷*Ibid.*

helped farmers by way of securing satisfactory prices for their grain. This is rather silly and far-fetched, and yet it is quite possible that in the farmers' present state of mind, some progress may be made in building sentiment against us.³⁸

Besides the relationship between the AFBF and the GFA, Duvel and others at the GFA had a very close relationship with Senator Capper. Capper and Duvel continued to share a similar philosophy regarding futures markets and kept each other informed on policy and markets throughout the interwar years. Capper was anti-manipulation but was equally unhappy recent government intervention in the futures markets. He wrote in 1931 to Duvel that, 'I am thoroughly sick of the Farm Board, but I think they are licked bad enough without these smart aleck speculators trying to bankrupt the entire agricultural regions of the United States'.³⁹

There were other pressures even during the Great Depression to restrict activities on the CBOT. The exchange knew that it had to take the offensive. 'Any demonstration now that ... the Chicago Board of Trade can be used for manipulative settlements would place arguments in the hands of those who are opposed to future trading – that the exchanges are unable, or unwilling, to control their practices in the interest of security of hedging... and strengthen the hands of those who want the Farm Board to use every attraction to build up such cooperation organizations of farmers as will themselves supersede ... [the exchanges]'.⁴⁰ That is, cooperative marketing such as existed in Canada was a real threat, and the Board knew it. Therefore, the pressure needed to stay high on the 1922 Act and any potential replacement. On 4 January 1933, the exchanges, through the Grain Committee on National Affairs (GCNA), published a pamphlet, *A Survey of the Farm Question*, claiming that the 1922 Act should be judged a failure as it did not meet its goal of bringing higher prices for grain.⁴¹ Of course, the Board was well aware that higher prices were not the goal of the 1922 Act, at all. But the grain trade further accused the 1922 Act of interfering with the proper functioning of the markets, concluding that the 1922 Act should be repealed in its entirety.

³⁸Letter, Duvel to Capper, 21 February 1933. NARA/KC, Box 12, 14-6.

³⁹Letter, Capper to Duvel, 27 August 1931. NARA/KC, Box 12, 14-6.

⁴⁰Letter from Barnes, 24 December 1929. CME III.13.14.iii.

⁴¹Grain Committee on National Affairs, *A Survey of the Farm Question* (Chicago: Grain Committee on National Affairs, 4 January 1933).

This strategy was targeted at the many voters and politicians who were anti-government intervention, even in 1933. The *Wall Street Journal* was of course sceptical of government involvement in the regulation of securities markets. On 27 July 1933, it reported:

It is a fair inference that the pressure that the government has exerted against short selling in the past few years had no small part in the building up of a price structure in the grain market that resulted in last week's crash. If we are to have healthy grain markets, neither codes nor regulations should seek to restrain the very forces that prevent prices from making mushroom growth that ends in collapse.⁴²

However, by 1933 the NIRA's Codes of Conduct (Code) required the Board to exercise a significant amount of self-regulation, overseen by the Agricultural Adjustment Administration. In the end, the Code failed for many reasons even before it was declared unconstitutional. However, the Code failure did provide an important catalyst for the AFBF in lobbying to devise replacement regulation.

Futures industry lobbying could indeed be aggressive. In 1929, Senator Caraway was furious with the access, through Julius Barnes, the grain men had to Alex Legge, the Federal Farm Board Chairman. Legge was said to have agreed with a proposal from Barnes that 'the Farm Board will not in future announce any policy affecting the price of grain until after a consultation with those engaged in the grain business'.⁴³ On 23 December 1929, Caraway sent an open letter to Legge, carried in full in many of the papers, stating that, 'Your announcement [...] is a surrender of the [Farm] Board to these grain people' and that it 'showed that the government was not supportive of the cooperative movement, contrary to the intentions of Congress'.⁴⁴ Caraway was furious that Legge went 'into a private, if not a secret, meeting with Mr. Barnes' where clearly a public hearing was warranted.⁴⁵ This example typifies the extent of the CBOT's lobbying efforts.⁴⁶

⁴² *Wall Street Journal*, 27 July 1933 as cited in United States Department of Agriculture, *Daily Digest*, Vol. 50 (Washington, DC: Government Printing Office, 1933).

⁴³ Memorandum, MacMillan to the Exchanges, republishing Senator Caraway's open letter to Julius Barnes, 23 December 1929. CME III.16.15.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Letter, Carey to MacMillan, 17 December 1929. CME III.16.15.

Interestingly, the exchanges were once more far from a united front at this time, and it was time for the dominant CBOT to go it alone. After the Board earlier resolved to abandon the exchanges' lobby group,⁴⁷ CBOT president Arnot wrote in a 10 May 1929 letter that the 'membership in Chicago, itself, as well as the Board of Directors are divided on what form representation to Washington should take'.⁴⁸ Arnot felt that it was almost impossible to produce a legislative agenda that would satisfy the Board's own membership, let alone all the member grain futures exchanges.⁴⁹ Wells from the Legislative Committee went further to state that attempts to distil a 'unified action in legislative matters' might 'hinder rather than facilitate agreement among the Exchanges'.⁵⁰ It was now even more clear that the CBOT's interests, even if agreed within the membership, were diverging from those of the primarily cash grain and regional futures exchanges.⁵¹ Carey accused Wells of representing 'such a small minority that he himself said he felt he ought to resign from the committee'.⁵² Soon after, Wells did resign. There was no longer a pretence of a united front in terms of one unique grain trade lobby, as Mrs. MacMillan pointed out to Carey in a letter dated 15 March 1930: 'There is such a variety of opinion in the grain trade itself as to what is the best policy [...] the trade to pursue in the present situation'.⁵³ Neither the exchanges nor the memberships of any one exchange were of one mind on any of the key legislative issues of the day. The collective action problems of the futures industry had clearly not lessened in the 1930s.

Under attack by the exchanges, almost abandoned by the Secretary of Agriculture and unsupported by the Courts and even the GFC, the GFA was experiencing its own existential crisis. Additionally, infighting was rife, especially in the Chicago office. In 1925, Duvel moved to Washington, after having spent three years in Chicago, taking over as

⁴⁷Statement, Legislative Committee of the Grain Exchanges, 11 June 1929. CME III.20.12.

⁴⁸Letter, Arnot to Siebel Harris, 10 May 1929. CME III.20.14.

⁴⁹Many examples in the archives, including letter, Arnot to Wells, 3 June 1929. CME III.20.14.

⁵⁰Letter, Wells to Arnot, 29 May 1929. CME III.20.14.

⁵¹Letter, Arnot, president, CBOT, to Mr. Kraettli, KBOT, that the Committee was not open enough with the CBOT Board, 18 June 1929. CME III.20.14.

⁵²Letter, Carey to Barnes, 19 February 1930. CME III.14.13.

⁵³Letter, MacMillan to Carey, 15 March 1930. CME III.18.4.

head of Grain Futures Administration. L.A. Fitz became head of the Chicago office. However, Fitz did not get on well with key CBOT members; consequently he was far from an ideal head of the Chicago office.⁵⁴ In fact, it may have been the case that part of the deterioration of relations between the BCC and the GFA was down to personal relationship issues.⁵⁵ On the other hand, several valuable new names had joined the GFA. Futures scholar George Wright Hoffman was hired as a consultant to the GFA soon after completing his PhD in 1926; he finally departed in 1942 after producing an incredible body of analytical and academic work. In 1933, one of the CBOT's own, Samuel Arnot, a progressive even before he moved from industry to government, turned gamekeeper to act for the AAA and the GFA as special advisor at the request of AAA Director Peek.⁵⁶ Duvel wrote of Arnot in 1933 that, 'He has been vitally interested in working for reforms relating to operations on the Board [...] As a result of Mr. Arnot's efforts much good has been accomplished'.⁵⁷ As another example of the understanding that the Board directorate, the executive and the membership could often be at odds, Duvel observed that, 'During his incumbency as president of the Board he necessarily had to reflect the policies approved by the [...] Directors even though they might not have been as good as his own personal policies'.⁵⁸

5.3 EVIDENCE ON SPECULATION, 1926–1936

In the later interwar years, the information gathered under mandate from the 1922 Act contributed to the evolution of futures markets and their regulation in four ways. Firstly, as already described in Chapter 4, this information was used to legitimise markets and to investigate questions of market function and efficiency. All key legislative actors had already agreed that futures markets were in the public interest as long as certain excesses were

⁵⁴Handwritten letter, Mrs. Louise Freeman to Duvel, 4 November 1929. NARA/KC, 101-1; Memorandum, L.A. Fitz to Dr. Duvel, 4 November 1929. NARA/KC, 101-1.

⁵⁵See, for example, letter, Barnes to Carey, 2 January 1930. CME III.14.13. Similar letters exist in the archive.

⁵⁶Letter, Fred Clutton to Edgar Markham with pencilled response to Clutton, 29 August. CME III.830.6.

⁵⁷Memorandum, Duvel to J.E. Jones, 25 July 1933. NARA/KC, Box 5, 3-4.

⁵⁸Ibid.

tamed. Secondly, information and analysis provided by the GFA were used to thwart attempts by the exchanges to roll back regulation. The GFA, the USDA and others used the information gathered to battle misinformation in the press and aggressive lobbying efforts by the CBOT. Thirdly, as with the 1926 institutional changes, the 1936 Act was the direct result of GFA analysis, this time revealing that buying by small speculators was critical to the efficient functioning of markets. The GFA concluded that accounts of sizes ranging from tiny (1000 bushels, even below the minimum in Chicago) to 100,000 bushels tended to be long through the harvest. It was decided that such long-biased speculators, as well as frequent hedgers such as the millers and country elevators, needed protection from fraud and sudden price moves that could scare off buyers and hedgers at crucial times. The GFA concluded that large speculators, generally classified as over the Special Account threshold of 500,000 bushels, were actually more likely to be short during the harvest rather than facilitating the risk management goals of farmers and middlemen, which contradicted Keynes' theory of speculation.⁵⁹ Fourthly, the GFA analysis uncovered other flaws in the system that it attempted to remedy beginning in 1925, and communicated these conclusions to powerful lobbyists and legislators. The next two sections analyse the results of the GFA's interwar analysis on modern understandings of futures markets and their regulation, and the defence of the regulatory regime from industry pushback.

5.3.1 *Transcending Ignorance and Rhetoric*

Before the GFA began its detailed investigations, ideology and normative theory dominated in academic and policy circles, beginning with Emery's 1896 thesis, with limited progress thereafter. Confusion reigned, and this permitted rhetoric to fill the void. As late as 1933, Duvel lamented that:

Since the Grain Futures Act went into effect in 1922, we have had 2-dollar wheat as well as 40-cent wheat. However, when the story is told to farmers, it is that speculators were responsible for the 2-dollar wheat and that the Grain Futures Administration is responsible for the 40-cent wheat.⁶⁰

⁵⁹US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, pp. 1, 6; Harold Irwin, *Seasonal Tendencies in Wheat Futures Prices*, USDA Grain Futures Administration (Washington, DC: Government Printing Office, 1936), p. 2.

⁶⁰Letter, Duvel to Capper, 21 February 1933. NARA/KC, Box 12, 14-6.

In hearings, nonsensical answers to simple questions were commonplace. Julius Barnes, for example, answering one inquiry about speculative losses responded that ‘in my experience, [speculative loss] is largely a revolving fund - a revolving insurance fund to cover this risk’.⁶¹ Pressed for more, Barnes deferred to the only real expert on the subject, ‘James E. Boyle, [...] an investigator for the Bureau of Markets and the Federal Trade Commission, [was] brought up in Kansas [...] and I should be glad to give a copy of this book to any member of Congress who will promise to read it’.⁶² But Boyle’s book contains no empirical evidence for any of his theories on speculation. Around this time, Boyle had proposed, in a long report commissioned by the CBOT, that the Board ‘court’ academics in order to legitimise markets through academic support.⁶³ Academics at this time were ideologues and their popular theories had no empirical justification. For instance, a supporter of the free markets of Chicago, Emery, in 1896 remained confused by speculation. While unsophisticated investors were experiencing often catastrophic losses, Emery felt that they should not, nor could not, be eliminated.⁶⁴ Harrison Brace, in his 1913 book, *The Value of Organized Speculation*, agreed with Emery that the minor reforms needed to manage ‘incompetent’ speculation and manipulation were achievable in the short run.⁶⁵ John Maynard Keynes, who likely would have read Emery, wrote in 1923 in the English *Manchester Guardian*, which was followed up in the *Treatise on Money* in 1930, that speculators were incentivised to go long towards harvest time and beyond in order to earn risk-adjusted returns.⁶⁶ So, was speculation necessary or a menace?

⁶¹Statement, L.F. Gates, President, CBOT, during 1919 and 1920, before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

⁶²Statement, L.F. Gates, President, CBOT, during 1919 and 1920, before the Committee on Agriculture, House of Representatives, Washington, 13 January 1921. CME VII.ss3.65.2.

⁶³Report of James E. Boyle, July–August 1920, 21 September 1920. CME III.ss1.6.

⁶⁴Henry Crosby Emery, *Speculation on the Stock and Produce Exchange of the United States* (New York: Columbia University Press, 1896), p. 191.

⁶⁵Harrison Brace, *The Value of Organized Speculation* (New York: Houghton & Mifflin, 1913).

⁶⁶This is the controversial idea of normal backwardation. John Maynard Keynes, “Some Aspects of Commodity Markets,” *Manchester Guardian Commercial*, Reconstruction Supplement (1923) in John Maynard Keynes, *The Collected Writings of John Maynard Keynes*, Vol. 12, eds. Elizabeth Johnson and Donald Moggridge (Cambridge: Cambridge University Press, 2013); John Maynard Keynes, *Treatise on Money* (London: Macmillan and Co., 1930).

For a summary of the controversy, see Colin A. Carter, “Commodity Futures Markets: A Survey,” *Australian Journal of Agricultural and Resource Economics* 43 (1999): 209–247.

Before 1923, academics were as much in the dark as practitioners when explaining how markets actually functioned with respect to hedging. In 1896, on hedging, Emery declared that '[it] is now universal in the trade in grain'. Yet the GFA showed in the 1930s that it was far from common, with many so-called hedgers such as the country elevators either unhedged, or sometimes 'Texas hedged'—i.e. 'long grain and long futures', increasing risk rather than reducing it.⁶⁷ This was not to be the first time that GFA work disproved or supported a common theory or misconception. Hoffman began his 1925 thesis on futures markets with the observation that the 1922 Act had 'brought with it renewed interest in [...] organised marketing', while resulting investigations had provided 'a considerable body of additional information'.⁶⁸ Clearly, more data was needed in order to ascertain exactly how markets functioned and what, if anything, could be done to improve them. Without the GFA analysis, myths might have dominated facts, and it is impossible to know if regulation would have been harsher, or perhaps completely avoided, if error-ridden theories and unsubstantiated rhetoric had prevailed.

