Fifteenth Annual Aldrich C. Bloomquist Lectureship

The 2007 Farm Bill Debate and its Impact on Cooperatives

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Al Bloomquist served a distinguished career at American Crystal Sugar Co. as president and longtime executive. This lecture series has been established in recognition of his contributions to the company and the industry by American Crystal Sugar through the Quentin Burdick Center for Cooperatives at NDSU.

This morning I would like to talk about farm programs and farm policy. Why do we need them? What is the history of them? What are the prospects? What we are the politics of this new farm bill with the change of Congress? I will also discuss the attitude of the administration and some current trade issues. In discussing the Farm Bill, I am going to concentrate on the commodity title.

I am sure we hear people say to us occasionally, "Why do we need farm programs? What is special about farms? Rural businesses don't have programs to help them." Certainly cooperatives don't have federal programs to help them out when they experience a loss for various reasons. So why do farmers have this farm program specifically why do farmers who raise wheat, corn, soybeans, oats, sorghum, cotton, and rice have farm programs?

The answer is because farming and agriculture is different from other economic endeavors. I think urban people believe that the only reason farming people have a farm program is that, since they can get money from Congress, they do. That is how a lot of the thinking goes. But actually farming is different from other economic enterprises. The classic laws of supply and demand, although they apply to agriculture in the long term, don't very much in the short term.

For example, supply should affect demand. That is the classic theory, but it really doesn't happen in agriculture. If the price of something at a retail store, let's say flat screen TV's, goes on sale for $75 dollars, people will run out to buy them. But if the price of bread or an egg product is reduced, some people may buy extra and store it in their freezer, but they are not going to eat more and so it will not increase demand and consumption when prices go down. That is not typical of anything else.

On the flip side if incomes go up you would expect demand to increase. That doesn't happen either in agriculture. If one of us gets a big raise we may go home to our spouse and say, "Wow, I got a great raise so we can start looking at that lake cabin we have always wanted to buy." Chances are you will never go home to your spouse and say, "Honey I got a raise today now we can eat that fourth meal we've always dreamed of." I just won't happen.

Likewise, on the supply side in most industries, if the price of the product you are producing was below the cost of production you shut off your production line. If you owned a Fargo toaster company and it was costing you more to make toasters than you are getting in the retail price for it you would walk over to the wall and you'd switch off the production line. That doesn't happen in agriculture, low prices don't cut production. There really isn't any alternative use for crop land and so it will stay in production even if prices are low. If there are too many gas stations in a town one or several of those gas stations will go out of business and they will become barber shops or beauty salons or something else. Not so in agriculture. If there is too much production of wheat I can't take my farm in Glenburn if the prices are low and say "I'm going to go build a shopping center or apartment complex out here in Glenburn, North Dakota." You just don't have alternate uses for land space and production. Because farmers have thick costs to cover, they won't even reduce the input to make their product more productive because you literally as a farmer can't afford, even at low prices, not to put inputs into your crop to try to increase production and cover at least your fixed costs. Who farms the land might change and, long-term, the people who are farming the land may change. The land prices would be reduced and people would probably lose their land but then somebody else

would pick it up at a lower price and produce an agriculture commodity on it. So land resources remain in production.

Why do we have these chronic problems in agriculture? We have some good years like we are having now but most of the time we seem to have some problem or another in agriculture. The answer is, in essence, because technology typically expands our output more rapidly than demand increases, due to population and export demand. Let me just say that again, technology and research which we develop at these fine institutions, like NDSU, is turned into technology which we apply on our farms and that expands our output faster than the demand for the product increases due to population increases and export demand. That's a good thing for society; it would be a horrible thing if we had to ration food. So it is in society's interest for it to keep our food supply well ahead of our population demand. This creates a price and income problem for farmers.

Output is also growing in countries that are new competitors for us. We are all familiar with some of those: Brazil, South America and parts of Africa, especially southern Africa.

