Quentin Burdick Center for Cooperatives

Bloomquist Lectureship Series 1999

FEATURED PRESENTER:

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April 13, 1999

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Why Farmers Won't Survive Unless They Become Food Merchants

Farmers' Contract Cooperatives and the Food Chain

It doesn't take a rocket scientist to see that agriculture is changing ... just look at the numbers: (overheads shown of population trends, rural development, farm numbers, age of farmers, and the advent of technology replacing simple farm machinery).

In my judgment the United States is in grave danger of losing one of the very sacred characteristics of the New World. (And I assume the same is happening in Canada) ... the individual ownership of productive land. We are about one drought or one run up in the dollar value away from the very reason our forefathers fled Europe — bureaucratic ownership of productive land.

Anyone who knows any history knows that most wars result from bureaucratic control of productive land and the vitally important things it produces, i.e., food and energy. The French Revolution and the Russian Revolution were clearly revolts against landed aristocracies. And the Cuban revolution was, as well, a revolt against the same bureaucratic control over the cane fields, the processing mills, and the profit derived from them. In this case, an American corporation, the Cuban-American Sugar Company, was the major player. Revolution evolved.

In all of Central America today a mix of landed aristocracies and corporate holdings give witness to the fact that in such a structure, democracy does not flourish, and there is vast separation between the wealthy and the poor.

The former president of Mexico who profited massively from the signing of NAFTA is reported to own over 150,000 acres of fruit, vegetable and sugar cane land.

Our generation has certainly seen the massive failure that communist bureaucratic control of productive land has realized. Bureaucracies have failed

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for two reasons. First, freedom is most vulnerable to tyranny when productive land and the absolutely vital things it produces; food and energy (for shelter and for production), are out of control and competition of individuals.

Second, because farming itself is an art form. The minute by minute decisions made by farmers far surpass empirical knowledge and absolutely defy bureaucratic management. And that is at risk in the United States and Canada.

The good news is that all across America farmers are starting to look at

CONTRACT COOPERATIVES to process and market the food they produce. They are the last ditch effort to save precious, personal, private farming in America. They are a clear recognition that vertical integration is necessary but that it must be done from the bottom up or it will certainly be done from the top down. Farmers are seeing clearly that unless they buy their way into the food chain they will be eliminated by the powerful forces of economics at work in the world.

Let’s talk about those forces. You must understand them and farmers must understand them because they are such powerful forces in today’s world.

There are five key phenomena at play in the world today that are dramatically affecting food production, processing and marketing.

1. Government
2. A free trade mythology
3. Fluctuating currency values
4. World trade shifts
5. High real interest rates

Let’s look first at what help we can expect from government in the foreseeable future. I’m relatively sure that farm programs, as we have known them, are over. I know that there is a great deal that could be said about this and I have no intention of going into it today. But there is one salient point to be made: If farmers in the US today do not get significant help soon — whole hosts of them are through. The fact is, nonetheless, that the urban dominated free trade mythology will give little concern to farmers in the future ... unless city people suddenly find their food supply threatened. Then we will see all sorts of hysterics.

Secondly, we hear a good deal about the virtues of free trade but ... is there really any new hope that "free trade" will work? I doubt it. Not in food and energy. They are far too critical to human existence. They are, as I pointed out earlier, what nations go to war over. And governments will do many, many dramatic things when food and energy are threatened.

For example, three presidents of the United States imposed embargoes on soybean sales when the U.S. found itself slightly short. Nixon, Ford, and Carter all succumbed to heavy U.S. processor pressure and literally stopped the music in soybean exports. And, believe it or not, the current Freedom to Farm Act contains a provision dealing with the potential of future embargoes.

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Certainly there is little hope of the European Union discontinuing farm subsidies. I remember vividly a lengthy visit with the 1995 European Agricultural Representative at Gatt. He said to me, "Governor, our people are scared to death of all this talk of free trade in food. Our people have starved twice in my lifetime. They are not about to leave something so vital to them, up to the whims of supply and demand, other government embargoes and manipulation, to say nothing of the vagaries of weather and the threat of war. We've been there and done that we don't like it!" he said. He conceded to me that export subsidies are another matter and should be ended. But they still have them. In sugar alone, the European Union literally breaks the world market with its dumped sugar.

Energy is the same. And many of the advocates of free trade speak with forked tongue when it comes to energy. Let me tell you what happened when Iraq invaded Kuwait in 1990.