The first widely distributed GFA study was '*Fluctuations in Wheat Futures*', a far-reaching piece of research on the Cutten Corner, with supporting documentation inches thick.⁶⁹ The investigation examined the trades of 627 entities that made large transactions in the May wheat future from 2 January to 18 April 1926. Two-thirds of all May wheat trades totalling 3,230,530,000 bushels were examined, no matter where the accounts were located.⁷⁰ The GFA reports on market activities continued to arrive on the desks of the legislators, the USDA, the US President and, of course, the grain men, on a regular basis. Two reports covered futures behaviour in Chicago from 19 April 1925 to 31 December 1926, periods of much lower price volatility. The main conclusion of the GFA reports was that the small speculators were at risk

⁶⁷Henry Crosby Emery, *Speculation on the Stock and Produce Exchange of the United States* (New York: Columbia University Press, 1896), p. 162. See George Wright Hoffman, *Hedging by Dealing in Grain Futures*, Grain Futures Administration (Washington, DC: Government Printing Office, 1925), for the rebuttal.

⁶⁸George Wright Hoffman, *Hedging by Dealing in Grain Futures*, Grain Futures Administration (Washington, DC: Government Printing Office, 1925), p. 7.

⁶⁹US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926.

⁷⁰*Ibid.*

in so many ways, but that they were usually long when short hedgers were active and generally lost money as a group. On the other hand, professional speculators were generally short at the same time. These observations were important when new regulation was being seriously considered in the early 1930s and up to the passing of the CEA in 1936. GFA reports informed others as well. Before detailed investigations by the GFA, it was normal to believe that hedging was universally practised by country, line and terminal elevators together with the major grain users, such as millers.⁷¹ But the GFA work showed clearly that hedging was not as common as was assumed by academics.⁷² The most vociferous protests at the CBOT over the 1922 Act and the 1923 Rules concerned the Special Account reports, as most members felt it was simply too much transparency. However, the reports revealed that the large speculators, rather than supporting hedging pressures during harvest, tended to be net short when the grain harvest was in its primary marketing period.⁷³ Large speculators did not stabilise markets.

Evidence gathered by the GFA percolated into academe. Hoffman, for example, modified Emery's ideas using GFA observations and data in 1937, arguing that 'the most important single source of information on this subject are the records of the Grain Futures Administration'.⁷⁴ The GFA knew in 1930 what Hoffman reported in academe in 1937. Hoffman, who based his work on the GFA/CEA studies, revealed that 'a large number of speculators carry the price risks of a much smaller number of trade interests, while large speculators tend to be long when prices rise and short while prices are falling, and it is their trades that influence

⁷¹George Wright Hoffman, *Hedging by Dealing in Grain Futures*, Grain Futures Administration (Washington, DC: Government Printing Office, 1925) cites the *FTC Report on the Grain Trade* (Vol. I, pp. 212–213) and others to conclude that 'line elevators and in some cases individual country elevators follow [the] practice'. Yet the GFA showed that hedging was uncommon for many likely candidates.

⁷²George Wright Hoffman, *Future Trading and the Cash-Grain Markets*, USDA Circular No. 201 (Washington, DC: Government Printing Office, 1932). Later: Harold Irwin, *Impressions Concerning Country Trading in Grain Futures*. USDA Grain Futures Administration (Washington, DC: Government Printing Office, 1936).

⁷³US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, pp. 1, 6.

⁷⁴Hoffman modified Emery in George Wright Hoffman, "Past and Present Theory Regarding Futures Trading," *Journal of Farm Economics* 19 (1937): 300–312, p. 300.

price movements'.⁷⁵ He concluded that, 'Small speculators supply the necessary counter positions completing a market that hedgers need but can not rely on large speculators to facilitate'.⁷⁶ Yet the fact that the small speculator was a key component to market function was understood and communicated within the GFA and the USDA much earlier, and then relayed to both Capper and the AFBF.⁷⁷

In addition to the observations regarding the small speculators' usefulness, the GFA recommended restrictions on large speculators, based on the knowledge that these bigger accounts often risked pushing markets lower at exactly the wrong time. Special Account reports could disclose the market actions of the large operators, but changes to either CBOT rules or the 1922 Act were not immediately forthcoming. Eventually, a frustrated Duvel publicly requested a limit of 2,000,000 bushels per speculator.⁷⁸ The *New York Times* reported that Duvel 'declared that one speculator carried thirty-four different accounts with eight commission houses'.⁷⁹ Duvel was further quoted as reporting that "Several years ago two traders held 32 per cent of all contracts in futures in the market at that time. They were 23,000,000 bushels short, and they were not carrying hedges".⁸⁰ Such evidence supported the more general observation that large sophisticated speculators were not consistently long through harvest periods.

Privately, also, the information gathered by Duvel and others was useful in justifying, or not justifying, activities on the exchange. Much earlier, in a note to the Secretary, Duvel concluded privately that one trader had been long 7,300,000 bushels on 26 December 1925, then

⁷⁵George Wright Hoffman, "Past and Present Theory Regarding Futures Trading," *Journal of Farm Economics* 19 (1937): 300–312, p. 302.

⁷⁶*Ibid.*, p. 307.

⁷⁷US Congress, *Fluctuations in Wheat Futures*, Senate Document 135, 69th Cong. 1st Sess., 3 June 1926, pp. 1, 6; Harold Irwin, *Seasonal Tendencies in Wheat Futures Prices* (USDA Grain Futures Administration) (Washington, DC: Government Printing Office, 1936), p. 2. There was significant interaction between the AFBF and the GFA during this period: Letter, Duvel to Chester Gray, 15 December 1930, NARA/KC, Box 3, 2-2; Letter, J.M. Mehl to Donald Kirkpatrick, AFBF, 24 January 1935, NARA/KC, Box 3, 2-2; and Letter, Kirkpatrick to Irving G Goldsmith, copied to J.M. Mehl, 21 January 1935, NARA/KC Box 3, 2-2.

⁷⁸Clipping, *New York Times*, 3 April 1934. NARA/KC, Box 5, 3-4.

⁷⁹*Ibid.*

⁸⁰*Ibid.*

short 9,900,000 less than two weeks later before switching again to a long position of 6,100,000 bushels by 3 February.⁸¹ On one of the most active days for some time, 1 March 1926, 110,000,000 bushels of wheat futures changed hands. That is, large speculators were not passive accepters of the risks of the hedgers during the marketing cycle as predicted by Keynes. That role was taken up by the so-called small grain gamblers. It was only in a much later study, based on a detailed investigation of all of the trades of one bankrupt member, that it was realised that small speculators almost always lost money trading. Interestingly, this study used data from the interwar period, even if the monetary and physical resources were too scarce until well after World War II.⁸²

Data could also be used to defend the CBOT. Senator Capper had heard from constituents that certain interests had been shorting the market in order to give adverse publicity to the US President. However, Duvel was able to inform Capper that the Special Account reports did not indicate any such action:

As to the wave of short selling for the purpose of embarrassing the administration, there is nothing which leads us to believe that any such conspiracy exists. Rumours of a similar character are frequently circulated but our studies of the records indicate that speculative traders enter the market only when they think they can make a profit.⁸³

In total, the interwar period witnessed an amazing amount of analysis. Up to March 1934, the GFA had issued at least twenty-five publications and mimeographs, including *Fluctuations in Wheat Futures*, Senate Documents 264 and 123 *Report by Members of Grain Futures Exchanges*, Senate Document 61, *Suspension of Reports of Large Speculative Accounts in Grain Futures*, Departmental Bulletin 79 *Major Transactions in the 1926 December Wheat Future* and *Annual Reports* for the years 1924, 1925, 1930, 1931, 1932, and 1933.⁸⁴ Thus, GFA studies legitimised futures while also providing impetus for the 1936 CEA by intelligently

⁸¹Memorandum, Duvel for the Secretary, 25 June 1926. NARA/KC, 305-1.

⁸²Blair Stewart, *An Analysis of Speculative Trading in Grain Futures*, Technical Bulletin, No. 1001, Commodity Exchange Administration (Washington, DC: Government Printing Office, 1949).

⁸³Letter, Duvel to Capper, 10 May 1929. NARA/KC, Box 12, 14-6.

⁸⁴Letter, Duvel to Hon. Joseph Weldon Bailey, Jr, 27 March 1934. NARA/KC, Box 5, 4-0.

informing on the many issues involving speculation and manipulation. Based on analysis and legislative action during the interwar years, futures were assumed by almost all observers to be the most efficient markets for managing commodity price risk, and then financial asset price risk, for the rest of the twentieth century.⁸⁵ However, the GFA work revealed two serious issues with the markets. Firstly, manipulation was far from rare, while prosecutions by the CBOT were infrequent. In one particularly egregious case, on 19 and 20 July 1933, wheat futures lost over a quarter of their value. The CBOT executive were livid, but did nothing.⁸⁶ The GFA found that ten traders who controlled fifteen accounts were responsible for the volatility.⁸⁷ Secondly, as identified above, the large speculator often moved in opposition to the small speculator, and in the same direction as hedging pressure, during the important harvest period and that therefore the small speculator was essential to deep and efficient markets. Further, the GFA identified that the small speculator's interests were poorly represented in the futures markets in the 1920s and early 1930s. Duvel believed a new law was needed to require consistent margining by all parties, to have such customers' margins held in segregated accounts as opposed to being accessible by the clearing broker for other uses, and to forbid customer agents from acting as principal, i.e. bucketing. The implementation of these solutions in the face of pro-business administrations and a strong CBOT lobby was difficult for a long while, although the AFBF and the GFA together finally succeeded in 1936.

In addition to government reports, data and analysis from this era were, and continues to be, used in scholarly research into futures markets long after publication.⁸⁸ As such, the information mandated under the

⁸⁵See, for example, Todd E. Petzel, "A New Look at Some Old Evidence: The Wheat Market Scandal of 1925," *Food Research Institute Studies* 1 (1981); Blair Stewart, *An Analysis of Speculative Trading in Grain Futures*, Technical Bulletin, No. 1001, Commodity Exchange Administration (Washington, DC: Government Printing Office, 1949).

⁸⁶Grain Futures Administration. *Annual Report* (Washington, DC: Government Printing Office, 1933), p. 21.

⁸⁷Grain Futures Administration. *Annual Report* (Washington, DC: Government Printing Office, 1934), p. 21.

⁸⁸See, for example, the following: Roger W. Gray and Anne E. Peck, "The Chicago Wheat Futures Market: Recent Problems in Historical Perspective," *Food Research Institute Studies* 18 (1981): 89–115; Todd E. Petzel, "A New Look at Some Old Evidence: The Wheat Market Scandal of 1925," *Food Research Institute Studies* 1 (1981). For one contemporary study on interwar data still cited in the current literature, see also Blair Stewart, *An Analysis of Speculative Trading in Grain Futures*. Technical Bulletin, No. 1001, Commodity Exchange Administration (Washington, DC: Government Printing Office, 1949).

1922 Act and the 1923 Rules were critical to the development and study of the current modern futures markets.

5.3.2 *Information Used Against the CBOT Lobby*

Throughout the interwar years, the USDA and the GFA had to defend themselves regularly from CBOT attacks in the press, in Congress and behind the scenes. As Secretary Wallace observed when interviewed in the *Northwestern Miller* on 6 August 1924:

Ever since the Department of Agriculture has attempted to enforce the Capper-Tincher law there has been a constant stream of propaganda to the effect that the regulation killed trading, kept money out of the markets and thus hurt farm prices [...] Market conditions [of...] the last few weeks have shown the government supervision does not kill trading. It has been enormous.⁸⁹

At the time more detailed analysis, with far-reaching implications, had not yet arrived.

After 1926, CBOT members had filled their press releases and lobbying efforts with discourses to the effect that removing the restrictions would result in higher prices. This eventually convinced the business-friendly Secretary of Agriculture, William Jardine, ‘early in 1927 that [restrictions] were responsible for the low price of wheat’.⁹⁰ After taking the questionable advice of the grain trade Legislative Committee that the rules were keeping those who might support the falling prices of grains out of the markets, on 25 February 1927 he lifted Special Account reporting requirements for large traders. This was seen as a significant victory among the Board’s membership, and this was echoed at the GFA, with Theo. Hammat complaining to Duvel that Jardine’s action ‘seems to be rather generally regarded as the beginning of the end for us. I hope they are wrong’.⁹¹ Once again the CBOT lobby had successfully flexed its muscles while the GFA was under renewed pressure and in crisis.

⁸⁹Memorandum, Morrill for HC Taylor, 21 October 1924. NARA/KC, Box 12, 14-15. The memorandum quotes the *Northwestern Miller*.

⁹⁰US Department of Agriculture, Press Release: Effect of Test Suspension of Grain Futures Traders’ Reports, 1 April 1930. CME III.13.34.

⁹¹Letter, T. Hammat to Duvel, 11 November 1927. NARA/KC, 101-1.

But the GFA did not lie down and play dead. With the new data and analysis filtering in over the 1920s and 1930s, the government was able to counter the powerful CBOT lobby. Not only did the information gathered during the interim years inform new regulations in 1936, it was used to defend the previously implemented *status quo* of 1922 and 1923 from industry rollback attempts. The GFA found no evidence that long-biased speculators had returned to the market following the first rollback of the 1923 reporting requirements. In fact, as Duvel reported to Jardine on 3 May 1927, a few months after the experiment began, generally the reports showed that the large speculators had mostly entered from the short side during the period.⁹² Large speculators did not support hedging markets. Moreover, the GFA found the large speculators were short before the suspension and carried sizeable shorts throughout the 1927 suspension period.⁹³ Chicago wheat prices fell during this time, while foreign markets rose, most unwanted during a period of depressed prices.⁹⁴ However, the lack of data during the period of suspended reports made many legislators uncomfortable and eventually, on 21 February 1928, Congress asked for and received a report based on the activities of the large speculators.⁹⁵ In the last of these reports, Duvel concluded that ‘the reports [...] of large traders have always been regarded as essential to effective regulation of the futures markets and to prevent manipulation of grain prices’.⁹⁶

The price action in the May 1927 future embarrassed the grain trade, coming just after the CBOT’s success in having reporting requirements lifted. The subsequent volatility caused the Senate to request even more information than was previously provided before the reporting

⁹²Memorandum, Duvel for the Secretary, 3 May 1927. NARA/KC, 101-1.

⁹³US Congress, *Letter from the Secretary of Agriculture, Reports by Members of the Grain Futures Exchanges*, Senate Document No. 123, 71st Cong. 2nd Sess. (1930). Part One was made to the Senate 2 March 1929 as Senate Document 264, 70th Cong. 2nd Sess. Part two on 1 April 1930.

⁹⁴Memorandum, Duvel for the Secretary, 3 May 1927. NARA/KC, 101-1.

⁹⁵Ibid. Senator Mayfield’s Senate Resolution No. 40, directing the Secretary of Agriculture to investigate the effect of the suspension of reports to the GFA as well as ‘the situation in respect of the 1927 May wheat future’.

⁹⁶US Congress, *Reports by Members of the Grain Futures Exchanges*, Senate Document No. 123, 71st Cong. 2nd Sess. (1930). On 1 April 1930, the GFA released its ‘final report regarding the effect of suspending, between February 26 and October 31, 1927, certain daily reports...concerning the operations of large traders in grain futures’.

requirements were lifted. The GFA was then tasked with obtaining evidence showing *all* accounts with purchases, sales or net long/short positions over 200,000 bushels between 3 January and 31 October, although code numbers were used for each account to preserve anonymity at the data collection level. The CBOT membership, of course, tried to push back against such demands,⁹⁷ with Gates finally asking Jardine on 30 March 1928 ‘to determine how seriously Senator Mayfield’s office intended to embarrass the trade in asking for the information called for in Resolution 40?’⁹⁸ The rollback on trader reporting had backfired, and reporting was resumed.