Another thing that is relatively new for agriculture is that technology, which used to be something that the United States and Europe had to themselves, is now available worldwide. If there is a new type of farm machinery or something developed for agriculture it's available not just in the U.S., but everywhere in the world.

Low prices don't correct over supply in the short run. Consumers don't buy more if the prices are low and farmers don't reduce production when prices are low either so we can't self correct. When prices are high for a while, like they are now, then we are

inclined to say, “The problem is solved, it’s a new era in agriculture. Everything is going to be fine.” In my lifetime we have had at least three of those “new eras” in agriculture when the future was going to be rosy. The essential problem is this: agriculture can’t get back on its own feet when it’s knocked down by sustained low prices. That is why we have to have government programs because agriculture can’t self correct its problems.

Over the past ten year history of farm policy, our commodity support payments, decoupled payments, and CRP payments are averaged between 8 billion per year and 25 billion per year. Since 2002, which is the present Farm Bill we are living under, payments have been mostly countercyclical to farmers. In other words, government payments kick in when prices get below a target price or loan rate below some point that has been pre-established. When prices are low and you need help you get the payments.

For well over 100 years, though, what we really had was an overriding farm policy of plenty. That’s why we have institutions like land-grant universities, ongoing public funding for research, and advancements in productivity so that we remain high so that are productivity remains at a high level. That is delivered to farmers through extension services.

Until recently, 1985, our farm program policy tried to manage our over production capability through controlling supply. That essentially tried to reduce supply to keep market prices higher. When we enter trade agreements we are competing with the rest of the world and we could import product into the U.S. Because of this it no longer made any sense for us to try to reduce our domestic supply if we were going to import from somebody else. If you can’t control your borders you can’t really do a supply management program.

So where does that leave us today? What kind of farm program can we look at today? We can't do much to increase demand. If the developing nations increase their economies and increase their standard of living there will more of a demand for higher types of food for meat and more value added food. We can't do anything to control supply because of the trade agreements. We can't have acreage reduction programs and non-recourse loans anymore. So, if you are going to support agriculture, what do you have left? Give them money, just give farmers checks. That is what our choice is about down to.

Since 1985, the Farm Bill really began to base policy in an export mindset. If we capture market shares globally, increase market shares globally, the reasoning was that we will just export our way out of surplus situations. Some of our competitors, our higher cost competitors, like the Europeans and Japanese, or other developed parts of the world, we should be able to out-compete them and drive them out of the market place.

In 1996, The Freedom to Farm program sought to get rid of farm programs over a phase out period by using direct government payments. Of course, by 1998 market prices had collapsed and that mindset had changed somewhere. But there was a belief that there was a new era in 1996 that we could accelerate export and rebalance world markets. In reality our U.S. population increased and that is really where most of our crops went to. We are basically flat in our exports.

Why haven't exports delivered like we hoped they would? Why haven't we been able to take a much larger share of the world export market? It is because export demand is tempered by some issues. In a totally free-market world perhaps we could have done that, but every country wants to have at least a measure of food security. Every country

wants to retain agricultural production and every country also wants to compete for a global market just like we do, including the Europeans. If we look at where our major competition is coming from and where there are potential gains in export markets, it isn't from us, it is from our competitors in our developing world. There is increased acreage in the world that is now being devoted towards agricultural production and there is increased use of higher technology, even in the developing world, to boost productivity per acre. We are the leading country in the world economically, militarily, and we are the leading country in the world when it comes to agricultural commodity prices too, since the rest of the world bases there prices off U.S. prices.

So let's look briefly at what is happening; the US is still a big, big player in the export market. But look where the growth is coming from in the exports. That is our developing competitors; Argentina, Brazil, China, India, and Pakistan.

