

# The 2002 US Farm Bill: What Impact and What Alternatives for Canadian Agriculture?

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# Outline

- Describe the major components of the US Farm Bill and how they will “work”
- Explain why we should care, and what the potential impacts are
- Introduce a framework for strategic management for a business
- Farm management as the first line of defence against the Farm Bill: applying strategic management concepts

# Farm Bill has three significant trade/price distorting components

- Income and price support
- Export incentives
- Country of origin labeling

# Income and Price Support

- Income support provided through three programs:
  - Direct payments
  - Counter-cyclical payments
  - Marketing Loans
- For the following major products:
  - wheat
  - feed grains
  - oilseeds
  - upland cotton
  - rice
- The total assistance of up to \$360,000 per grower, 3 programs combined

# Direct Decoupled Payments

- Intended to provide income support without affecting production decisions.
- Fixed payment based on historic yields and “base” acreage
  - Yield based on 1981-85 average yields
  - Payments are on 85% of base acreage
- Base acres from 1996 Act can be updated to include soybeans with 1998-01 acreage and yields
- Doesn't “count” toward AMS limit (?)

# Counter-Cyclical Payments

- Intended to provide an income safety net against low prices and to replace the “disaster” programs of the past few years.
- Payment is the target price less market price, adjusted for the direct payment
  - Payments are on 85% of base acreage
  - Yield is 93.5% of average in 1998 -2001
- Option to convert existing base acreage from other crops to soybeans
- Doesn't “count” toward AMS limit (?)

# Marketing Loans

- Intended to enable farmers to store their crops and sell at more favourable prices, and to provide cash flow
- Government loans are taken following harvest
  - They are non-recourse; collateral is the crop
  - Loan dispensed based on loan rate (floor price for the crop) times total production
  - Loan matures after nine months
- Farmers are allowed to repay a loan at the lower of the loan rate or the market price
- Thus, the loan rate is effectively the floor price
- This component “counts” toward the AMS limit

## Loan Rates, Direct Payment Rates and Target Price

		Loan Rates		Direct Rates	Target Prices	
Crop	\$/Unit	2002 Farm Bill		2002 Farm Bill	2002 Farm Bill	
		(2002-2003)	(2004-2007)		(2002-2003)	(2004-2007)
Wheat	Bu.	2.8	2.75	0.52	3.86	3.92
Corn	Bu.	1.98	1.95	0.28	2.6	2.63
Sorghum	Bu.	1.98	1.95	0.35	2.54	2.57
Barley	Bu.	1.88	1.85	0.24	2.21	2.24
Oats	Bu.	1.35	1.33	0.024	1.4	1.44
Up.Cotton	Lb.	0.52	0.52	0.0667	0.724	0.724
Rice	Cwt.	6.5	6.5	2.35	10.5	10.5
Soybeans	Bu.	5	5	0.44	5.8	5.8
Minor Oilseeds	Lb.	0.096	0.093	0.008	0.098	0.101
Small Chickpeas	\$/cwt.	7.56	7.43	-	-	-
Lentils	\$/cwt.	11.94	11.72	-	-	-
Dry Peas	\$/cwt.	6.33	6.22	-	-	-

# Production Incentives?

- So, what will determine farmers' planting decisions?
- Direct payment and counter-cyclical payments are based on history, and triggered regardless of production
  - don't even have to produce anything to get it
- Marketing loan assistance depends on current production; assistance varies according to:
  - choice of crop
  - yield

## Loan Rate Margins

Region	Corn		Soybean		Wheat		Cotton	
	\$/acre		\$/acre		\$/acre		\$/acre	
	(2002-2003)	(2004-2007)	(2002-2003)	(2004-2007)	(2002-2003)	(2004-2007)	(2002-2003)	(2004-2007)
US	111.73	107.59	127.88	127.88	46.9	45.02	35.78	35.78
Heartland	131.97	127.53	150.62	150.62	91.45	88.5	122.71	122.71
Northern Great Plains	58.68	55.77	123.99	123.99	42.31	40.63		
Prairie Gateway	64.05	60.24	47.62	47.62	30.31	28.885	-10.65	-10.65
Southern Seaboard	53.95	50.77	103.74	103.74	21.74	19.61	75.28	75.28

- Loan Rate Margins represent the difference between the national loan rate and regional operating cost

Source: USDA

# Pulses

- The new Farm Bill established marketing loans for small chickpeas, lentils and dry peas.
- The marketing loan program is the only program for pulses.
- Will it induce acreage into pulses?