The conclusions of Resolution 40, released in 1929, should easily have been able to counter any future CBOT attempts to roll back reporting requirements.⁹⁹ However, the CBOT was not easily thwarted, and it was Secretary Hyde this time, who responded to demands from industry, once again suspending the reporting requirements on 22 October 1932. The degree of pressure put on Secretary Hyde must have been immense, illustrated by Henry A. Wallace’s later statement that ‘it is not clear [...] why the suspension of these reports as an experiment again in 1932 should have been necessary in the face of the conclusive results from a similar experiment conducted in 1927’.¹⁰⁰ The report responding to a Senate resolution concluded that ‘a requirement of daily reports covering the commitments of large operators on the boards of trade serve a very useful purpose’.¹⁰¹ Once again, the CBOT was thwarted. As in 1927, futures prices fell soon after reports were suspended, but this time open interest was seen to be falling as prices fell, leading to the suspicion that those CBOT insiders who had called for the moratorium shorted the market anonymously.¹⁰² The study also revealed that, before requirements were lifted, large speculators were actually very active, but on the short side once again.

⁹⁷Letter, L.F. Gates to Jardine, 30 March 1928. NARA/KC, 101-1.

⁹⁸Ibid.

⁹⁹Letter, J.M. Mehl to A.U. Chaney, General manager, American Cranberry Exchange, 21 August 1929. NARA/KC, Box 3, 2-0.

¹⁰⁰See US Secretary of Agriculture, *Response to Senate Resolution 376: A Report Relative to Suspension of Report of Large Speculative Accounts in Grain Futures*, Covering Letter (Washington, DC: Government Printing Office, 15 May 1933), p. 5.

¹⁰¹Ibid., p. 2.

¹⁰²Ibid., p. 5.

In both 1929 and 1933, the GFA concluded that the largest traders were actually short. The reporting requirements did not result in any large traders entering the market from the long side. Again speaking to the GFA's desire to understand rather than control the markets, the GFA report stated that:

By actual demonstration the claim that the removal of reporting requirements would attract large buyers [...] was shown to be unjustified, and the 8-month suspension, by settling this important question, is regarded as having served a useful purpose.¹⁰³

Thus, twice the CBOT lobby had been able to evade previous regulations and twice the power of information and the GFA had prevailed. No further attempt at rolling back such regulation was ever attempted.

5.4 POST-CRASH GOVERNMENT INTERVENTIONS

5.4.1 *Legitimacy Through Intervention, 1930–1931*

Immediately preceding the 1929 Crash, agricultural markets were in the midst of a major crisis of confidence, with cash Chicago wheat falling from 165 cents per bushel to 95 cents per bushel from 27 April 1928 to 31 May 1929, a decline of 42%.¹⁰⁴ Nevertheless newly elected President, Herbert Hoover, opposed subsidies championed by those in favour of the McNary-Haugen-like demands to increase the domestic price level for the major export crops relative to the world level. As a compromise, he supported a bill that created a Federal Farm Board (FFB) that, with a \$500 million stabilisation budget, would loan money to farmers to create and strengthen farm cooperatives in the hope that they would control production and bring crops to market more efficiently. A political deadlock ensued, as factions in Congress battled over farm policy while Hoover did little to break the impasse.¹⁰⁵

¹⁰³USDA Press Release: Effect of test suspension of grain futures traders' reports 1 April 1930. CME III.13.34.

¹⁰⁴Holbrook Working, "Prices of Cash Wheat and Futures at Chicago Since 1883," *Wheat Studies of the Stanford Food Institute* II (1934).

¹⁰⁵Martin L. Fausold, "President Hoover's Farm Policies 1929–1933," *Agricultural History* 51 (1977): 362–377.

In June 1929, Congress passed the Agricultural Marketing Act, replete with a Federal Farm Board but no subsidies for farmers. Hoover saw the Board as a shining example of how voluntarism and cooperation between competitors could produce a more efficient economy without government intervention. The FFB was intended to strengthen farmer cooperatives through operational loans while also providing for short-term price stabilisation known as ‘orderly marketing’ using a \$500 million revolving fund.¹⁰⁶ FFB loans supported larger advances to cooperative members, and loans were forgivable down to a ‘pegged price’ or ‘loan basis’ for wheat, effectively creating a floor price for the farmer.¹⁰⁷

At the time, Sir Josiah Stamp was appointed in April 1930 to head a Royal Commission in Canada, asking the key existential question as to whether futures markets should be allowed to continue in the interests of ‘orderly marketing’. This worried the CBOT. On 11 April 1931, Fisher reported to Carey that, ‘If the findings should be adverse, trading in grain futures will be doomed as far as Canada is concerned’.¹⁰⁸ The FFB was a similar existential threat, bypassing the futures markets at first to deal directly with cooperatives. However, the FFB continued its actions and distorted normal price relationships, the CBOT began to protest both publicly and privately. In the end, the manipulation failed, and the use of futures markets by federal authorities succeeded only in reinforcing the legitimate nature of trading on the CBOT, especially after the GFA had already produced defences of the futures market as a key institution in the marketing of grain.

While publicly vilifying the Farm Board, the CBOT membership privately practically begged for intervention, then profited from the intervention and the speculative fever surrounding it, finally benefiting when the intervention further bolstered arguments in favour of the exchanges as vital elements of the grain marketing cycle. In the ensuing panic, ‘a good many people in the grain trade, including Lonsdale and Wells, telephoned their advice to the Farm Board to enter the market’.¹⁰⁹ Not long

¹⁰⁶Hope Chamberlin, *A Minority of Members: Women in the U.S. Congress* (New York: Praeger, 1974), pp. 92–95.

¹⁰⁷Clipping, ‘Kiplinger’s Washington Agency on the Federal Farm Board,’ 25 January 1930. CME III.12.8.

¹⁰⁸Letter, F.G. Fisher to Carey, 11 April 1931. CME III.16.16.

¹⁰⁹Letter, Barnes to Carey, 3 March 1930. CME III.14.13.

after this, however, aware that intervention by the Farm Board endangered markets, the grain trade changed its tune. However, the grain men indulged in a good deal of hindsight when criticising FFB's intervention. On 7 March 1930, the Minneapolis exchange president admitted that the FFB had 'saved the market from a real break' and that he felt no need at the time to second-guess the government since perhaps the intervention was 'the lesser of two evils and it may work out'.¹¹⁰ Interestingly, in 1930, Carey was terrified that a short crop may come to pass and make the FFB's actions look prescient, setting the stage for similar government interference.¹¹¹ But a bumper crop in 1930 sealed the fate of the intervention and such action was never attempted again.

Privately, the CBOT executive and its lobby machine recognised that the FFB was legitimising futures trading. MacMillan wrote to Carey:

The use of the Futures markets by the Farm Board agencies at least served to show the country, particularly members of Congress, that the Futures Markets must be used in any grain marketing plan and, from an entirely selfish standpoint, the Futures Markets are now saying that the Government has proved the need for Futures Trading. Certainly this all has humorous aspects.¹¹²

Around this time not everyone in Congress supported the role that futures trading had in contributing to grain marketing, and several Congressional post-mortems were held for years afterwards. However, the intervention did confirm that futures markets were legitimate venues for effecting policy in that futures prices influenced the cash prices that farmers received for their commodities.¹¹³

CBOT resentment and ideology did not seem to affect members' desire for more business and profit. The archives are full of discussions about how the CBOT membership could profit from the FFB

¹¹⁰Letter, Carey to president, Minneapolis Chamber of Commerce, 7 March 1930. CME III.12.5.

¹¹¹Letter, Carey to Barnes, 4 March 1930. CME III.14.13.

¹¹²Letter, Mrs. MacMillan to CBOT president Frank Carey, 15 March 1930. CME III.18.4.

¹¹³Anne E. Peck, "The Futures Trading Experience of the Federal Farm Board," *Futures Trading Seminar Proceedings*, Vol. iv (Chicago: Chicago Board of Trade, 1976), p. 55.

‘interference’, whether by trading with the government, against the government, or even *for* the government (as agent).¹¹⁴

5.4.2 *The Failure of the Voluntary Codes*

The legislative efforts of the AFBF, other grain market users and the GFA were delayed due to the passage of both the 1933 Agricultural Adjustment Act (AAA) and the 1933 National Investment Recovery Act (NIRA).¹¹⁵ The highly contested 1933 election resulted in a victory for Democrat Franklin Delano Roosevelt (FDR) as President. Henry C. Wallace’s son, Henry Agard Wallace, became Secretary of Agriculture.¹¹⁶ It was the father who had been heavily involved in the founding of the AFBF in 1919.¹¹⁷ But even if the younger Wallace proposed the ever normal granary in 1933, he was not interested in intervening in the futures markets. The pro-business Hoover was out, but the interventionists were marginalised in at least two key areas of policy, the first being securities legislation—the Securities Act of 1933 and the Securities Exchange Act of 1934, where Felix Frankfurter and James Landis were given the power to design an act that focused on disclosure rather than restriction.¹¹⁸ The second key area was commodity futures regulation.¹¹⁹

Several years before the CEA was passed, the grain trade was focused on developing a voluntary Code of Conduct to satisfy Peek and his Agricultural Adjustment Administration. The entire history of the event cannot be covered here, but it is important to note who demanded

¹¹⁴Letter from Barnes to Carey 5 March 1930. CME III 14.13. On 5 March 1930, Julius Barnes advised Carey that was morally and ethically acceptable to execute the Farm Board’s trades. An idea to profit from FFB positions is outlined in Letter from Carey to Barnes, 12 May 1930. CME III.12.9.

¹¹⁵For the purposes of this work, only the implication of these Acts on the futures markets are (briefly) covered.

¹¹⁶The son was elected US vice-president in 1941.

¹¹⁷Donald L. Winters, “The Persistence of Progressivism: Henry Cantwell Wallace and the Movement for Agricultural Economics,” *Agricultural History* 41 (1967): 109–120, p. 113.

¹¹⁸James M. Landis, “Legislative History of the Securities Act of 1933,” *George Washington Law Review* 28 (1959): 29–49.

¹¹⁹*Ibid.*; John H. Stassen, “The Commodity Exchange Act in Perspective—A Short and Not-So-Reverent History of Futures Trading Legislation in the United States,” *Washington & Lee Law Review* 39 (1982): 825–844, pp. 825–827.

what, and who achieved their goals for the Code. The Code negotiations between the Agricultural Adjustment Administration and the exchanges, primarily the CBOT, pitted a rent-seeking Peek against a rent-seeking CBOT executive. Nevertheless, the voluntary Codes of Conduct required for each industry under the NIRA influenced the substance of the eventual 1936 Act, while also finally setting mandatory margining of futures positions by the futures customers of clearing house members. The Code officially recognised the right of the CBOT to govern its own affairs, and, even if the AAA felt differently, it was not intended to be rent-seeking in any way. When the Code failed, many of the often controversial key features of the Code pertaining directly to futures trading rules were implemented in the 1936 Act.

The AFBF and the GFA, although supposedly tasked to act in the interests of grain producers, were not interested in Peek's goals of stabilising and increasing grain prices. The AFBF was primarily concerned that the CBOT was bullying cooperatives by, for example, banning them from clearing memberships, while not adequately protecting the interest of the key market participants, especially the small speculator. As a result, the AFBF did not support the Code, and, when it failed, was eager to lobby for the changes it had worked out together with the GFA. Consequently, the AFBF passed a resolution 'condemning the proposed code of fair competition prepared by the grain exchanges' as it did not force the CBOT to take on cooperatives as members, while also, importantly, not addressing problems caused due to manipulation.¹²⁰

The cooperatives, in their turn, demanded more protections for their interests, including guaranteed membership in the Board's clearing operation. Membership to the clearing corporation was restricted, with even Grimes' Cargill, the grain giant, denied privileges. The large cooperative, FNG, was unsuccessful in gaining access for some time, as the exchanges pushed back on any amendments that would make it easier for cooperatives to join.¹²¹ The archives reveal a concerted effort by the AFBF to bypass what they saw as unproductive Code negotiations, to which they were not invited, to focus directly on legislative solutions to the cooperative problem.¹²²

¹²⁰Letter, Chester Gray to Duvel, 26 December 1933. NARA/KC, Box 3, 2-2.

¹²¹Letter, Edgar Markham to the Exchanges, 29 November 1933. CME III.830.5.

¹²²Letter, Chester Gray to Duvel, 26 December 1933. NARA/KC, Box 3, 2-2.

On 24–25 July, the AAA hosted the first of two private hearings. As much as Peek tried to turn the conference’s attention to raising the price of grain, almost all of the other participants at the hearings focused solely on the more reasonable goals of reducing manipulation and price volatility.¹²³ The Code, dealing as it did with the enforcement of good behaviour by industry, could do nothing to increase farm prices.

The Board’s negotiators proposed to include permanent daily price limits, maximum open interest limits per speculator and adequate margin requirements particularly as applied to increased requirements for larger speculative commitments.¹²⁴ Permanent price limits (daily highs and lows) were put in place under CBOT Rules immediately following the banning of privileges. However, even though the CBOT executive and lobby agreed on a ban on privileges, many members battled for the reinstatement of privilege trading. Thus the discussions in the hearings reveal a disunited CBOT, but they also provide another example of the power of information over the CBOT lobby. The information gathered by the GFA refuted statements by the grain trade, such as those by a vice-president of the Ralston Purina Company and St. Louis exchange representative, that privileges had legitimate uses within the marketing system. Duvel replied to aggressive statements to the contrary, ‘In the investigation with reference to puts and calls, we find them used very little by the people engaged in the grain business’.¹²⁵ Privileges were observed to be used solely for highly leveraged, aggressive speculation. Lindley of the clearing house at Chicago was an unlikely supporter of Duvel’s observation, confirming that privileges ‘are usually sold by the professional traders and bought by small speculators’.¹²⁶ When pushed, even CBOT members representing the grain trade found privileges indefensible.

A second informal conference was then held with CBOT representatives, Thies, Duvel, Peek, Milnor (of the FNG) and others. These internal discussions of 9 August 1933, which were not meant for public

¹²³Transcript, informal conference with Chicago Board of Trade, other Exchanges and the Federal Government, 10am, Reporter Mr. Sharkey, 24 July 1933. CME. III.850.1.

¹²⁴Transcript, Informal Conference Committee Representing Grain exchanges, 10.30 a.m., Reporter Miss Dolan, 25 July 1933. CME 830.III.4; Original letter: Letter to the Agricultural Adjustment Administration from CBOT, 25 July 1933. CME III.830.5.

¹²⁵CME III.830.4. Report on Informal Conference Representatives of the Grain Exchanges, Frank A. Thies, 9 August 1933.