China is a great example. I was in China in 2000. I think we think of China from the old movies that we've seen on TV that show masses of population in cities, with streets just packed with people moving to and fro. We don't think about agricultural production in China. I remember back around 1985 I was at a farmer meeting and we were talking about demand for products and somebody said, "What about China? We need to feed all that billion people." Everyone applauded, but China has farmers too. You often hear people say in the US that 95 percent of the world population is outside our borders. That's true-95 percent of the world's population does live outside of the US. But 98 percent of the world's farmers also live outside of the US. So there is Ag production in all of those countries. And China, which we forecasted in the mid 90's

would be big importers of US corn, was actually a competitor with us for awhile in the export market for corn.

Our competing nations are grabbing more market share because they are lower cost producers for various reasons. One reason is they don't have the standard of living we do. Our exports actually are still rising but we are also importing a lot more, so our balance of export earnings has been reduced to almost zero on food and it's projected to remain that way for awhile.

Remember when I said we don't reduce acreage when prices are low? Here the chart is showing the price for the leading 4 commodities covered by the farm program since 1996 in a red line. The blue line is the acreage devoted to those same crops. Even when the price dips from an index of one hundred down to about 65, our acreage remained almost completely unchanged. Farmers continued to plant the same crops.

Here are some foreign examples. In Canada, they reduced their farm subsidies drastically in the 90's. They eliminated grain transportation subsidies in 1995. Crop mixes changed somewhat; they have a little less wheat production and more oilseed production but the total farm land planted remains the same. We don't in agriculture, even when prices get low, abandon the land.

Australia dramatically reduced all their subsidies, but particularly in wool. They are big wool and sheep producers. When they abandoned the wool program the total land in production actually went up because they went out of sheep pastures and planted more wheat. As farmers, we really don't abandon our productive capabilities.

I wanted to talk about the effect ethanol and biodiesel have on demand. According to the USDA it is going to have a dramatic effect on demand and a dramatic

effect on prices. The Ag Outlook conference in D.C. in February predicted our major crops corn, soybeans, wheat, barley are all going to be substantially above the target prices or the loan rates all the way through the next ten years. Supply and carryover supplies for all those crops, especially corn, are going to remain very low; so low that we have never been in that territory before, like carryover may be just 5 percent. Will that spur more corn production? That is a good question and we can talk about that later. It's interesting to try and figure out where this Biofuel demand will leave us as farmers. Will it really be a new era or not?

What do farmers need in the new Farm Bill? We need two things essentially: protection in times of natural disasters and protection in times of low prices. The existing Farm Bill has done a really good job of protecting farmers in times of low prices. We would have to say that and maybe it isn't perfect from a lot of our perspectives but it has done a good job. In the NDSU studies that Dr. Koo and his shop have done show that all the farmers in North Dakota by class (whether they are small farms, medium size farms or large farms) have done really very well in the aggregate over the seven year life of this Farm Bill.

What it really lacks is a permanent disaster bill provision. I think there is consensus now that in the new Farm Bill we need a permanent disaster bill that will offer production protection and some income protection to farmers when they lose production due to droughts, floods, and so forth. In the future, the existing Farm Bill will potentially be inadequate, in terms of a safety net as well, because we have had rising input costs for all our farm input, especially with the rapid increase in petroleum prices recently. This impacts fertilizer prices, machinery prices and everything else.

The discussions for the 2007 Farm Bill are underway. The Senate and House have both had hearings. Senator Harkin from Iowa is the chairman of the Senate Agriculture Committee. Kent Conrad from North Dakota is the senior member on the Agriculture Committee next to Harkin on the Senate. In the House, Colin Peterson, whose district is just over the river in Minnesota, is the chair of the House Agriculture Committee. Both of those committees say that their goal is to get this new Bill out of committee. That means written as they want to see it, out of committee, and onto the floor by the August recess, which is a pretty speedy process.