# Pulse Loan Rate Margins

	Loan Rate Margin (\$/acre)	
	(2002-2003)	(2004-2007)
<b>Chickpeas</b>		
Northern Idaho	-42.52	-44.08
<b>Lentils</b>		
North Dakota	91.71	89.07
<b>Dry Peas</b>		
North Dakota	79.00	76.69

Source: Chickpeas – University of Idaho 2001 budget

Lentils and Dry Peas – North Dakota State University 2002 budgets

# Pulses

- Loan rate for chick peas not attractive
- Loan rates for all pulses based on US #1 grade
  - majority of production is US #3 grade, and the loan rate grade discount is significant
- US simply lacks domestic production, marketing, and export infrastructure Canada has
- **Probably negligible supply response**

# Export and Trade

- Market Access Program

- Purpose is to encourage a public/private partnership to create, maintain and expand foreign markets for US ag, fishery and forestry products
- Shares costs of eligible overseas marketing and promotional activities
- Minimum funding to increase to \$200M per year from \$90M by 2007

# Export and Trade

- Export Enhancement Program (EEP)
  - Bonuses that make US commodities more competitive, offsetting adverse effects of “unfair” trade practices or subsidies
  - Max funding extended through 2007 at current levels of \$478M annually
  - ‘Unfair trade practices’ definition expanded to include:
    - Trade distorting subsidies
    - Unjustified sanitary and phytosanitary restrictions
    - Trade barriers such as labeling that restrict new technology
    - Monopolistic state trading enterprises implementing non-commerical pricing practices

# Country of Origin Labeling

- Country of Origin Labeling (COOL)
- Requires retailers to inform consumers, at the final point of sale, of the country of origin of:
  - ground and muscle cuts of beef, pork, and lamb
  - fish
  - perishable agricultural commodities
  - peanuts
- Meat and fish products can only be labeled as US product if animal was born, raised and slaughtered in the US

# Country of Origin Labeling

- Food service establishments are exempt
- Voluntary at first, mandatory in fall 2004
- Sought by northern state politicians looking to impede imports of Canadian meat and livestock
- Will impose new costs on US livestock, processing, and retailing segments
- American Meat Institute estimates cost to various industries in the US at \$1B annually, and \$60M in USDA regulatory costs

# Farm Bill: Implications for Canada

- Price support programs:
  - will induce acreage and yield response
    - Negative price impact for soybeans, canola, and feed grains
    - Neutral to positive wheat price impact
    - Neutral pulse price impact
- Maintenance or expansion of export subsidies
  - EEP as an assault weapon against CWB
- COOL- will widen basis for Canadian livestock
  - Additional handling costs associated with Canadian livestock slaughtered in US plants will be worked into a lower bid price

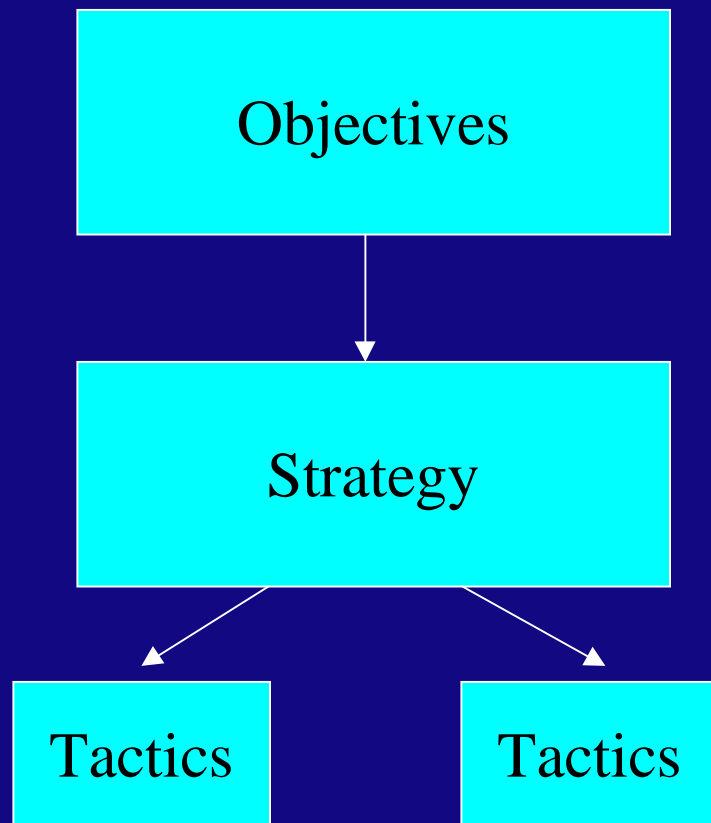
# Farm Bill: Implications for Canada

- For continued agricultural growth, Canada needs meaningful progress at WTO
- Reception of Farm Bill at Doha WTO negotiations:
  - US helped draft an ambitious Doha agenda
  - Farm Bill violates literally every single agenda item
- Legitimizes EU protectionism
- An affront to the developing countries
  - Success at Doha?