¹²⁶Ibid. Lindley was also a partner in the Clement Curtis Company of Chicago.

release, are crucial in understanding the key issues of the day and how the various parties felt about the current situation in grain markets and their regulation. Peek insisted that the Grain Committee members ‘clean house in their organisation’ through a better functioning BCC.¹²⁷ Self-regulation, which was to be the keystone of both the Code and then the 1936 Act, focused on increasing the power of the BCC, with the GFA as enforcers of last resort.¹²⁸ Enforcement was actually seen as a burden that could be mostly shifted on to the exchanges. Finally, Peek wanted the exchanges to fully cooperate with the GFA in every aspect of their business.¹²⁹ But the rent-seeking nature of Peek and the AAA was still in evidence. Peek stated that:

Unless we get these farm prices up, and immediately – I don’t mean after the farmer has sold his grain, I mean before he has sold his grain – I anticipate that you will face legislation next winter which makes what we are talking about now fade into insignificance compared with the restrictive provisions that will be pressed upon you. And I say that with all the friendliness in the world.¹³⁰

Carey responded that ‘None of us, least of all grain exchange men, want a repetition in the break in the market that did occur two weeks ago and we are doing everything possible to avoid reoccurrence’.¹³¹ But the CBOT could not really help Peek with his problem. The membership, alone, could not raise prices. Peek noticed that there was little support for his latter statements: ‘I didn’t hear three rousing cheers to the suggestion of the possibility of a minimum price’.¹³² Carey responded immediately that the problem was that the price had to be indicative of supply and demand, eloquently stating the obvious:

As to the minimum price, we would all be in favour of putting that as high as possible if it could be maintained, but with the thought of minimum

¹²⁷Letter from Thies to Peek, 9 November 1933. CME II.830.1.

¹²⁸Letter, John E. Dalton, Code Analysis Committee, to Thies, 19 October 1933. CME III.830.1.

¹²⁹Letter, Thies to Peek, 9 November 1933. CME II.830.1.

¹³⁰Report on Informal Conference Representatives of the Grain Exchanges, Frank A. Thies, 9 August 1933. CME III.830.4.

¹³¹Ibid.

¹³²Ibid.

price must go the same thought that the buyers must be provided on that minimum price, in some way.¹³³

It must have been clear to all present, all grain market experts, that the Code could in no way bring about higher prices.¹³⁴ Yet Peek did not let up in his rhetorical support for higher prices.¹³⁵ This could not have been a calm and pleasant conference.

In private code hearings, the grain trade, for its part, retained its bias to self-regulation, in spite of obvious evidence of their failure to prevent abuses by recalcitrant traders. Cargill executive and grain trade representative E.J. Grimes boldly declared, ‘The rules and regulations that we now have in force and which are now effective. The unfair trade practices are being taken care of and being regulated. They always have been and are now’.¹³⁶

As a result of subsequent Code conferences, it was agreed that the CBOT would notify the Secretary of Agriculture upon any rule change and other exchanges would follow the CBOT’s 1926 lead in setting up BCCs and full-time supervisors would be hired to execute the Committee’s duties.¹³⁷ Such professionalisation was becoming more commonplace in the interwar USA.¹³⁸ The Code of Fair Competition for Grain Exchanges and members was made effective on 31 March 1934 under the Agricultural Adjustment Act and the National Industrial Recovery Act.¹³⁹

As part of the collective action problem, the CBOT had to negotiate with government without having the unanimous support of its membership. Of course, many members, including the powerful interests, rebelled against the imposition of rules that had been decided in

¹³³Ibid.

¹³⁴Ibid.

¹³⁵Ibid.

¹³⁶Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4.

¹³⁷Letter, Thies to Peek, 9 November 1933. CME II.830.1.

¹³⁸Edward J. Balleisen, ‘Private Cops on the Fraud Beat: The Limits of American Business Self-Regulation, 1895–1932,’ *Business History Review* 83 (2009): 113–160.

¹³⁹Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4; Telegram, E.J. Grimes, Cargill, to F. Clutton, 14 October 1933. CME III.830.1.

conference without their input. The CBOT's Clutton, with others, regularly had to defend the GCNA's and the CBOT executive's actions against its own membership, taking the obviously legal stance that:

Our Board of Directors was quite within scope of our charter powers in accepting and approving suggested code as binding upon the Chicago Board of Trade and its members. Members were advised via newspapers and publicity of features of code on various newspaper released beginning in July. Many copies of code were distributed to those interested who requested them. Safe to say practically every member of floor understood the code and [...] that a code once adopted became binding on all members in industry, and understood further that Directors were acting on their behalf.¹⁴⁰

But it is also clear from the archive that the CBOT membership was uncomfortable about combining lobbying efforts with the other exchanges. The Board's executive was aware that the CBOT dominated the industry. A handwritten note reveals such thinking, concluding that the CBOT should leave both the Code Authority and the GCNA.¹⁴¹

Even after the submission of the Code, the powerful lobby machine of the grain industry did not rest. On 23 December 1933, Grimes and Markham of the GCNA, met with the final judge and jury of their Code and, at the last minute, appear to have deflected some unfriendly proposed changes.¹⁴² The Code hit new snags in the middle of 1935 when, between 15 and 17 May, a hearing was held to determine if the CBOT was acting monopolistically by deliberately excluding certain grain marketers—the cooperatives—from membership; the question was also raised as to 'whether [or not] the Code Authority selected pursuant to the provisions of such Code is truly representative of the industry'.¹⁴³ The Code appeared doomed to fail, even as it was signed into law.

5.4.3 Mandatory Margining

Regulating the size of the initial and ongoing—or 'maintenance'—margin required to be placed by a trader as a good faith deposit is justified on four grounds, (i) protecting investors from self-harming, (ii) defending

¹⁴⁰Telegram, Clutton to Grimes, 23 January 1934. CME III.831.6.

¹⁴¹Handwritten note, Grimes (no date but 1935). CME III.831.1.

¹⁴²Letter, Grimes to Clutton, 23 December 1933. CME III.830.

¹⁴³Letter, Edgar Markham to Exchange Code Authority, 20 May 1935. CME III.831.1.

markets from fragility caused by over-speculation, (iii) limiting price volatility, and (iv) limiting over-allocation of credit to the financial markets.¹⁴⁴

After years of asking the government not to interfere in its own affairs, between 1929 and 1931 the CBOT came to realise that mandatory margining would improve business prospects by mitigating counterparty credit risk.¹⁴⁵ Equally, however, there were strong forces at the exchange that did not support mandatory margining, and particularly did not want to cede control to the government over the existence and size of margins. This, again, was a collective action problem, since margins made most traders better off, in that credit risk was mitigated, yet some wanted the power to set their own margins, and/or use them in order to manipulate markets. Additionally, though history has proven otherwise, it was argued by some CBOT members and even Board directors that the mechanics of margining was too complex to be implemented in the immediate future.

There existed a real worry at the GFA that ‘emergency calls’ after a huge move might exacerbate price volatility by forcing weak hands out at just the wrong time. This became a well-understood phenomenon during the FFB intervention. Dr. Duvel observed that ‘the real difficulty on these emergencies where there is more or less of a general call from practically all the commission houses when the market gets into difficulty for increase in margin is that it is a form of manipulation’.¹⁴⁶ CBOT President Carey responded:

I called a special committee to go into that question. The Chairman of that committee doesn’t know himself that I have appointed him. He is here, the Vice-President of the Chicago Board of Trade, Mr. Boylan, together with two members of the two Board of Directors, and we are going to put teeth in that business conduct rule of the Board of Trade. We intend to put auditors and such other help as may be necessary to properly supervise the marginal requirement and long and short commitments and every other requirement that is intended either in spirit or in letter or in anything that is included in this code. With the cooperation of Dr. Duvel’s department, I think we will clear this situation up.¹⁴⁷

¹⁴⁴Hersh Shefrin and Meir Statman, “Ethics, Fairness and Efficiency in Financial Markets,” *Financial Analysts Journal* (November–December, 1993).

¹⁴⁵Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4.

¹⁴⁶Ibid.

¹⁴⁷Ibid.

This unit was to work under the Business Conduct Committee, even if the members were unaware that they had been drafted into serving. The 1936 set up of the BCC is echoed in the professionalism of current market supervisors such as those at the CFTC.

However, such margining was rare; James Boyle observed that ‘credit is rather freely extended in these matters’.¹⁴⁸ The Code set mandatory margin requirements at 10 and 25% for positions greater than two million bushels—much higher than previously called for by the clearing house or by some members from their clients.¹⁴⁹ Contrary to the historiography, even though margins were indicated by exchange rules, they were rarely called for, even in the 1930s. E.J. Grimes admitted that margins ‘have not been strictly applied, are not enforced at the present time by a mandate of the exchange, but in effect they are operating with perhaps almost all of the houses’.¹⁵⁰ The CBOT had finally acknowledged another key weakness in its business model.

The recognition that margining could both control unwanted speculation and reduce credit counterparty risk was not new. For example, the FTC in 1926 called for stricter margin rules, methods to ensure the financial stability of the ‘commission houses’, and mechanisms to restrict the use of margin deposits by brokers.¹⁵¹ Yet, when Peek asked what the present policy at the CBOT was regarding margins, E.J. Grimes confirmed that:

[Margin called for] varies. In the last month it has been down to 5% or less. Maybe some grain has been carried down to the full clearing house requirement, which is around 4 cents [...] It has been up to the judgment of the house itself as to what could be applied.¹⁵²

¹⁴⁸James E. Boyle, *Speculation and the Chicago Board of Trade* (New York: Macmillan, 1920), p. 85.

¹⁴⁹Arthur F. Lindley and H.S. Irwin, “Essentials of an Effective Futures Market,” *Journal of Farm Economics* 19 (1937): 321–333, pp. 329–330.

¹⁵⁰Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4

¹⁵¹US Federal Trade Commission, *Annual Report of the Federal Trade Commission for the Year Ended 30 June 1926* (Washington, DC: Government Printing Office, 1926), p. 60.

¹⁵²Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4

The Code finally mandated the enforcement of margins.¹⁵³ Mr. Lindley of the clearing house did point out that some firms, including his own, called for significant margins. He estimated that about 50% of customers' business was being carried on a 10% margin.¹⁵⁴ But of course, there was no obligation to do so, 50% of business was on less than 10% margin.

Importantly, it was acknowledged that the banks that lent to the grain trade did not have the information to properly judge the credit risk of hedgers and traders on grain futures. As a result, banks were in favour of enforced standardised margining.¹⁵⁵

However, the CBOT pushed back hard on the margin proposal in the Code. Though history has proven otherwise, it was argued by the membership and the executive of the Board that the mechanics of margining was too complex to be implemented in the immediate future. Indeed, it took until the Act of 1936 before margining was finally forced on the CBOT.¹⁵⁶

¹⁵³Sub-paragraph (c), Article V: 'Each exchange shall require its members to demand and receive from all customers, both members and non-member customers, and to maintain at all times, subject to reasonable regulations as to call and notice minimum margins on all future trades in grain excepting futures trades and contracts of the following classes.' Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4.

¹⁵⁴CME III.830.4, Report on Informal Conference Representatives of the Grain Exchanges by Frank A. Thies, 9 August 1933.

¹⁵⁵Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4.—'Mr Lindley: the banks would have no knowledge of what you are doing in the market. It would have to come from the various members of the exchanges disclosing what the members' bushel might be and the tabulation of that at some central point. The banks couldn't be of assistance because they have no knowledge... We discussed this situation with Mr. level of the Continental Illinois National Bank, with Mr. Brown of the First National Bank. They are quite in agreement with us as practical men that something must be done in the way of a standard marginal system that will be adequate to protect markets and this proposition has been put up to them and to them it seems to be quite satisfactory and quite in accord with what they would like to have us do.'

¹⁵⁶Telegram, Fred H. Clutton to Grimes, 28 December 1933. CME III.830.5.—'Markham requested we advice you by phone or wire opinion regarding new margin proposal... Boylan Harris Lindley [committee members] feel technical problems involved in depositing excess margin with supervisor require careful study by our Directions and full mutual understanding of mechanics in handling before an agreement is made. Prefer to bring matter to our Directors next Tuesday and if necessary have Lindley or some brokerage office expert present problems to you Duvel and Mehl after Directors have given approval to policy in general.'

Until 1933, ad hoc and inconsistent enforcement could be used to manipulate markets, as well as putting members at financial risk to their clients. Additionally, Grimes acknowledged that the banks that lent to the grain trade did not have the information to properly judge the credit risk of hedgers and traders on grain futures, and the banks were said to be in favour of enforced standardised margining.¹⁵⁷ Lindley boldly added that enforced standardised margin requirements would reduce price volatility.¹⁵⁸ The margin requirements from the Code were so favoured by so many of the key interests, such as the CBOT directorate, the GFA and the AFBF, that they were easily accepted into the 1936 CEA. As such, fixed margins, currently mandated in all futures markets and many over-the-counter markets, became the next important institutional consequence of the co-constructed interwar regulatory regime.

When a new ten cent price limit pledge was announced by the CBOT after the hearings of 24–25 July, ‘The Secretary evinced pleasure [...] Administrator Peek smiled. “That’s fine,” he said, adding quickly [...] “what about margins?”’.¹⁵⁹ Peek demanded that they act by August 5th, otherwise he was ‘prepared to [do] the job for them’.¹⁶⁰ Soon after, mandatory margins were incorporated into the Code. The Code set 10% *mandatory* margins and higher limits for larger sizes up to the limit of two million bushels. Mandatory margins were the main feature of the Code. But when the Code was declared unconstitutional, margins were no longer mandatory. Nevertheless, after 1934, the CBOT membership found that margins were indeed beneficial, especially in reducing counterparty credit risk to customers.¹⁶¹ As a result, they remain a fundamental requirement at futures exchanges to the present day.

¹⁵⁷Ibid.

¹⁵⁸Ibid.

¹⁵⁹Letter, Edgar Markham to Exchanges, 29 July 1933, CME III.830.6.

¹⁶⁰Ibid.

¹⁶¹US Congress, House, *Hearings Before the Committee on Agriculture on HR 3009*, 74th Cong. 1st Sess., 7 February 1935, p. 40.

5.5 THE COMMODITY EXCHANGE ACT AND THE GRAIN GAMBLER

The Code negotiations and their eventual failure had two important results for futures markets. Firstly, mandatory margining was finally (voluntarily) adopted and was never abandoned by the CBOT membership. After many years of ad hoc rules and lax enforcement, a key counterparty credit risk mitigation method as well as a useful policy tool was universally adopted. Secondly, and perhaps more importantly, the Code's failure left a policy window open that the GFA and the AFBF were able to take advantage of in 1936.

Even before the New Deal institutions were ruled to be unconstitutional, the American Farm Bureau Federation (AFBF) had begun its work with the GFA on a new bill that eventually became the CEA. Therefore, in May 1935 when the Supreme Court abolished the AAA in *Schechter Poultry Group v US* 495 (1935), the stage was set for voluntary aspects from the Code the GFA and the AFBF supported, together with other controls, to be set into legislation. The Codes, which mandated significantly more robust governance policed by the Boards themselves, were now the starting point for new regulations.

5.5.1 *In Defence of the Small Speculator*

The earlier comprehensive FTC study had showed that low margins both encouraged speculation, resulting in more losses, and, potentially, discouraged and even bankrupted small speculators. Sophisticated scalpers and traders took advantage of the small speculators, who were usually long, by 'gunning for the stops'—i.e. selling temporarily to force the speculators out of the market.¹⁶² Therefore, mandatory margining leading to limiting manipulation was the solution, even if the Federal Government was never allowed this level of control.

It was generally agreed, even at public hearings, that small speculator participation benefited commercial hedgers selling during the harvest.

¹⁶²Federal Trade Commission, *Report on the Grain Trade*, Vol. V (Washington, DC: Government Printing Office, 1923), p. 157; Federal Trade Commission, *Report on Methods and Operations of Grain Exporters* (Washington, DC: Government Printing Office, 1923), p. 49; and Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014), p. 41.