The big issue is money. This is because agriculture, due to our history, gets less money going forward than we have had with the past Farm Bill. We spent a little over 23 billion dollars less in this current Farm Bill than what was expected. Under the federal rules, and especially under the rules of the democrats who have taken control over Congress recently and adopted the "pay as you go" rule, Congress is committed to trying to balance revenue with expenditures. They use some pretty strict rules and the past determines the future. Because we have spent $23 billion less than expected, our baseline going forward is $23 billion less than the assumptions were with the last Farm Bill. That leaves us 43 billion dollars to spend in a commodity title on the next Farm Bill rather than 66 billion, a cut of almost one third. We can be proud of the fact that we spent less money than expected in this type of farm programs. Ironically, this ends up possibly hurting us in the future.

Can we write a Farm Bill for eight and a half billion dollars a year, with commodity programs averaging a half billion dollars a year? One could increase the countercyclical safety net to a percentage of the cost of production. If you assume that the

prices are going to be as high as the USDA predicts, you could increase your countercyclical payment to 90 percent of the cost of production on all the major commodities and still provide a pretty good safety net in the eight to nine billion dollar average annual expense range because prices are projected to be so much higher. It won't matter if actual prices are a lot lower as long as they are projected to be a lot higher.

We also need to find $1.8 billion per year, or 9 billion dollars over the five years, for a permanent disaster program. I think that is a high priority for us in North Dakota. Can that happen? Possibly. There is a 40 billion dollar fund, that was recently ended, which gave tax credits to petroleum producers, but I think taking money from anything else is going to be very difficult. If prices remain as high as the USDA says they will, what we have for a farm bill won't matter much because we won't need it. But history has shown us that we shouldn't count on that kind of assumption. We did that in 1996 and it was disastrous. It would be a mistake to go into a future Farm Bill thinking it really doesn't matter.

What does this Farm Bill mean to North Dakota and what does this Bill mean to our cooperatives? If farm income does well then the old rule is that Main Street does well. If farmers do well their cooperatives do well too. If farming does well, everyone in local businesses in North Dakota do well.

There are many other issues impacting cooperatives, mostly related to demographics and the decreasing number of farms and the increasing farm size. Farmers expect more from their co-ops. They expect more service, more income, more rapid turnaround of their equity in that cooperative, and they want more service in terms of customized application for herbicides, fertilizers, and agronomic expertise. Things they

can't do on their own farm they want to be able to hire a cooperative to do for them. They want this all done at a competitive price. The old generation, people that started a cooperative like my grandfather and my father, didn't expect a co-op necessarily to have competitive prices. They thought if we pay a little higher price now we will just get a bigger dividend later. That's not so true of people now. They want a competitive price and a dividend. They want the dividend fairly quickly. So, we have some issues to deal with co-ops such as small margins and shrinking numbers of people. If our agricultural economy remains good overall, our farm cooperatives remain good as well.

Let me show you some impact of what the farm bill means in North Dakota. Here we have the 2006 numbers just in from the North Central region of the state; it will be different for the areas such as the Valley and those areas that had the drought. For much of the state you won't see the same numbers but rather the same kind of trend on the bar graphs. Net farm income in 2006 is $50,000. Net farm income does not take into account the amount you have to take out for paying the capital part of your land or the interest part of your land costs.

Let's subtract government payments out of what farmers get in North Dakota and sometimes we have huge negative farm incomes. In 2002, net farm income was negative $35,000; it was negative $20,000 in 2005. We would have only a little over 20,000 for 2006 in net farm income. Take out the government payments and we have an entirely different picture.

If you also subtract what farmers get in crop insurance, which is 58% subsidized by the federal government, then consider these figures. Would you farm in North Dakota if you saw those numbers? Not at current land values you wouldn't. You couldn't

continue to farm for very long at those kinds of returns without government payments and without crop insurance. Government payments were equivalent to 10% of expenses in 2006. Since prices were good there weren't many payments. But some years, like 2001 & 2002, the percentage was very high. So farm programs are very important in North Dakota.

Thank you for your attention.