# What We Can Do About It: Strategic Management

- Simple Concepts:
- Step back from day-to-day operations
  - Think strategically
- Start with the end in mind- **objectives**
- Understand your intrinsic sources of comparative advantage, and relate them to your objectives- **strategy**
- Conduct activities that will implement the strategy- **tactics**

# What We Can Do About It: Strategic Management



- Objectives- where you want to go with the farm business and your personal life
- Strategy: Your approach to achieving the objectives
- Tactics: Specific activities used to implement the strategy

# What We Can Do About It: Strategic Management

- In tough times, your objective is survival
  - Need cash revenue to match cash costs
  - Longer term, you need to cover non-cash costs and grow the business
- Strategy
  - What special capabilities and expertise do you bring to the table? How can you exploit them to accomplish your objectives?

# Strategy

- There are only 3 generic strategies:
- **Low Cost Strategy**
- **Specialization/Niche Market Strategy**
- **Diversification Strategy**

# Low Cost Strategy

- Default; 98% of farmers pursue it
- Logic: You can survive at low prices that others can't
- Sources of low cost efficiency: many- e.g.
  - can recognize quality livestock
  - get good yields from poorer (cheaper) land
  - good mechanic
  - farm located close to key markets
- But:
  - Most farmers don't think about the source or develop their low cost advantage
  - It's a *relative* advantage; most people can't have it, or it wouldn't be an advantage

# Specialization/Niche Strategy

- Requires:
  - Ability to anticipate consumer/customer wants
  - Attention to detail-capability to deliver specialty attributes
- But:
  - Each niche is apt to be small
  - Niches get commoditized
- It's a treadmill, so others will catch on, get into the market, and compete with you
  - Need to keep searching for new niches

# Diversification Strategy

- Special case of specialization
- Ability to simultaneously cater to separate demands for your product
  - e.g. supply 2 different niche products and the commodity product
- One stop shopping for your customer
  - grow and warehouse complete line of produce
  - supply multiple breeds/genetic lines of livestock

# Strategy to Tactics

- Understanding your strategy leads logically into a set of tactics, e.g.
- Low cost- buy new equipment, acquire additional acreage, choice of inputs
- Specialization/Differentiation- choice of outputs, new relationships with customers, specialty facilities
- We have a tendency to go straight to (tangible) tactics and ignore the (intangible) objectives and strategies and that motivate them

# Farm Bill: How Can We Respond Strategically

- In a variety of ways, the Farm Bill is saying that we should expect low farm prices to continue
- Despite the apparent gloom, are there ways that we exploit the situation?
- Consider:
  - Has the US committed self-injury through the Farm Bill, and can we capitalize on it?
  - What can we bring something to the table that US farmers aren't?

# Self-Injury in US Farm Bill

- Crop subsidies tend to be capitalized into inflated land values and other assets
  - By living without subsidies, we have lower-cost land
- COOL places new costs on the entire US red meat supply chain, and livestock exports to US
  - But for the Canadian meat supply chain, no change
- Crop subsidies tend to focus US farmers on commodities, de-emphasize participation in value-added supply chains
  - Less incentive to develop relationships, take risks

# Strategic Response to US Farm Bill

- Anecdotal cross-border comparisons suggest significant land price and rental rate differences
  - Suggests relatively low-cost land as a strategy
  - Tactics: grow something different than the subsidized commodity that prices up US land
  - Already happening:
    - West- potatoes, pulses
    - East- processing vegetables, other horticultural crops
- Farm Bill tends to keep land in commodities, so there will be ongoing rewards from diversification

# Strategic Response to US Farm Bill

- COOL adds layer of logistics costs in US livestock production, processing and retailing
  - Canadian exports of red meat do not face these costs
  - **Low-cost strategy**- export meat instead of livestock
  - **Niche strategy**- brand Canadian product
  - Tactics- build finishing space, establish processing capacity
  - Target the US market or the markets the US exports to- Japan, Asia

# Strategic Response to US Farm Bill

- The Farm Bill focuses US farmers on commodity products
  - will hurt us in commodity markets, but not in value-added
- Strategy: develop value-added supply chains for farm products
- Already happening:
  - Hay products
  - Grass-fed beef
- Will need to become the rule, rather than the exception

# Strategic Response to US Farm Bill

- Still need focused ag/trade policy response:
- WTO/CITTA challenges to Marketing Loan, (Direct and Counter-cyclical: AMS) ?
- NAFTA/WTO challenges to COOL, but post-2004
- Organized pressure among trading partners and developing countries in WTO
- Organized pressure to remove COOL

# Conclusion

- Farm Bill stands to further reduce farm prices in Canada
- There will be a diplomatic/policy response
- However, the first line of defense is sound farm management at the individual farm level
- We need to apply strategic management concepts in deploying our farm management defense
- In the short-run, our optimal response will be damage control; long-run it will lead to growth