Responding to a question about price making from Mr. Peek, Lindley stated, ‘A risk-bearing public of millions of individuals, nationally and internationally [are among those who] determine from day to day and from time to time what is the market price of grain’.¹⁶³

The GFA’s attempted battle against fraud, especially against the smaller speculators, was an almost futile task. The USDA was not particularly supportive of the GFA’s policing efforts in protecting customers. For example, in 1933 the Grain Futures Commission ruled that fraud could not be prosecuted under the 1922 Act, as it did not result in a manipulation of prices.¹⁶⁴ Customers could therefore not seek redress from the GFA. This the GFA saw as a major issue, since small speculators needed to be protected and encouraged. Also, customers who complained about cotton manipulation or fraud were completely unprotected by the GFA, as the 1922 Act only covered grain futures. But neither the USDA, the Commerce Department nor the Attorney General agreed that the Rules allowed for the prosecution of manipulation. Importantly, the CBOT’s BCC, under no such limitations, did not expel these same fraudsters, nor did it prosecute other fraudulent activity such as that of the Reddy Brothers in 1930.¹⁶⁵

During Code hearings, it was confirmed even by the exchanges that the small speculator ‘is the fellow who carries our hedges and without those hedges [...] prices [will be] substantially lower than they are otherwise’.¹⁶⁶ Mr. Wells of the Minneapolis Chamber, and key exchange lobbyist, agreed, adding, ‘I personally would not want to see the men who trade in five, ten, fifteen, and twenty thousand bushels drift out of the market because he is our mainstay in controlling the market’.¹⁶⁷ Clearly, the exchanges favoured having a greater number of smaller speculators,

¹⁶³Memorandum, Informal Conference Representatives of the Grain Exchanges by F. Thies, 9 August 1933. CME III.830.4; Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997).

¹⁶⁴*Secretary v. Massey* (GFA Docket 2–3, 1933) as in Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014), p. 83.

¹⁶⁵US Congress, Hearings Before the Committee on Agriculture and Forestry on HR 6772 (Washington, DC: Government Printing Office, 1936), pp. 21–22.

¹⁶⁶Report on Informal Conference Representatives of the Grain Exchanges, Thies, 9 August 1933. CME III.830.4.

¹⁶⁷*Ibid.*

since more gamblers meant more revenue. But both the exchanges and the farmers' organisations agreed with the GFA that market stability at harvest time was an additional benefit. Milnor of the Farmer's National, the cooperative grain market originally associated with the AFBF, also defended the need for a liquid futures market, stating that:

Opportunity of hedging cash grains, stocks and purchases is very vital to the economical handling and marketing of the grain that we handle for farmers [therefore] you should have enough volume of trade so that when we sell cash wheat over night to a miller we can buy in the hedge during the market session without much variation in price [and] reverse the trade after the cash grain is sold.¹⁶⁸

Protecting the small speculator would be a key component of the 1936 Act. The unsaid corollary was that the large speculator tended to make life more difficult for hedgers during the marketing season, often shorting alongside the legitimate hedgers.

Roosevelt was also aware of the benefits of small speculation. In his 1934 message to Congress, he attacked the securities and commodity exchanges by calling for legislation based on eliminating 'destructive speculation'; crucially his priority was to protect both stock and commodity investors as well as safeguard values through price support.¹⁶⁹ However, the legislation that emerged in 1936 only met his first priority.

5.5.2 *A Policy Window Opens*

Up until the early 1930s, the futures exchanges were loosely supervised or controlled, and the political environment, biased as it was to free market ideology, was not conducive to any improvements of the 1922 Act; however, key new catalysts were to emerge in early 1935.

The Code was intended to be the final word on regulation. Indeed, the Senate Banking and Currency Committee sponsoring securities legislation in the form of *S. 2693* did not want to include commodities in any such regulation.¹⁷⁰ Edgar Markham of the GCNA guessed that Secretary

¹⁶⁸Ibid.

¹⁶⁹US Congress, Cong. Rec. 73rd Cong. 2nd Sess. (Washington, DC: Government Printing Office, 9 February 1934), p. 2264.

¹⁷⁰Letter, Edgar Markham to the exchanges, 10 February 1934. CME III.831.6.

Wallace ‘doesn’t seem to be very strong for further legislation now’.¹⁷¹ But by early February 1934, it was clear the Code was being delayed ‘to afford opportunity to get commodity exchange legislation introduced in Congress before the Code is sent to the President for approval’.¹⁷² The CBOT’s Washington representative wrote to the Board executive on 10 February 1934, ‘While definite information is lacking, there are strong intimations that a commodity exchange bill will be introduced early next week’.¹⁷³

In early 1934, the US President had stated in Congress that while exchanges ‘are necessary and of definite value to our commercial and agricultural life [there is a need for the] elimination of unnecessary, unwise and destructive speculation’.¹⁷⁴ President Roosevelt refused to get involved directly in the new legislative process, stating the matter was a strictly Congressional measure.¹⁷⁵ However, it was clear by the mood in Washington that ‘this Congress is still for what and only what Roosevelt wants’.¹⁷⁶ Nevertheless, the President did finally interfere, and in February he sent letters to Representatives Jones and Senator Smith of South Carolina, chairman of the Senate Committee on Agriculture, advising them that he wanted Congress to introduce new futures regulation immediately.¹⁷⁷ Thus, the window opened for a bill from the AFBF and the GFA. However, on 24 February, the preferred Administration Commodity Exchange Bill had not been formally introduced in either branch of Congress, with neither ‘Representative Jones of Texas, chairman of the House Agricultural committee, nor Senator Smith of South Carolina, chairman of the Senate Agricultural committee, anxious to sponsor the legislation’.¹⁷⁸ Things were looking up for self-regulation advocates, with Jones and Smith more interested in ‘calling the presidents of the various grain exchanges to Washington for a conference looking to action by the exchanges that will make legislation unnecessary’.¹⁷⁹

¹⁷¹Ibid.

¹⁷²Ibid.

¹⁷³Ibid.

¹⁷⁴Letter, Edgar Markham to the exchanges, 10 February 1934. CME III.831.6.

¹⁷⁵Ibid.

¹⁷⁶Ibid.

¹⁷⁷Letter, Edgar Markham to the exchanges, 17 February 1934. CME III.831.6.

¹⁷⁸Letter, Edgar Markham to exchanges, 24 February 1934. CME III.831.6.

¹⁷⁹Ibid.

Eventually, however, the Chairman of the House Agricultural Committee, Representative Jones of Texas, who had been conferring regularly with the Department of Agriculture, introduced the eponymous Jones Bill, the first draft of commodity futures legislation. The Dickinson Interdepartmental Committee, reporting on securities regulation, rejected commodity regulation suggestions from the USDA, as they appeared to be in conflict with each other. However, after many meetings, Duvel, chief of the GFA, and Nils Olsen, head of the Bureau of Agricultural Economics, had resolved such conflicts within the Department.¹⁸⁰ At a press conference on the Thursday before 17 March 1934, both Secretary Wallace and Administrator Davis ominously served notice to all parties of an intention to approve the Code as an interim measure to reduce volatility, but that the Code's adoption would not affect the likelihood of further legislation.¹⁸¹ Shortly afterwards, Representative Jones, at an executive meeting of the House Committee on Agriculture, threatened new legislation even as some in the media had attributed to Jones comments to the effect that new legislation may not be necessary if the Code is approved by the President.¹⁸²

The AFBF saw the failure of the Code as a huge opportunity, since they had been lobbying for new futures legislation. The price action during the Great Depression, the behaviour of the futures industry during key hearings and the final straw of a glaring weakness of the 1922 Act had embarrassed all those individuals, at all levels, who had been involved in the Code. In Duvel's 1934 testimony before the House Appropriations Committee, he stated:

We believe in the futures market: we think it should be maintained, but that it should be on a basis where everyone who finds it necessary to use it for hedging or who desires to use it for speculative purposes should have a fair chance. Whenever a single individual can control 10 or 15 percent of the open contracts or can do 10 percent of the days trading, that it is not a free and open market; it is anything else but that [...] Based on information accumulated during the past 10 years we believe the system of future trading should be maintained, but it does need to be improved in many respects.¹⁸³

¹⁸⁰Ibid.

¹⁸¹Letter, Edgar Markham to the exchanges, 17 March 1934. CME III.831.6.

¹⁸²Ibid.

¹⁸³Ibid.

By 1935, the GFA wrote to the AFBF asking to have final changes made to Section 6a of the Jones Bill HR 6772 so that it could offer its unconditional support when asked by Congress and the USDA and would permit the GFA to mention this support in a report by the Agricultural Secretary to the Senate Committee on Agriculture and Forestry.¹⁸⁴ The AFBF was then able to rally the USDA and the powerful Congressional Committees around a bill mostly written by the GFA technocrats and tables by the AFBF. Indeed, the archival records provide evidence of the pressure from the FNG on the AFBF, which then worked with the GFA to pressure the USDA and federal legislators. A key section of the AFBF's comments on HR 6772 covered the issue facing the FNG:

The American Farm Bureau Federation is for H.R. 6772, which proposes to amend the Grain Futures Act and to re-designate it as a commodity exchange act [...] The Farmers National Grain Corporation is interested especially in one amendment [that] would give a cooperative its day in court before being disciplined by the exchange in which it had membership.¹⁸⁵

The FNG and Paul Mehl, assistant head of the GFA, were unimpressed with the arguments against allowing shared commissions within a cooperative transaction.¹⁸⁶

To summarise, the FNG and the AFBF objected to the treatment firms were receiving at the hands of the Board of Trade under the useless 'captured' sections of the 1922 Grain Futures Act. The GFA, displeased at being targeted by reactionary elements of the Board of Trade and experiencing a new lack of cooperation with the CBOT's BCC, was keen to help the AFBF get what it wanted in exchange for forwarding its own agenda, even if most of the GFA's proposals for new regulatory legislation were ultimately benign.

The GFA, which had little interest in the cooperative movement, accepted the support offered in the Jones Bill and, in return, became a key supporter of AFBF. Mehl wrote to the AFBF's legal representative:

¹⁸⁴Letter, J.M. Mehl to Donald Kirkpatrick, General Counsel, American Farm Bureau Federation, 14 June 1935. NARA/KC, Box 3, 2-2.

¹⁸⁵Letter, Donald Kirkpatrick to Seth Thomas, General Solicitor, Department of Agriculture. NARA/KC, Box 3, 2-2.

¹⁸⁶Ibid.

Regarding the support of Grain Futures Administration for the cooperative features of the bill, I wish to make clear, if it is not already clear, that neither the Grain Futures Administration nor any member of our staff will oppose the cooperative provisions of the bill even in their present form. While we feel it our duty to point out what we think are objectionable features, we shall leave to the cooperatives and farm organisations determination of those questions which directly affect their particular problems.¹⁸⁷

The GFA was adamant that new legislation was needed in spite of the Code and was working with the AFBF during the Code negotiations. Of course, the AFBF felt the same way. Mehl reminded the exchanges in Washington that Code approval would not preclude new legislation.¹⁸⁸ In its 1934 *Annual Report*, the GFA Chief, Duvel, made a public appeal to the USDA and Congress to ‘reinforce’ the 1922 Act.¹⁸⁹ Yet it was still too early at that time. Yet the failure of the Code, even before the AAA was declared unconstitutional, only spurred on the demand for new legislation.

In 1935, the Commodity Exchange Bill passed the House but not the Senate. However, the Cutten decision spurred all parties to move forward. Cutten was charged in 1934 for the 1931 violation that, (i) he underreported his short position of over 2 million bushels, and (ii) for market manipulation. He was often spectacularly short, once in excess of 7 million bushels. But the Supreme Court ruled that he could not be prosecuted for alleged manipulation due to the poor wording of the 1922 Act, in that it was not a criminal offence since manipulators could only be barred from the markets if ‘caught in the act’.¹⁹⁰ In 1935, the Supreme Court ruled that any other punishment required proof that manipulation was actually in process, and, even if manipulation could be proved, charges could not be brought at a later date.¹⁹¹ This had been big news at the time, given the focus on commodity prices and farm

¹⁸⁷Letter, Mehl to Kirkpatrick, 8 June 1935. NARA/KC, Box 3, 2-2.

¹⁸⁸US Congress, House, *Hearings Before the Committee on Agriculture on HR 8829*, 73rd Cong. 2nd Sess. (1934), p. 255.

¹⁸⁹US Department of Agriculture, *Annual Report of the Chief of the Grain Futures Administration, 1934* (Washington, DC: Government Printing Office, 1935), p. 3.

¹⁹⁰Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), pp. 285–257.

¹⁹¹Summary of CEA activities to Senator Mead of NY, 20 April 1939. NARA/KC, Box 3, 1-3-1.

relief throughout the Great Depression. The Cutten case was brought up regularly in hearings and the language used was often very negative on short selling and excessive speculation. The government, of course, was embarrassed that the element of power bestowed in the 1922 Act really was close to zero, and the USDA immediately backed what became the Commodities Exchange Act.¹⁹² Jerry Markham has agreed that Supreme Court and Grain Futures Commission decisions ‘underscored the fact, as did several price breaks, that the GFA was an impotent agency that had no effective means of regulating the markets. In fact, it was stated in Congress that the Act was a complete failure’.¹⁹³

5.5.3 *The Final Commodity Exchange Act*

The CEA, which was approved on 15 June 1936, established the Commodity Exchange Administration in place of the GFA. It now covered wheat, corn, oats, rye, barley, flaxseed, rice, grain sorghums, cotton, butter eggs, Irish potatoes and millfeeds, which amounted to approximately 90–95% of all futures trading.¹⁹⁴ Also, under the Act, manipulation became a criminal offence, even if most of the responsibility for policing and enforcement remained with the Board’s BCC. Improvements were made to the self-regulatory framework under which the CBOT operated before 1936 by professionalising the BCC, ensuring that the institution responsible for policing the markets had full-time expert support and eliminating most possible conflicts of interest within the committee. However, this was far from the Act’s most important consequence. The Commodity Exchange Administration now supervised \$13 billion in futures trading.¹⁹⁵ Growth in the futures markets has been fantastic, to the extent where, in 2015, the CFTC, under the authority

¹⁹²US Department of Agriculture, *Report of the Chief of the Grain Futures Administration, 1934* (Washington, DC, Government Printing Office, 1935); Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014), p. 86.

¹⁹³Jerry W. Markham, *Law Enforcement and the History of Financial Market Manipulation* (London: Routledge, 2014), p. 304.

¹⁹⁴Commodity Exchange Act, 15 June 1936, 49 Stat. 1491 (1936).

¹⁹⁵US Department of Agriculture. *Report of the Chief of the Commodity Exchange Commission* (Washington, DC: Government Printing Office, 1938).

of the latest Act, supervised an estimated \$300 trillion in futures and swaps trading.¹⁹⁶

The new regulator was tasked with ‘setting limits for daily trading and open interest per speculator [and] preventing misuse of customers’ funds’.¹⁹⁷ The archives show that these key aspects of the current exchange-traded futures regime—including customer protection and mandatory margins—were initially identified in earlier letters between the GFA and the AFBF, along with letters to and from Senator Capper.¹⁹⁸ The public interest was thereby satisfied due to a seemingly unlikely coalition of a powerful private interest and a weak government regulator, with contributions from a CBOT continually attempting to solve its own collective action problems.