Panic broke out in the Bush White House ... not because of the loss of crude oil supply, but because in Kuwait lay 8% of U.S. refining capacity. In October President Bush sent an urgent message to all of the governors warning of impending short supplies of propane, particularly in the New England states, because most of the propane there was refined in Kuwait. But the real cause of the panic was the fact that in Saudi Arabia lay another 12% of U.S. refining. Saudi Arabia was believed to be Iraq's next target..

President Bush acted swiftly and forcefully, as he should have. There had been over 100 oil refineries shut down in the U.S. in the ten years preceding the invasion of Kuwait by Iraq. Not a single new refinery had been built in the U.S. in 25 years (and still has not, as far as I know). Everything had moved to the Middle East, in the name of "free trade," of course.

The President told the nation that we were fighting, not over oil, but over tyranny. But it was oil ... it was oil tyranny. What was the most troubling about this whole episode was that five short months later in announcing his national energy strategy, the President said, "The national energy strategy of this country will be based on market forces, because," he said, "the market is working so well!" I was at the White House for the press conference and sat six feet from the President.

I couldn't believe my ears!

200,000 people had died. Kuwait was still in flames. And "the market is working so well?"

Is war part of free trade? We will without doubt have to return to the Middle East, with military force every time an Iraqi soldier walks in the wrong direction. Is that free trade?

I will rest my case on the free trade issue as it applies to food and energy. But I want you to know that I was the lead governor on energy for two years and I know where of I speak.

But now let's talk about something that is not a myth -- <u>shifting currency values</u>. The single most important factor in world trade is changing currency values. There is no question that American and Canadian producers of all kinds lost their foreign markets in the 1980s precisely because the dollar was

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so high. At one point the dollar was worth 250 yen. A bushel of our wheat cost the Japanese 1000 yen ... and every other North American product was similarly priced out of the market. Our production economies went into a tail spin. The first down was agriculture and mining and other raw product producers. Eventually the dollar itself crash dived as foreign investors here suffered right along with our own investors. The dollar fell to 70 yen. And that bushel of North American wheat was available to the Japanese buyer for about 300 yen.

But it took our production and marketing a long time to build back its quality and its proof of reliability. The economy didn't recover in time to save George Bush and Bill Clinton has reaped the benefits of the recovery.
Make no mistake about it, if we let the dollar go back up ...the whole nation will be right back in the soup again!

One of the main reasons that many raw product supplies have gotten so low in recent months is the fact that the dollar has been reasonably priced and foreigners can easily purchase dollars to buy our grain, meat and processed foods.

The problem of over-valued currency is amplified immensely for farmers because even our own processors can go to foreign markets to buy their grain and beef and other raw products. For our farmers the only hope of dealing with this is to buy heavily into food processing ... and to scream like hell every time the dollar starts to move up. The dollar is around 120 yen today. If it goes much higher we will see the entire production sector suffer again. Not just agriculture.

The fourth major factor in world trade that makes it imperative that farmers get into the food chain is the tremendous shift away from raw products in trade to processed products. Look at the numbers in the overheads and you will see that the amount of consumer foods moving in world trade has more than doubled in the last 20 years. Meanwhile the amount of raw products has been cut in half. Intermediate processed food sales have remained relatively constant.

The lesson is clear: **Farmers must get into the *processing* part of the food business ... that's where the market is. That's where the stability is and that's where the profit is.**

The fifth economic force at work that is killing us on the farm is something called high real interest rates. High real interest rates are directly responsible for the pervasive trend toward vertical integration in our industry and in industries in other countries, as well.

Fundamental to this move to integrate has been the high cost of inventories as a result of high real interest rates. "Just in time" management theories resulted directly from the high cost of money. What am I talking about? Weren't interest rates much higher in the 1970s? Is the term "high real interest rates" some more voodoo economics? Well, the fact is that nothing could be more real than "real interest rates." And NO, they weren't a lot higher in the 1970s. Nominal rates were a lot higher ... but that is not the reality of things.

Real interest rates are the difference between interest paid and inflation.

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In the 1970s interest paid was often as high as 12-15% ... but inflation was rolling along at near similar percentages. There were, I'm told, periods in the 70s when real interest rates were actually a negative. If you are paying 8% interest on a house loan and the value of that house is inflating at 3% per year, your real interest rate is 5%. That's very high by historic terms. But consider the plight of the business that must pay 10 or 11% for operating money and its inventory has no inflation factor. You can darn well bet that a company like that is going to cut that inventory just as low as possible and go to "just in time" management, pronto!

That's why inventory costs are being eliminated every place possible. And that is why inventories will be pushed back on farmers whenever possible and that is why whenever there is a catch up in inventory, the raw market will dive like a rock. Then the farmer who has the same high cost of money must either sell at fire sale prices or go broke carrying the inventory.

