

**RESPONSES TO QUESTIONS ADDRESSED TO PANEL III FROM THE
RANKING MEMBER ---REP. CHARLES STENHOLM**

QUESTION 1:

I take it from your testimony that you do not believe the existing laws and programs are enough for farmers and ranchers to remain competitive given current market conditions. Do you believe the CoBank proposal will help address equity capital and cooperative lending issues?

RESPONSE:

Yes, your interpretation is correct. The existing laws need to be changed to reflect the array of changes that have occurred and continue to occur in the marketing system for U.S. agricultural products. Equity and credit demands are growing and the ability of a declining number of producers to meet these growing capital requirements is a significant challenge.

A smaller number of producers must now shoulder the growing capital requirements for the entire agricultural production sector. That burden was in the past dispersed over a more numerous group of producers. At the same time more capital is required for producers to participate effectively in a more concentrated processing and marketing sector. The net result is a diminished producer group facing growing capital requirements on both the production front and the marketing and processing front.

The farm credit system is an important tool for addressing the capital needs of U.S. farmers and ranchers on both fronts. The changes embodied in the CoBank proposal will help to address the capital and lending issues farmers and ranchers now face (and will continue to face in the future) on the marketing and processing front. These changes will permit more farmer owned businesses to qualify for CoBank lending and access competitively priced loan funds. While the CoBank proposal is not the only change that will be necessary for farmers to remain competitive under the current market conditions, it is a critically important one.

QUESTION 2:

You expressed the need for structural change at the cooperative level in order to meet the changing needs of producers. How would you recommend doing this without diminishing the role and influence of producers?

RESPONSE:

Producer influence can be perceived in more than one way. Some perceive it as the ability of an individual producer to impose his or her individual will through the democratic governance process of the cooperative. The weight of any one individual producer's influence is likely to be decreased as structural change occurs and cooperatives become fewer and larger. (Although it could be argued that prior to the mergers and structural change in the cooperative sector, this kind of influence had

actually been increasing for decades as a consequence of the declining number of farmers.)

But this kind of individual sovereignty may be of little value if the cooperative is not capable of competing effectively in the marketplace. Most would agree that it is important to maintain member control and to have effective internal cooperative governance. But there is usually a trade-off between this internal influence and the external market influence producers can gain from the cooperative. Having greater individual influence in the governance of a cooperative that is less and less competitive because it is too small does little to improve the overall economic position of farmers and ranchers.

The power and influence of producers may alternatively be viewed as the ability of the entire group of producers acting collectively (i.e. the cooperative itself) to participate on equal footing with the other firms participating in the marketplace. I believe it was this kind of producer power and influence that was envisioned in much of the existing cooperative legislation. Furthermore I believe that it is this kind of power and influence that will be increasingly important for the economic well being of farmers and ranchers of all sizes and types in the future.

Structural changes now occurring are resulting in fewer, larger and in many cases refocused cooperatives. These larger cooperative organizations are not being developed as a means to reduce the power and influence individual members have on internal governance. They are instead being developed in response to the concentration occurring among investor-owned firms in the sector. Cooperative restructuring is necessary to hold a parity position with the larger firms that now populate that sector and will on balance increase the influence that producers (acting as a group) have there.

QUESTION 3:

As you mentioned, many of the value chains of the food and fiber produced on U.S. farms and ranches are becoming increasingly coordinated and are heavily influenced by large and powerful firms, how has this affected small farmers and ranchers?

RESPONSE:

More coordinated value chains populated by large firms have had an impact on farmers and ranchers of all sizes—including smaller operations. Access to markets is one area where there appears to be a significant impact. Obtaining a fair share of the value added is another area where small farmers and ranchers are affected. Open markets generally place few non-price restrictions on access or the quantities that individual producers can deliver. In the more coordinated systems there has been a tendency for processors, manufacturers and retail distributors to reduce costs and add value by dealing with fewer suppliers who deliver a more uniform product on a more regular basis. Smaller farmers and ranchers are often not selected and as a result face greater difficulty in accessing the market.

Even the producers who are selected as suppliers may encounter difficulty sharing equitably in the added value they help to create. These producers are frequently required make changes in operations that increase their operating costs to add value in the chain. But a power disparity often exists between producers and the other firms in the value chain. This disparity makes it difficult or impossible for individual producers to negotiate effectively for a fair share of the added value these changes bring about. Operating cooperatives and cooperative bargaining associations can be of value in this effort.

**RESPONSES TO QUESTIONS ADDRESSED TO PANEL III FROM THE
RANKING MEMBER ---REP. COLLIN PETERSON**

QUESTION 1:

In your testimony you note that CoBank has played an important role in financing cooperatives. If Congress does not take action to update the cooperative provisions of the Farm Credit Act, who will be hurt?

RESPONSE:

CoBank's role in financing cooperatives has been an important factor in the past success of cooperatives for several reasons.

Some traditional lenders are reluctant to finance cooperatives because cooperatives differ from investor owned corporations in the way they are governed and the way they distribute net margins. In many cases, traditional lenders do not fully understand these differences. CoBank serves as a reliable competitor in the market with a long term commitment to cooperative lending. Both existing cooperatives and start-up cooperatives need a reliable source of senior debt at competitive prices from a lender with a strong commitment to cooperative lending.

If the provisions of the Farm Credit Act are not revised groups of farmers who are attempting to form value added businesses as LLC's would be the groups most affected. These producers already face numerous challenges in raising equity and debt capital, and reducing the number of potential lenders only adds to these problems. Groups attempting to organize would in essence be forced to make a choice between:

- (1.) Organizing under the LLC form which provides significant tax advantages and advantages in using outside capital but requires giving up access to CoBank lending services or
- (2.) Organizing under the traditional cooperative form to gain access to CoBank lending services but accepting a significant tax disadvantage (in the form of the Self Employment tax) and tighter limitations on the amount of outside capital that can be used.

It is difficult or impossible to predict accurately which groups may be forced to make this kind of choice in the future. In the near term, I would expect that groups around the U.S. who are organizing to produce BioDiesel would be most affected. The capital requirements for these plants will in many cases greatly exceed the amounts that individual community banks can prudently provide. Thus the groups will be forced to work with a smaller set of much larger commercial lenders located outside the community. In many cases these larger lenders may be less competitive and/or may not have a long term commitment to cooperative lending.

Unlike the ethanol plants that formed primarily in the Midwest, it is expected that plants organized for BioDiesel production will be dispersed over a much wider geographic area. As a consequence the affected producer groups will be more widely dispersed. Although BioDiesel may be the type of activity that will be most affected in the near term, efforts to organize many other kinds of producer-owned value added ventures that have not yet been identified are likely to be affected in the longer run.

Finally the current CoBank borrowers could be adversely affected over time. As the restructuring among its traditional borrowers continues, CoBank's membership becomes smaller and more concentrated. If CoBank cannot participate in the market growth created by start-up organizations its size and the scope of its activities in the future will be limited. All other things equal this is not a positive outcome for its existing owner members.