In spite of the bungling of the CBOT lobby with the Code negotiations and the CBOT membership’s handling of the cooperative issue, the Board faced in 1936 a new workable regime that focused on protecting and encouraging the small speculator, without imposing any significant control on the exchanges or their membership. The CEA, combined with the margining result from the Code negotiations, bestowed upon the CBOT a set of institutions that remain to this day. Indeed, all substantive changes in the 1936 CEA are present in the rules of all of futures exchanges. From 1936 on, these changes improved the confidence of speculators in the commodity markets. As such, once again the CBOT benefited from benign Federal Government interference, even if such legislation was sponsored by farmers’ organisations and effectively written by the agency set up to oversee the industry.

¹⁹⁶Commodity Futures Trading Commission. Strategic Plan 2014–2018. <http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/2018strategicplan.pdf>. Accessed 1 March 2017.

¹⁹⁷Donald A. Campbell, “Trading in Futures Under the Commodity Exchange Act,” *George Washington Law Review* 26 (1958), pp. 224–225.

¹⁹⁸Frustration is evident in the archival correspondence. See, for example, Letter, Duvel to Cargill Commission Co, 26 November 1928. NARA/KC, Box 12, 15-1. Interactions in 1930s are documented archival correspondence in, for example, letters between Capper and J.M. Mehl, including 17 August 1934, NARA/KC, 14-6. See also Letter, Duvel to Capper, 6 January 1932. NARA/KC, Box 12, 14-6; Letter, Repr. Clifford Hope to Duvel, 11 May 1932. NARA/KC, Box 12, 14-6; Letter, Kirkpatrick to Irving G. Goldsmith, copied to J.M. Mehl, 21 January 1935, NARA/KC Box 3, 2-2; and Letter, GFA to Arthur Capper, 23 June 1925. NARA/KC, Box 12, 14-6.

5.6 CONCLUSIONS

The salience of futures markets as measured by the number of mentions of market troubles in the press was very low, even among farmers' publications.¹⁹⁹ A disinterested public allowed grain professionals and technocrats, grain experts all, even if on opposing sides, to negotiate improved regimes in order to develop rational solutions to small investor protection and reduced manipulation, of which advances stand to this day.

The development of the 1936 CEA involved many competing interests. The exchanges had ceased operating as a unit and their memberships could not always agree on what legislative actions to favour or new institutions to adopt. Fuelled by enforcement failures and buoyed by an almost overwhelming amount of market data and analysis, the GFA sought to implement new legislation beginning in the late 1920s, but the administrations of Coolidge and Hoover showed little interest in regulating any business and certainly not commodity markets. The government compromised with the 1933 AAA. However the Codes failed at the Supreme Court, giving the AFBF an opportunity to work with the GFA in the public interest to overcome both government and the industry's objections to have key regulatory innovations enacted. Prohibitions on self-dealing and a separation of customer and broker funds were only two of the results. Both of these continue to characterise present-day exchange-traded futures markets.

Some politicians debating the CEA called its proposals 'Russian. Only the cellars of Petrograd and mines of Siberia are missing', while others described the CBOT as 'one of the world's great gambling places, where big manipulators [...] have been in control of the board of trade and [...] used it unscrupulously to accomplish their own ends'.²⁰⁰ Neither view is even close to correct. While the 1922 Act limited government power to information gathering due to capture/rent-seeking behaviour of the powerful, the 1936 Act can best be viewed as a rational technocratic reaction by a government agency based on solid analysis of the information gathered under the 1922 Act. The Act's agenda was aggressively advanced by powerful interests as a clearly non-rent-seeking

¹⁹⁹For quantitative measures of salience of futures regulation during the 1920s, see Roberta Romano, "The Political Dynamics of Derivative Securities Regulation," *Yale Journal on Regulation* 14 (1997): 279–406.

²⁰⁰US Congress. House Congressional Record, 73rd Cong. 2nd Sess., 27 May 1936, p. 8014.

solution to the problem of protecting the small speculator, mostly against fraud, and ensuring and robustness of markets generally. Such changes may have contributed to the stability and longevity of futures markets, as well as the enduring monopoly of Chicago.

The CBOT and the GFA from time to time worked together during the interwar years and continued to do so beyond the 1936 Act.²⁰¹ This was partnership, if not quite capture. Even in the mid 1920s, the partnership sometimes functioned well. But during the mid-1930s, the GFA grew increasingly frustrated with the CBOT. Nevertheless, the GFA never sought harsh control. Co-regulation and enforced self-regulation, combined with the criminalisation of manipulation was considered more than adequate control. For example, the GFA and the CBOT agreed that margining should remain within the discretion of the Board, especially since it had been accepted by the membership as an extremely useful rule.²⁰²

5.6.1 *From Gambling as Social Disease to Being in the Public Interest*

Before federal intervention in 1922, State law provided the sole government restrictions on the exchanges. Yet, State law focused either on limiting wagering or the banning of bucket shops.²⁰³ As late as 1926, legislators and bureaucrats still considered speculation by unsophisticated small investors as gambling that required government social regulation.²⁰⁴ The FTC in 1926 recommended that regulation be taken up by the CBOT or the GFA/USDA in order to ‘prevent all unwise speculation [...] and to keep out incompetent speculators’.²⁰⁵ To the FTC,

²⁰¹On ‘grain councillors’ in 1938, according to Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), pp. 324–325, and on a scalping tax in 1938, p. 346.

²⁰²Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 326, quoting from Hearing before a Senate Subcommittee of the Committee on Agriculture and Forestry on S 831, 76th Cong. 1st Sess., 14–16 June 1939 and 12–13 July 1939, pp. 1–2.

²⁰³“Federal Regulation of Commodity Futures Trading,” *The Yale Law Journal* 60 (May 1951): 822–850, p. 831.

²⁰⁴US Federal Trade Commission, *Report on the Grain Trade*, Vol. VII (Washington, DC: Government Printing Office, 1926), p. 10.

²⁰⁵*Ibid.*, p. 180.

uninformed futures trading was gambling.²⁰⁶ James Boyle, in his 1920 book on speculation, supported the view of some on the CBOT executive that ‘unfit’ speculators should be banned and Emery had a similar take on ‘small town’ speculators.²⁰⁷ So the academic and government view was that small speculators were harmful to themselves *and* to markets.

Later, during the early 1930s, there was serious talk among legislators and bureaucrats about eliminating margin trading in stocks for ‘unsophisticated’ investors. The CBOT was aware even in 1933 that some powerful legislators were not in favour of the participation of unsophisticated traders:

The President definitely announced [...] that he was going to insist upon the complete elimination of trading in margin accounts wherein the speculator was too small to be able to completely protect himself. The President has no interest in the large speculator who either through knowledge or funds is able to handle his own business, but he insists that the small speculator speculate on commitments based upon cash purchases.²⁰⁸

Although this stance threatened at times to filter over into commodities regulation discussions, that the opposite occurred speaks to the power of the ideal of ‘free’ grain markets shared by all participants in the legislative process and the conclusions of the GFA as to the role of the small speculator in Chicago futures. Neither the Securities Act, the Securities Exchange Act nor the CEA restricted small speculation in any way.

By 1936, the social, political and legal turn was complete. State social regulation controlling, or even banning, in 1922, futures trades was replaced with federal protections for the industry, increased legitimacy of the markets and speculation in the markets throughout the interwar years, and finally, in 1936, active encouragement and protection for the grain gambler.

²⁰⁶Ibid., 10.

²⁰⁷Julius Baer and George Woodruff, *Commodity Exchanges* (New York: Harper & Brothers, 1929), p. 110.

²⁰⁸Memorandum, legal counsel to P. Carey, president, CBOT, 17 November 1933. CME III.830.1.

5.6.2 *Rent-Seeking Versus the Public Interest*

Some forces seeking to reign in abuses at the CBOT had the farmer in mind, and there were good reasons to satisfy the grain producers in this era of communism and fascism. As Administrator Peek warned the exchanges in 1933:

If you don't keep the farmer conservative, then he is going with the other crowd [...] and it is in the interest of the nation, I think that everything that can be done be done to keep him conservative; and he is not going to remain conservative when he loses his home and his property through no fault of his own.²⁰⁹

Yet this study has shown that demands by farmers cannot explain the regulation of 1921–1923, the co-constructed innovations of 1926, nor the CEA of 1936. Although often seen as the result of farmer pressures due to its proximity to the 1933 AAA and a farmers' organisation being the source of many of the proposed legislative changes, the CEA should be viewed as a more pragmatic attempt to level the playing field for small speculators to encourage their continued participation in markets otherwise shown to be highly susceptible to manipulation and fraud. The AFBF, although it was a farm lobby group, toiled tirelessly to help enact legislation that preserved as free a market for grain futures as was possible while still providing all market participants with important protections. The GFA and the AFBF were able to take advantage of a vacuum in policy leadership to enact new laws that were truly in the public interest.

Crucially, while the AFBF was lobbying for new legislation, nowhere in any of the correspondence are higher prices for producers ever mentioned as a goal. It was not the intention of the AFBF to rent seek while it was lobbying for the 1936 Act. And, accordingly, in the resulting legislation there is no evidence of rent-seeking. Regarding amendments to the 1922 Act, the AFBF categorically stated that rent-seeking was not on its agenda. The president of the AFBF stated in Congress that 'what our farmers want is not a price which at one time is artificially high and at another time artificially low. Farmers want honest prices'.²¹⁰

²⁰⁹Report on Informal Conference Representatives of the Grain Exchanges by Thies, 9 August 1933. CME III.830.4.

²¹⁰US Congress, Hearings Before the House Committee on Agriculture on HR 8829, 73rd Cong. 2nd Sess. (1934), p. 236.

Nevertheless, the dispute between the FNG and the CBOT was ‘important’ and ‘notorious’.²¹¹ Yet, eventually, the FNG was finally admitted to the CBOT after experiencing much friction that involved multiple lawsuits and court decisions at almost every level. Therefore, if cooperatives had been the only issue, why didn’t the AFBF drop its heavy support of the bills that were to become the CEA? The simple reason is that the AFBF was honouring its private agreement to support the agenda of the GFA. The 1936 CEA contained provisions that even most of the CBOT were not able to argue against, and these rules have defended the interests of traders on the exchanges up to the present day.

Might the CEA have been rent-seeking by encouraging small speculators, who were generally long, to raise prices for farmers at harvest time? The answer must be no, since, of course, not all small speculators would be long, and few restrictions were placed on larger speculators or on short sales in particular.

Paul Mehl, in his 1937 essay on regulation, shows why self-regulation alone is inadequate to prevent manipulation, and that the law was not intended to restrict speculation; hence it was not rent-seeking. Mehl, in a defence of the 1936 Act, wrote:

The Commodity Exchange Act is *not* intended [...] to guarantee high prices or prevent low prices. It is not intended to stop speculation in commodities. It is not intended to prevent short selling as such, and it is not the purpose of the Act to prevent price fluctuations or changes in price except as these are the result of manipulation or are artificially induced by excessive speculation. It is the purpose of the law to assure the reflection of true prices and to prevent or diminish excessive speculation causing unwarranted price changes [...]

It is the purpose of the law to prevent cheating and fraud, to compel honest accounting to customers, to require actual and open execution of orders and to stop bucketing. It is the purpose of the law to require commission firms to treat and deal with customers’ margin moneys and moneys accruing as the result of trade as belonging to such customers and to prevent the use of such funds for extending credit to others. Futures

²¹¹Leon Kendall, “The Chicago Board of Trade and the Federal Government” (PhD diss., Indiana University, 1956), p. 258. See also Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406.

commission merchants and floor brokers handling orders for others must register with the Secretary of Agriculture.²¹²

It is difficult to argue that the CEA was not in the public interest. As in the legislation and governance efforts, described in Chapters Three and Four, the CEA and the Code were not meant to help farmers, but to make markets less volatile and less prone to both over-speculation and manipulation.

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²¹²John M. Mehl, "Objectives of Federal Regulation of the Commodity Exchanges," *Journal of Farm Economics* 19 (1937), pp. 315–316. See also US Congress, House Committee on Agriculture, *Hearings on Futures Regulation* (Washington, DC: Government Printing Office, 1935).

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CHAPTER 6

The Legacy, Causes and Relevance of Interwar Futures Market Regulation

The legacy of the interwar futures market in Chicago should by now be obvious. The causes of the modern markets and governance regime that was mostly born during this period has been, at times, more contentious. This work uses the inside story to set the record straight. What can we say of the relevance of the findings herein? This concluding chapter reviews the legacy of the innovation of interwar years, summarises the inside story and addresses possible applications of the knowledge to today's markets.

The interwar futures market provides a rather unique case study of a significant institutional and governance evolution as well as of a nascent regulatory regime. The archives truly allowed us to be in the room where it happened. This work investigated the causes of the regulation and governance systems and made some hitherto undocumented conclusions, which are generally contrary to the accepted account as well as the public record. The interwar period left a substantial legacy of new institutions makers, rules and regulations along with two regulators: the industry itself, and the predecessor to the current futures markets regulator, the CFTC.

6.1 THE LEGACY OF THE INTERWAR PERIOD

The markets grew rapidly during the 1920s and 1930s. In 1937, the US television network CBS marvelled at the combination of the tallest and most impressive building in Chicago, overwhelming technology,

including ‘3000 miles of wire beneath the floor’, and a mass of ‘600 men in action’, concluding

We cannot help but be impressed by the international aspect of the business being transacted here on this great trading floor, and that the Chicago Board of Trade is the pivotal point about which the grain commerce of the nation flows.¹

The inevitability of the dominance of modern futures trading was already well understood by the middle of the interwar years, however. As reported in one newspaper:

In time to come [wheat] may be carried through the air in flying machines of fantastic size, but even then there will be a need for a market, like that one we call the wheat pit, where supply and demand can make their adjustments in a clamour of voices crying “Buy” or “Sell”.²

Yet, of course, modern futures trading dwarfs the commodity markets of the 1920s and even 1937. Wheat and corn, especially, are only a very small fraction of the world’s futures volume, and it is financial assets that dominate today, even as commodity futures markets are rapidly expanding in developing countries.

This legacy of the interwar interactions between the US Federal Government and the futures industry and its users is easy to identify in the present day. Firstly, the Federal Government negotiated market transparency, surprising a resistant CBOT and ushering in the modern era of information and knowledge about market function and control. Secondly, the current regulatory regime of co-regulation and enforced self-regulation was established. Thirdly, the institutions and regulations that evolved during the interwar years in Chicago have remained relatively unchanged into the twenty-first century. The now ubiquitous institutions of modern clearing, Business Conduct Committees and key investor protections such as market data transparency that first came into

¹CME III.23.3. Transcript of CBS news report, 8 July 1937.

²J.A. Pattern and Boyden Sparkes, “In the Wheat Pit,” *Saturday Evening Post* (Reprint Curtis Publishing Company, 1927).

being in the 1920s, lives on in all futures markets in almost identical—though now computerised—form. Many of these changes were resisted by powerful elements of the CBOT membership.

6.1.1 *Market Transparency*

The importance of the government's desire in 1921–1923 for transparency—for themselves in order to govern and for participants in order to make the markets more efficient—is often overlooked. We now take for granted the characteristics of modern futures markets, such as access to price, volume, large trader and clearing house balances, but those were simply unavailable or did not exist before 1923. Before 1923, academics, market participants, the government, individual exchange members and even the Board, themselves, had no market data or analysis to rely on in their activities of trading, hedging, market making, governing and monitoring.

