The Wheat Crisis at Winnipeg

Trouble Arose in the First Place From the Unusually Poor Quality of Much of the Wheat Bought From the Farmers in the Fall of 1916

By H. M. P. ECKARDT.

The propensity of some newspaper editors to seize on every conceivable opportunity of scoring a point against the "big interests", has been strikingly illustrated in the case of the famous wheat crisis in Winnipeg. Following is a quotation from a Winnipeg despatch published a few days ago by a Toronto evening paper: "Grain speculators of Winnipeg, with the assistance of banking institutions throughout the west, played for a stake of something like $100,000,000 against the need of the people and armies of the allied nations for grain......Stripped of all diplomatic language the corner was the logical result of the effort of a few powerful elevator and milling interests to make a 'killing', as the trade expresses it."

Such stuff as this, when capped by lurid headlines, may possibly stir up the animosity of the public against the corporations, but it certainly does not give a true or reliable description of the causes of the uncomfortable situation that recently developed in the Western grain trade. The fact of the matter is that the trouble arose from the working out of a system, long in vogue, the principal object of which is to eliminate speculation from the credit transactions undertaken by the banks to enable the millers, elevator companies, etc., to buy grain from the farmers. It will be well to explain the method of short sales as devised by the banks and the grain interests with the object of making bank loans on grain safer and more conservative. This can best be done by means of an illustration.

The Omega Elevator Co. has a line of elevators in Saskatchewan. They wish to buy wheat actively and arrange with the Bank of X for a credit line of $300,000 to be secured by bills of lading and elevator receipts covering the purchased grain. Now the capital of a company of this kind is mostly sunk in elevators and plant, but let us suppose that the Omega Co. has enough cash capital to give the bank a 10 per cent margin of security over the loan. Now let us follow the working of the credit, say after December 1st when lake navigation has closed. The elevator company has the full amount of $300,000 borrowed from the bank while the bank holds elevator receipts, etc., for grain worth at current market quotations $330,000. In other words it has a margin of 10 per cent to protect it from loss through falling prices. To simplify the illustration let us say that the grain held by the bank is all of one grade No. 1 Northern and that the market price is $1.20 per bushel. The bank thus holds 275,000 bushels. Assume also that the elevator company bought the grain at an average price of $1.17 per bushel. It has therefore a profit of something over $8,000, from which operating expenses are to be deducted. The intention is to hold the grain in the company's own elevators until spring and then to ship to Fort William when lake navigation opens.

The company's bankers state emphatically that they will not lend their money to facilitate speculative holding. Perhaps the bank manager puts it to the company like this: "If you wish to borrow large amounts from us there must be no speculation. You must sell as fast as you buy; and if circumstances do not permit you to sell and deliver the actual wheat you must sell for future delivery so that we shall not have to run the risk of loss through falling prices." As the bank would not take the chance or risk of carrying the unsold wheat from December to May, the elevator company is required to sell the 275,000 bushels for delivery next May it sells the May option. This sale is made at a price which, after allowing for carrying charges, is equivalent to $1.20 per bushel for cash wheat. When this is done the bank has its protection against a sudden drop; and the elevator company has virtually no further interest in the market fluctuations for if prices drop it loses on the actual wheat exactly what it gains on the short sale, and if prices rise it loses on the short sale exactly what it gains on the actual wheat.

However, another point is to be considered here. When the elevator company thus hedges against its holding of 275,000 bushels, the grain exchange clearing house requires the deposit of a margin. The parties who buy the 275,000 bushels for May delivery have only the contract or promise of the grain exchange operators who made the sales, and these operators in turn have only the contract of the Omega Elevator Co. that the grain will be duly delivered. To protect the purchasers and the operators from the consequences of possible breach of contract, the elevator company must deposit a certain cash margin. If the margin was at the rate of 10 cents per bushel, $27,500 cash would be required for the purpose. This amount the Bank of X would have to lend its customers, and against this loan it would have no wheat security its security would consist of the assignment of the Omega Elevator Co's interest in the margin deposit. In normal times, when spring comes round, the wheat carried through the winter in interior elevators goes forward and is sold, proceeds of the sales being applied to liquidate the bank loans. As each sale of actual wheat is made, an equivalent amount of the short sale contract is cancelled through buying the May option in the market; and when all the actual stuff is sold, all the "future" contract is in this way cancelled and the balance of the margin deposit is paid to the Bank of X and by it applied to wipe out the remainder of the elevator company's debt. Of course the company could deliver its own wheat in May in settlement of the outstanding contracts, if its wheat was of contract grade; and in that case the parties receiving delivery would pay the company's bankers, and when the contracts had ben duly filled the margin deposit also would be returned to the bank.

THE CAUSE.

It will be seen that the system of short sales as above described is designed to prevent speculation, not to encourage it. In normal times it works satisfactorily for banks, elevator companies and all other parties concerned. What caused the trouble on the present occasion was the application of the system to a wholly abnormal set of circumstances, some of them being attributable to the war and some to other things. Trouble arose in the first place from the unusually poor quality of much of the wheat bought from the farmers in the fall of 1916. Millions of bushels graded under Number 3 and thus could not qualify for delivery under contract. Although contract wheat is supposed to be Number 1, yet Numbers 2 and 3 are usually accepted, subject to penalties of a few cents per bushel. Thus as a result of their sales of the May option, the elevator companies were technically in the position of selling what they did not own and what they could not deliver.

A RESULT.

Again, as a result of the war conditions, practically all of the contracts they gave, passed into the hands of the purchasing agents of the Allied Governmnets. Ordinarily these contracts would be so to speak in floating supply at the grain exchange. Speculators would buy them for re-sale at a profit: and the elevator companies could usually count confidently on being able to go on the exchange almost any time and buy enough of the required option to cancel their outstanding obligations. But on this occasion the Allies' agents had nothing to sell. When they bought 10,000 bushels of wheat for delivery in May, it was with the intention of taking delivery of the grain in nearly all cases—it did not suit their purposes at all to cancel the contract in consideration of getting back their money along with a varying amount of profit. Considering, however, that the contracts were issued in the course of legitimate business and that they were a necessary part of the credit arrangements between the elevator companies and the banks, it was to be expected that the Allied Governments would, when the circumstances were properly explained, meet the grain trade with reasonable concessions. Apparently they have agreed to accept the off grade stuff, as deliveries on contracts held by them, according to specified scale of penalties—ranging from 20 cents per bushel for Number 4 up to 75 cents for Number 6. Also it appears that they have placed the elevator companies under obligation to sell 90 per cent of all wheat handled to the Allied agents or to the Canadian millers. Finally, it should be remembered that the late opening of navigation this year has been another complicating feature—tending to upset the arrangements of the grain trade for making deliveries under their contracts.

The Smallness of Five Billion Dollars

Relative Size of the U. S. National Debt After Issue of $5,000,000,000 Liberty War Loan—Graph Reproduced by Courtesy of the National City Co., New York.