Look at what has happened to the food chain already. Huge portions have disappeared already. Integration is still going on at every turn. Will it eventually include the farm? I think it has to.

So now the question is: **Who will do that integration? The farmer or someone else?**

If you want to survive and have a good life on the farm you have to do the integration. If you do it well you will be richly rewarded, as you should be, in this land of the best fed people in the world. And you will not be alone. Look at Denmark and the Netherlands, California, and the Midwest. For those who do it well, there is clear evidence of historic success and of current success with new adaptations that are leading to even new successes. Many new large cooperatives are on the drawing boards and will be surfacing soon.

Before we start on details, let me tell you one real life scenario that absolutely cried out for a cooperative. North Dakota for a long time grew about 60% of the malting barley raised in the U.S. It had for a long time. During the 70s the largest malt house in the world was built in the center of North Dakota by a very good maltster named John Ladish. During the eight years that I was governor, the state lost between 20 and 25% of her farmers. During that same time period the malt house doubled or tripled in size. I've been told that it made more on a bushel of barley than the farmers got. Now that was not John Ladish's fault. Nor can we blame Cargill which now owns the plant. Both Ladish and Cargill are very good operators. It is our fault ... the farmers' fault. And we must do something about it.

What are the key ingredients of a good **CONTRACT COOPERATIVE?**

Are they different from the traditional service cooperatives that have served us so well through the years? Yes, there are differences and they are significant. Let's look.

The first important characteristic is SIGNIFICANT INVESTMENT. Big time commitment of money, head, and heart. This is a life change. It means commitment if it means anything. But it will pay rewards in money and satisfaction. When American Crystal Sugar growers bought that investor owned company in 1973, we paid 100 million dollars for it. Obviously, there was huge banker help from the Bank for Cooperatives ... but I want to tell you, we were committed. We put it all on the line.

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Second: It must be understood that a BINDING CONTRACT will exist between the individual producer and the processing cooperative. The producer agrees to deliver a quality product on a timely basis and the co-op agrees to pay him everything it earns on an equally timely basis. These are binding contracts that will quickly help the producer learn what the processor needs to serve his customer that is ultimately responsible for the quality determinations.

The third essential is PROFESSIONALISM. It must pervade the organization from the management, to the board, to the farmer-member who must become a professional producer suddenly in a position to become the best food producer in the world. Top notch managers must be hired. Board members must learn the board limits and its responsibilities. There is no substitute for this search for professionalism.

The fourth essential is CUSTOMER ORIENTATION. Everything must be done with the customer in mind ... everything from the day the ground is prepared and the seed is bought to the instant delivery of the highest quality product to the customers—every one of which are number one. The wonder is that with this integration will the farmer really know what the customer wants ... not just what some middleman can make the most money on?

The fifth critical ingredient is MARKET SHARE. There is a world of giants who are capable of being the single suppliers that most customers today insist upon. There are niche products and niche markets, but for the most part size, quality, and reliability go hand-in-hand. You have to be <u>big</u>. One of the great tragedies in the co-op movement is the failure to think big enough. Small co-ops often compete with each other for the same market when <u>together</u> they might really be a good supplier. Unfortunately, <u>pride</u> too often gets in the way of intelligent cooperation.

The final all important essential of the new Contract Cooperative is the RETURN OF ALL PROFITS every year to the members. There can be no automatic hold backs. Every year the members must, through their board, decide where the money must go. Must it all go back to the members or can some be reinvested in capital expansion? That is how the co-op is reinvented each year. It is for the members that it must exist ... and if further investment must be postponed, that is what the board must do. But at the same time, growth in size and better service for the customer will increase the members' profits in the long run. That's what this is all about.

The development of a good CONTRACT COOPERATIVE is one of the most satisfying works that any farm group can ever undertake. It is in the final analysis, the only way that we can continue to keep American people the best fed in the world. No longer will farmers be just the producers who are separated from their produce at the lowest possible price. **They will be the processors and distributors and marketers. The miracle will be created!**

The people who raise the food will finally get adequate and stable income as a reward for their work in delivering to our people, not only the best, but the cheapest food in the world.

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George Sinner

Former North Dakota Governor George "Bud" Sinner, native North Dakotan, was raised on a farm near Casselton, North Dakota. He graduated from St. John's University, Collegeville, Minnesota, and served as Governor of North Dakota from 1986-1994. Prior to retirement, he served as Vice-President, in charge of government relations, of American Crystal Sugar Company based in Moorhead, Minnesota.

Throughout his career he has remained active in a six-family farming operation near Casselton. Sinner and his wife, Jane, live in Fargo, North Dakota.

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