There were many reasons for the CBOT's reluctance to disseminate or accumulate markets data. Data, which was considered to be proprietary, remained confidential in order to defend the exchange from competition and members from one another. It was also expensive and time-consuming to accumulate. Overall, the membership of the CBOT of the time did not want information out in the open, and many in the membership did not want transparent, well organised and (possibly) efficient markets and market institutions—in particular, modern clearing. The membership was dragged into the twentieth century by a US government and bureaucracy, led by J.W.T. Duvel, intent on understanding all aspects of the futures markets. Government was able to access, analyse and distribute information and develop initiatives, including legislation, which widened the scope of the markets while broadening their appeal and reducing inefficiencies, such as counterparty credit risk. By 1936, data of all sorts, as well as new groundbreaking academic and practitioner interpretations, were widespread.

Data, in raw as well as analysed form, played an important role in the discussions, formations, implementation of, and reactions to, policy by non-state players. Academics and bureaucrats responded to the dearth of knowledge of futures markets by compiling reams of comprehensive, often handwritten data, from which they created sophisticated statistical data. Practitioner and academic studies of futures markets were both a result and a cause of interwar years' regulation, and some of this work

is still being cited and reinterpreted to this day.³ In the interwar years and beyond, well-educated bureaucrats worked alongside top academics, some having trained at the USDA's own school for statistics, to produce landmark studies of the futures markets on behalf of the GFA and the Bureau of Agricultural Economics.

The work conducted by the GFA during the interwar years has often been praised by practitioners and academics alike. It has been said that 'the economic analysis behind most regulation of the futures markets has generally been less careful than that performed by the GFA in 1925'.⁴ Current work should be judged against the interwar standard. Both modern commentators and numerous contemporary students, ideologically opposed to state regulation, were, and are, less pleased with the work done by the GFA and its successors. Hieronymus agreed that the GFA's studies were 'interesting pieces of pioneering work' even if regulations based on the studies were on 'shaky ground'.⁵ Indeed, the level of detail in the GFA reports is staggering. In one study, the regulator identified every single long and short position held, even down to one contract held in a small village in deeply rural Germany.⁶ While some details in that study were not particularly enlightening, such deep investigation identified some instances where certain large speculators were acting through more than one account, in some cases by using overseas agents. This latter fact was previously unknown to the CBOT executive, directorate or the membership.⁷ From that period to the present, reporting requirements have meant that it is more difficult to manipulate the markets by using multiple accounts.

Outside the USDA, initiatives by the likes of the Food Research Institute at Stanford (FRI) and various academic bodies, broke new

³See, for example, Michael Dotsey and Jed DeVaro, "Was the Disinflation of the Early 1980s Anticipated?" *Federal Reserve Bank of Richmond Economic Quarterly* 81 (1995): 41–59; James D. Hamilton, "Was the Deflation During the Great Depression Anticipated? Evidence from the Commodity Futures Market," *The American Economic Review* (1992): 157–178.

⁴Todd E. Petzel, "A New Look at Some Old Evidence: The Wheat Market Scandal of 1925," *Food Research Institute Studies* 1 (1981): 127.

⁵Thomas A. Hieronymus, *Economics of Futures Trading for Commercial and Personal Profit* (Washington, DC: Commodity Research Bureau, 1977), pp. 336–337.

⁶US Commodity Exchange Administration, *Report of the Chief of the Commodity Exchange Administration* (Washington, DC: Government Printing Office, 1937).

⁷Ibid.

ground in data collection and analysis in related aspects of the markets. Academically trained bureaucrats in Washington and Chicago, together with academics in Stanford and Penn, gathered information on prices, volumes, participants and other inner workings of the exchanges. A ‘scientific’—currently called ‘technocratic’—plea for more empirical and theoretical evidence on which to base policy gave rise to comprehensive handwritten data as well as larger studies of the markets, such as a dedicated volume of the *Annals of the American Academy of Political and Social Science* in 1931, as well as the FRI’s *Wheat Studies* analysis series.

As expected, the results of sponsorship by Hoover, Rockefeller and Carnegie, among others, mixed into an unpredictable froth when combined with the big budget investigations of the USDA. Empirical in nature, and in its earliest days largely theory-free, the data obtained was used by academics and practitioners to test old theories and hint at new ones that could explain their results. Thus, hard evidence began to inform theory in the 1930s, such as appears in an *American Journal of Agricultural Economics* Special Issue (1937) entitled ‘Theory and Evidence in Future Markets’.⁸

From such data, Holbrook Working and others derived the important ‘theory of storage’ in an attempt to identify cases of John Maynard Keynes’ ‘normal backwardation’, and proposed the possible original version of the Efficient Market Hypothesis (EMH).⁹ Working also identified a problem with the way futures accounts were classified, by identifying speculation among hedgers that he referred to as ‘speculative hedging’, an observation that is still occasionally overlooked.¹⁰ According to futures scholar Scott Irwin, Holbrook Working ‘was a giant [...] who stepped into the public fray over speculation in futures markets [...] and saved future markets [...] based on his personal observation of the

⁸Special 1937 Edition of *American Journal of Agricultural Economics*, American Farm Economics Association, Chicago, 28 December 1936.

⁹Peck agreed with Samuelson that Holbrook Working was the father of the EMH in Anne E. Peck, “The Economic Role of Traditional Commodity Futures Markets,” in *Futures Markets: Their Economic Role*, ed. Anne E. Peck (Washington, DC: AEI Press, 1985), p. 71; Paul Samuelson, “Mathematics of Speculative Price,” *SIAM Review* 15 (1973).

¹⁰Holbrook Working, “Futures Trading and Regulations: Discussion by Holbrook Working,” *Journal of Farm Economics* 19 (1937): 309–312. Speculative hedging was identified as a major problem in analysing markets in Holbrook Working, “Speculation on Hedging Markets,” *Food Research Institute Studies* 2 (1960).

markets'.¹¹ Unfortunately, some of this early work has since been forgotten by historical economists such as James Hamilton and Frederic Mishkin.¹²

Long after the 1930s, Working praised the efforts of Duvel and the Grain Futures Administration. In 1962, he wrote that the decision to collect statistics on, for instance, open interest, should be credited to Duvel.¹³ Additionally, 'Duvel [...] during his long occupancy of [the GFA] gave research a prominent place in [its] work'.¹⁴ In 1935, GFA staffer Irwin had reached some interesting conclusions, while Hoffman used the information to analyse grain prices and the futures market.¹⁵ Working's comment on Hoffman's paper is critical of his use of correlations between speculator positions and market moves, but does not challenge the rest of his conclusions. In fact, Working concluded:

I want to [express] my commendation of the Grain Futures Administration for the wise policy it has followed in [...] establishing at the outset a program of research aimed at developing the knowledge essential for intelligent supervision of the markets [...] The work of the Grain Futures Administration has contributed much to present-day knowledge of the functioning of futures markets.¹⁶

¹¹Scott H. Irwin, "Futures Markets and Speculation: Lessons from the Past for Today," Chancellor's Lecture-University of Illinois, Chicago, Illinois, October 18, 2012. <http://at.pscdn.net/008/00102/videoplatform/kv/121018aceskv.html>. Accessed 1 March 2017.

¹²James D. Hamilton, "Was the Deflation During the Great Depression Anticipated? Evidence from the Commodity Futures Market," *The American Economic Review* (1992): 157–178; Frederic S. Mishkin, "Can Futures Market Data Be Used to Understand the Behavior of Real Interest Rates?" *The Journal of Finance* 45 (1990): 245–257; and Michael Dotsey and Jed L. DeVaro, "Was the Disinflation of the Early 1980s Anticipated?" *Economic Quarterly-Federal Reserve Bank of Richmond* 81 (1995): 41–59. See Rasheed Saleuddin and D'Maris D. Coffman, "Can Inflation Expectations Be Measured Using Commodity Futures Prices?" *Cambridge Working Papers in Economic and Social History* 20 (2014) for an example of reintroducing the historical observations into the debates.

¹³Holbrook Working, "New Concepts Concerning Futures Markets and Prices," *The American Economic Review* 52 (1962): 431–459, p. 434.

¹⁴Ibid.

¹⁵Harold S. Irwin, "Seasonal Cycles in Aggregates of Wheat-Futures Contracts," *Journal of Political Economy* 43 (1935): 34–49.

¹⁶Holbrook Working, "Futures Trading and Regulations: Discussion by Holbrook Working," *Journal of Farm Economics* 19 (1937): 309–312, p. 312.

As one futures scholar acknowledged in 1985, ‘although it is convenient to think of position traders as absorbing the imbalances in commercial positions in a futures market [such as Keynes proposed¹⁷ ...] extensive empirical analysis [...] has yielded no consistent verification’.¹⁸ Anne Peck interpreted Keynes as stating that ‘position traders needed to be net buyers to absorb hedging’. However, the GFA showed that the largest position traders were more often short during peak hedging periods. This means that speculators were not enabling the market for the real users (the hedgers), but were in fact competing with them.

The mountain of knowledge, the development of academic and practitioner expertise and the analyses and subsequent conclusions drawn by many students of the markets would not have been possible without the 1922 Act and the GFA.

6.1.2 *A Regime of Co-regulation and Enforced Self-regulation*

The 1936 CEA, 1933 Securities Act and the 1934 Securities Exchange Act are prime early examples of what we now call both enforced self-regulation and co-regulation. A critic of the legislation and former counsel to the CBOT, John Stassen, recognised that the 1922 Act ‘emerged in 1922 as a model for further federal economic regulation, including the federal securities laws which appeared over a decade later’.¹⁹ That is, it was the 1922 Grain Futures Act that inspired all that came after it, right up to the CFTC Act of the 1980s and, of course, securities regulation until the present day. As with the current equivalent, the CFTC Act, the government of 1936 mandated the industry with performing certain minimum required enforcement powers as well as information gathering and disclosure. Though now not quite a long ‘chain letter’ beginning in 1922, even the 1980s CFTC legislation contained much of the wording and

¹⁷John Maynard Keynes, “Some Aspects of Commodity Markets,” *Manchester Guardian Commercial, Reconstruction Supplement* (1923) in John Maynard Keynes, *The Collected Writings of John Maynard Keynes*, Vol. 12, eds. Elizabeth Johnson and Donald Moggridge (Cambridge: Cambridge University Press, 2013), pp. 255–266.

¹⁸Anne E. Peck, “The Economic Role of Traditional Commodity Futures Markets,” in *Futures Markets: Their Economic Role*, ed. Anne E. Peck (Washington, DC: AEI Press, 1985), p. 27.

¹⁹John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, p. 635.

meaning of the 1921 and 1922 Acts. Thus, the template from the 1930s manifests today government continues to guard certain powers, such as those to make and enforce the most serious rules and laws. But generally, the exchanges, or organizations of exchanges, are left to police their own memberships, subject to rules and regulations they themselves develop, but also based on laws made in Washington, D.C.²⁰ But Stassen 1982 (p. 825) was wrong when he says ‘the “last bastion of free enterprise” has suffered increasingly meddlesome oversight since 1921. Conceived in error...and largely administered under delusion for six solid decades’. The legislation provided for disclosure but not control.

This work does not make any normative judgements as to the effectiveness and the equity of the current regulatory regime for futures trading. Indeed, there have been many complaints over the years relating to the particularly egregious ways in which the industry was unable to control the excesses of the markets. A 1986 FBI sting uncovered rampant corruption on the floors of the CBOT, while fraud and manipulative practices are far from rare.²¹ As previously mentioned, self-regulatory regimes are more likely to operate in the interests of the regulated, and futures markets are not likely to differ significantly from that norm.²² However, the institutions created during the 1920s and 1930s, including mandatory margining, central clearing and large trade reporting, are respected by almost all experts as being beneficial to modern futures trading, even if other regulatory and institutional innovations benefitted the membership of the CBOT more than the public.

6.1.3 Key Institutions

As expanded on elsewhere in detail, the following co-constructed institutions and rules came into existence in the interwar years:

1. Large trader reporting
2. Business Conduct Committees

²⁰John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, p. 636.

²¹David Greising and Laurie Morse, *Brokers, Bagmen and Moles: Fraud and Corruption in the Chicago Futures Markets* (New York: Wiley, 1991).

²²See, for example, Martin Wolf, *The Shifts and the Shocks: What We’ve Learned—And Have Still to Learn—From the Financial Crisis* (New York: Penguin, 2014).

3. Central clearing at the CBOT
4. Mandatory margining for client trades
5. Mandatory segregation of clients funds from firm capital
6. Requirement for a futures dealer to not act as agent and principal.

This history has shown that all of these key characteristics of modern futures markets were a result of deep interactions between government, the futures industry and (in the 1930s) futures market users. There is therefore a compelling argument for involving all parties—including government—creating new efficient market regulation.

6.2 THE CAUSES OF INTERWAR FUTURES MARKET INNOVATION

This work chronicles the inside story of the earliest Federal market regulation, while also explaining the origin of many of the current institutional characteristics of a highly successful financial market. The study of regulation is said to be in flux, especially given the recent contentious debate over the regulatory failures of the global financial crisis.²³ In regulation study, debates abound about the value of the various formal regulatory regimes available to policy-makers. For example, how does society decide between regulation by technocrats, as in the interwar years' futures regulation, and democratic legitimacy? Is regulation meant to foster the most competitive markets, the most competitive industry, provide protection to the unsophisticated or some combination of these goals? Should policy-makers use coercion, persuasion, transparency or education?²⁴ Should rules be inflexible or should regulation be 'smart' or 'responsive'? Should we bias our regimes to private/self-regulation or to traditional command and control? The cacophony of responses proves a lack of consensus on these questions by both academics and practitioners. In the past, scholarly works have tended to apply the economic theory of regulation, or public choice, to the exclusion of other tools, and have focused mostly on rule-making rather than other elements of a polycentric regime, such as information disclosure and rule implementation,

²³Martin Lodge and Kai Wegrich, "The Regulatory State in Crisis: A Public Administration Moment?" *Public Administration Review* 70 (2010): 336–341.

²⁴Ibid.

though this is changing.²⁵ Industry representatives tend to favour less rather than more of any regulation, while government agencies seem sometimes ill-equipped to determine the best courses of action. This study is not capable of answering all open questions. Yet we can draw some important conclusions here that have far-reaching implications.

Absent evidence to the contrary, there is a presumption of the state-markets dichotomy: that regulation must be either command and control or *laissez-faire*. Too many studies on markets, especially historically, have focused primarily on the public record or have been written by those biased in favour of so-called free markets over government interference. Such works conclude that market governance in absence of government control was remarkably successful, whereas government regulation generally resulted in failures. Some academics and policy advisors go further to claim that almost all regulation chokes off innovation in markets and that self-regulation is the only solution to efficient markets.²⁶ Yet I have shown, using inside evidence, that the making of a new market and its governance structures is a result of a highly complex series of interactions with not fully predictable results. There was clientele/rent-seeking politics in the early years, facilitated by a desire in Washington to not overly interfere and in fact support capitalistic institutions. Later, elements of the government and pragmatic regulatory officials worked together with key industry leaders to solve collective action problems within the markets. The result was key institutions that survive into the present day. Towards the end of interwar years, a powerful private interest was able to effect changes that made markets safer for all. If the trope that free markets should (and do) triumph over restrictive government interventions is so easily falsified in this history, might that be the case in other markets as well?

The regulation of futures markets in the interwar years is a story of the reactions in the formal and informal regulatory regimes to the motivations, power and assumptions of the key actors. Such tendencies, let alone their legislative and organisational effects, tend to be unpredictable. Unfortunately, there is a bias to reify simplified theories as to how policy is made, especially in histories of regulation. The preoccupations of the existing literature with a states-market dichotomy obscure

²⁵Ibid.

²⁶Stephen Craig Pirrong, "Self-Regulation of Commodity Exchanges: The Case of Market Manipulation," *Journal of Law & Economics* 38 (1995): 141–206.

an important case study in market regulation, including ‘co-regulation’, government-protected monopoly, the trend towards bureaucratic administration and the search for information required for any rational scientific approach to controlling the ‘dark side’ of industry. Another issue when invoking any ‘markets versus state’ explanation for regulation is the important observation that more of one does not lead to less of another. Indeed, it is possible to end up with ‘freer markets and more rules’, as *laissez-faire* is in fact impossible without state intervention, since the state has ultimate power over property rights.²⁷ Recent deregulation studies show that markets became freer no matter whether the state maintained or increased its grip on regulation. The dichotomy incorrectly defines the government as perennially anti-free market and business as never welcoming government intervention. What is often ignored in the text of important studies of regulation such as those by Markham, however, is that legislators were just as much in support of futures markets as they were against it and exchanges, such as the CBOT, were not wholly anti-regulation.²⁸

Despite the large body of work in the area on alternative explanations for regulation, many historians of the interwar years, following modern economists and political scientists, also view the regulation of this period as a simple battle between the state and the free market interests (the latter as represented by the Chicago Board of Trade). Previous studies of the CBOT framed the interwar experience as one of self-regulation, and are set against narratives of populism and farm relief, which in turn are commonly reduced to rent-seeking by farmers. As it is, the unhelpful false dichotomy of government and markets drives a huge wedge

²⁷Stephen Kent Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1996); Karl Polanyi, *The Great Transformation: Economic and Political Origins of Our Time* (New York: Rinehart, 1944); Max Weber, Peter Lassman, and Ronald Speirs, *Weber: Political Writings* (Cambridge: Cambridge University Press, 1994); and Adam Smith, *Wealth of Nations*, 1776, esp. Vol. 1, Ch. 5.

²⁸See John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, for examples of support for futures markets by Congressional leaders. For two examples of the exchanges being pro-regulation, see *Hill v. Wallace* 259 US 44 and G.O. Virtue, “Legislation for the Farmers: Packers and Grain Exchanges,” *The Quarterly Journal of Economics* 37 (1923), p. 701.

between those who favour more *laissez-faire* approaches, such as Robert Litan and Donald Trump, versus those who wish to further the command and control powers of the state, such as Admati and Hellwig and Elizabeth Warren. Neither end of the ideological spectrum is likely to be correct. Yet these ideological differences make consensus nearly impossible, resulting in the rolling in of regulations in times of crisis, such as Dodd-Frank, and the rolling back of regulations, or even the remaking of regulations on the ground, during periods of red tape cutting or, I might argue, selective amnesia. Such a life cycle of regulation was first identified in 1955, yet is typical of the post-crisis state of regulatory affairs.²⁹

Rather than being a failed command and control experiment that was replaced with self-regulation, as most of the historic literature presumes, the regime and institutions for governance that developed in Washington and Chicago resulted in an enforced (by the state) self-regulatory system on both informal relations and formal mandates for the key requirements for efficient markets, such as informational transparency. These innovations were a result of the intersection of many interests, including politicians, bureaucrats, futures market users, the CBOT membership, other exchanges and the Board's executives. At various specific points during the interwar period, one set of explanations was better than others. Yet there was no overarching theme to this period, other than regime polycentricity.

The notion of a polycentric regime in a regulatory space with its (often varying) membership having 'regulatory conversations' better explains the history of government and industry regulatory efforts during the interwar years and may also be the key to future implementation issues. In futures markets, a multiplicity of actors played important roles in the development of a long-lasting institutional framework and regulatory regime.

This study has been necessarily limited to addressing three very specific periods of regulatory regime change in one—albeit the largest—futures market. Not only did significantly more activity occur in this

²⁹Marver Bernstein, *Regulating Business by Independent Commission* (Princeton: Princeton University Press, 1955). For a post-GFC modern example, see Charles Goodhart, "A Ferment of Regulatory Proposals", in *The Social Value of the Financial Sector: Too Big to Fail or Just too Big?*, eds. Viral Acharya et al. (Singapore: World Scientific Publishing Company, 2014).

period that contributed to the development of the dominant tool for managing financial risk, but there are both minor and major stories of interest in this particular history of government and industry relations. For example, one interesting comparative analysis is how and why the US system for grain marketing and its regulation differed so much from those in other countries. In spite of the narrowness and context-specific nature of this study, however, it does provide an important example of a polycentric regulatory regime that was able to overcome many obstacles, including the collective action problems that prevented potentially efficient innovations being readily accepted, but which are now indispensable features of the mostly efficient markets of the twenty-first century.

The evolution of a regime cannot easily be predicted based on the initial motivations and power relations of the actors, and there is a banality in institutional change that is rarely appreciated. Multiple forces, including many intertwining and volatile human relationships, were at work, particularly during the interwar period. At different times, different interests held the inside power in Washington, even if the CBOT lobby consistently made its presence felt on Capitol Hill. Hopefully, historians examining the larger story of administrative or political history of the interwar USA will be able to use this study as an example of policy-making during this period.

Polycentric forces came to bear on the futures industry during the interwar years. As such, binary-based debates and analyses, such as ‘the farmers versus the (self-regulating) exchange’ are unhelpful. This work is one more example which makes it clear that government and markets relied (and do rely) deeply on each other. Current market practices are testament to the successful innovations of the period. Understanding how the institutions developed and how effective they really were can inform today’s regulatory practices. Regime elements, which were often thought to be against the public interest, such as ‘captured’ regulators and large rent-seeking farm lobbies, can, when fused together, create a long-lasting and robust regulatory framework for financial markets. The lesson that this study has revealed is that government regulation, both formal—by government agency—and informal, combined with other interested parties whose intentions were often far from rent-seeking, can be extremely beneficial to society and to market participants, even if they have been captured to an extent by other interests. In essence, this historical study should prove useful, not just to historians, but to anyone engaged in real time policy design, implementation or review. Finally, the

successful development of modern futures in the interwar years relied heavily on special interests and government working together behind closed doors. Further work could focus on how ubiquitous the types of forces, contexts and actors analysed in this study are in other regulatory regimes, not just for financial markets and throughout history. Can the evolution of other industries besides modern exchange-traded futures markets be described in enough detail to make conclusions as to how and why their market structure and their regulation exist today?

Many of the principle sources for futures markets history of the nineteenth and early twentieth century rely largely on the public record. This is a significant hurdle in determining how the legislation, never mind the behind the scenes agreements on mid-1920s institutions, really happened. Newspaper accounts, especially, were often sensationalist or politically biased: in their desire to sell papers, they would embellish and even purposefully misinterpret events. Additionally, the New Deal dominates much of our post-Great Depression history. The populism of the turn of the century as well as the policy changes of the 1930s has left an image of the period's public and legislators, since the Chicago markets first began in the middle of the nineteenth century, as being anti-futures and anti-grain middlemen. By studying the public record, it is too easy to chronicle the struggle for the regulation of futures markets as pitting the people's interests against those of the grain trade. This issue is further complicated by the tendency to analyse the 1922 and 1936 Acts in terms of the older value-driven historiography of Arthur Schlesinger and William Leuchtenburg who documented an ideological struggle between 'people' and 'interests' during the 1930s—an approach that has endured into this century.³⁰ While the popular literature views the New Deal as either 'a revered model of enlightened government' or a 'repudiated symbol of obsolete statism', its academic reputation as a period of evolution of state control continues today.³¹

Romano's political history of futures regulation takes the agrarian influence on legislation as a point of departure, yet does not explain why

³⁰William E. Leuchtenburg, *Franklin D. Roosevelt and the New Deal, 1932–1940* (New York: Harper, 1963); Arthur N. Schlesinger, Jr., *The Crisis of the Old Order, 1919–1933*, Vol. 1 (Boston: Mariner Houghton Mifflin Harcourt, 2003); and Melvyn Stokes, *The State of U.S. History* (London: Bloomsbury Academic, 2003).

³¹Melvyn Stokes, *The State of U.S. History* (London: Bloomsbury Academic, 2003).

the legislation did not benefit farmers.³² In fact, the only rent-seeking actor in this history was the CBOT itself in that it almost totally captured the regulatory regime, gaining new legitimacy in the face of legal challenges as well as new monopoly powers. By shifting attention away from the farmer, there is no need to answer the question asked by Romano: ‘why would farmers pursue what would appear to be a fruitless strategy?’³³ As such, focus on ‘the public’, in the form of agrarian populism, and their often very visible struggle against ‘speculators’, monopolists and other grain interests misses out wider developments in the political, cultural and economic spheres of interwar USA as well as the internal structure of interests within both the public—consumer versus producer—and the grain trade—country elevators versus national grain transporters and merchants. The literature tends to focus on such public anti-futures propaganda from farmers, consumers and politicians as reasons for the regulation that followed World War I. Yet there is good reason to disregard much of the sniping, posturing and rhetoric appearing in the press. The next section pursues this further.

In place of the public record, this study uses private and often confidential—even coded—correspondence between the stakeholders—the grain exchanges, their customers, their lobbyists, their regulators and key Congressional committee members. Such archival material shows that the simplistic ‘state versus market’ dichotomy can be challenged, and that the futures exchange markets, legislators and bureaucrats worked in collaboration on market structure and legislative developments as well as their implementation. In practice, command and control regulation of the grain trade in the interwar years was almost non-existent.³⁴ Although Stassen accuses the 1922 Act of codifying ‘a populist anti-speculative bias which totally misperceives the function and purpose of futures markets’,³⁵ the actions, text and legal interpretation of, and bureaucratic motivation for, the legislation were anything but populist.

³²Roberta Romano, “The Political Dynamics of Derivative Securities Regulation,” *Yale Journal on Regulation* 14 (1997): 279–406, pp. 292–294.

³³*Ibid.*, p. 307.

³⁴This is best argued by Jerry W. Markham, “Manipulation of Commodity Futures Prices—The Unprosecutable Crime,” *Yale Journal on Regulation* 8 (1991): 281.

³⁵John H. Stassen, “Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress),” *Chicago-Kent Law Review* 58 (1982): 635–656, p. 655.

Continuing to focus on a false dichotomy of government control versus effective self-regulation also misses much of the complexity in the formation and maintenance of the regulatory regime of the futures markets. In 1925, when the industry had difficulty in regulating itself, the government stepped in to co-construct new institutions. By 1935, the traditional tension between the industry reactionaries and a progressive government was now interrupted by the introduction of new influences that demand attention, as is often the case with such polycentric regulation. These influences include the public as consumers and taxpayers, farmers and the interests that served them, local grain traders and elevators, millers, State lawmakers, the Court system, Congress, grain middlemen such as futures brokers, integrated grain companies, railroads, line elevators, terminal elevators and international shippers and agents. In the 1930s, farmers' organisations—although not the farmers themselves—were the key influence on a highly technocratic bureaucracy that oversaw a new style of co-regulation towards the end of the interwar years. This study documents the evolution of the regulatory regime from captured process resulting in an engineered compromise through co-construction behind closed doors involving bureaucrats, politicians and industry leaders and finally to the current co-regulatory framework.

The archive investigation was designed to uncover all possible state and private influences on the legislation, concluding that farmer and Farm Bloc influences were overstated and other sources of pressure and knowledge were significantly more important in shaping events. Some historians have hinted at the ideas that this work examines in detail. Kolko views the progressive tilt towards Federal Government regulation as nothing less than a benefit to the regulated. This study goes further by identifying Kolko's effect as but only one of a myriad of influences on a regulatory regime.

6.3 IMPLICATIONS

This story of how government, pragmatic and knowledgeable bureaucrats and progressive industry leaders worked for over a decade to create modern (and efficient) futures markets runs counter to the traditional view of unfettered markets as being optimal, or at least the story that industry can create its own effective governance and institutions. It was clear that in the 1920s, the industry was not going to provide transparency on its own and was not going to adopt institutions such as modern

clearing without some sort of external catalyst. The interwar US government played a very important role in constructing many key institutional and governance characteristics of current modern futures markets. Besides mandating informational transparency, engaging with all participants and devoting time and monetary resources to truly understanding the markets (perhaps a ‘public good’?), the government worked closely with the futures industry and its users in the mid-1920s and the early 1930s to create long-lasting critical institutions, without which the markets might not have been successful as they have become.

The identification of the critical nature of the varieties of government intervention, engagement, coordination and study in making modern markets provides an interesting addition to the history of financial capitalism. There no reason, in my opinion, to think that the actions documented in this history could not be revisited when re-defining post-crisis market regulation. Instead of debating whether or not we need more government command and control, or indeed less, we should rather empower regulators to provide as much positive influence, as possible, as well as a space for regulatory conversations to a pluralist and polycentric regime for governing financial markets. The industry, itself, can not be trusted to build its own institutions in the public interest, as it could not have done so in the 1920s and 1930s. Regulatory discussions between all parties are necessary in order to create a regulatory framework for this next millennium, just as such discussions and interactions created the first modern futures markets and governance around the same point of the last millennium.

None of the concepts in this work are new. Market co-construction has been recognised in markets as varied as US drug approvals and clean technology, while co-regulation has the known ability to reduce the influence of more reactionary private interests, as is shown here. But self-regulation on its own is unlikely to function well. Indeed, there have been many self-regulation failures that likely contributed to the GFC, such as the lax oversight of Consolidated Supervised Entities under the SEC. Such failures have led some to leading centrist economists to conclude that ‘self-regulation... is preposterous’.³⁶ Joseph Stiglitz, however, has the solution: ‘the problem is not self-regulation per se, but the failure

³⁶Joseph Stiglitz, “Government Failure vs. Market Failure: Principles of Regulation,” in *Government and Markets: Toward a New Theory of Regulation*, eds. Edward Balleisen and David Moss, 13–51 (Cambridge: Cambridge University Press, 2009), p. 129.

to integrate structures of private governance effectively within a larger institutional setting—to embed those structures within a broader framework of public oversight'.³⁷ Self-regulation requires public oversight, rulemaking and even enforcement, hence the name enforced self-regulation. Karl Polanyi recognised the necessity of governments in markets in 1944, writing 'free markets could never have come into being merely by allowing things to take their course'.³⁸ The post-crisis challenges for financial regulation are great. But true positive reform will be difficult if constantly framed as a battle between laissez-faire free market capitalism and controlling state authorities. That is, it is highly likely that modern markets, like the less developed wheat futures exchanges of post-World War I, could benefit from more rather than less cooperation between governments and industry, especially if performed in public spaces for deliberation.

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³⁷Ibid.

³⁸Karl Polanyi, *The Great Transformation: Economic and Political Origins of Our Time* (New York: Rinehart, 1944).

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