

NEW NATIONAL CENTER FOR VALUE-ADDED AGRICULTURE

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My research center is one of the organizations that have formed the Agricultural Marketing Resource Center, which is the new national center supporting value-added agriculture. The other partners are the Ag Issues Center, run by Dan Sumner at the University of California, Kansas State University and Oklahoma State University. Iowa State University Extension administers the new Center, and is responsible for creating a web-based delivery mechanism to support the value-added endeavors of farmers. I would like to use my time today to talk about value-added agriculture in the context of rural development and the direction of mainstream agriculture.

The Agricultural Marketing Resource Center is an important investment by Congress and USDA because it represents a signal that perhaps the future of mainstream agriculture lies somewhere other than in commodity production. I see two possible paths for Midwestern agriculture. The first path is "Business as Usual," which means ever fewer farmers producing commodities that are transformed into consumer products by large, innovative food companies, such as Hormel, ConAgra, Kraft, Nestle, and Smithfield. Success in commodity production means specialization in either crops or livestock, specialization within crops, a focus on low costs, high volumes, and the continual need to adoption yield-increasing, cost-decreasing technologies. Congress acts like it does not recognize that this focus on generating profits from commodities means lower real prices for farm production, so this path also means increased dependence on the federal government by crop farmers. In other words, this is the success story of American Agriculture since World War II.

But however much we try to stand still with increased price supports for commodity production, this future will involve the inevitable departure of a large portion of the human infrastructure from vast areas of the Great Plains. James Hodgson, a self-described Minnesota prairie boy who was Secretary of Labor for President Nixon, recently wrote that the original purpose of the Midwest small town "...was as a necessary hub, a two-way flowthrough point for the local agricultural economy, and its pattern was dictated by the mobility limits of the horse." (p.-5). In Mr. Hodgson's view, small rural towns have been doomed ever since adoption of the internal combustion engine. And, of course, many small towns and counties reached their population zenith before 1930. In the commodity business, cutting costs is everything, so economies of scale in storage, production, and transportations will drive decisions, not a concern for rural development. I believe that a continuing focus on commodities will lead to continued stagnation and loss of infrastructure in agriculturally dependent areas.

Is this an overly bleak assessment of where we are in agriculture? I think not, and neither does Congress. Although Congress continues to offer unprecedented levels of support for commodity production, funding for rural development programs that focus on value-added agriculture is also increasing. Funding for our center, for example, was provided by an appropriation in the Agricultural

Risk Protection Act in 2000. And both the House and the Senate Farm bills provide increased funding for value-added enterprises and centers.

Does expansion of value-added agriculture offer agriculturally dependent America an alternative path to increased economic activity? Answering this question and providing information and educational resources to those who are pursuing this alternative path is what the Agricultural Marketing Resource Center is all about

What is the Agricultural Marketing Resource Center?

Partners in the Agricultural Marketing Resource Center are Iowa State University, Kansas State University, the University of California and Oklahoma State University. Our purpose is to collect and interpret information, and to conduct research on value added agriculture. Our mission is to provide independent producers and processors with information needed to build successful value added ag enterprises.

How will we do this? First and foremost, we will create an electronic, web-based library for all producers and producer groups to access. Secondly, we will provide information on business principles, legal, financial and logistical issues that producer groups need to consider before investing their money. AgMRC will coordinate research and outreach support systems on value-added enterprises.

Each organization brings provides the Center with differentiated expertise. Iowa State University provides administrative leadership for the Center, as well as expertise on corn, soybeans, pork and woods and biomass production, and knowledge about the economic realities of value-added agriculture. Kansas State University provides information on small grains, wheat and cattle. Oklahoma State University offers specialized services in food processing. The University of California provides expertise on fruits, vegetables and dairy and the outstanding research resources available there.

What is Value-Added Agriculture?

Perhaps this question should be, what isn't value-added agriculture? After all, unless the revenue from sales is less than the cost of production, value is added. In most regions, commodity production creates added value. But the term "value-added" has come to mean any activity that either 1) increases the per-unit price received for farm production, or 2) transforms a product into another product that can be fetch more revenue in the market.

For example, identity preserved, free-range, chicken eggs, produced by Weisengold in Germany are a value-added product. A farmer adds value to corn by converting it into meat, eggs, or ethanol. Value is added to sugar beets by converting it to granulated sugar. Value is added to non-GMO soybeans sprayed with Pursuit, if they are segregated and marketed as non-GMO soybeans.

Can Farmers Make Money Investing in Value-Added Agriculture?

How can farmers make money? There are three ways. The first is to be lucky. Almost all Iowa corn and soybean farmers made large amounts of money in 1997. Both yields and prices were high. Not

many people will obtain the financing necessary to operate a new business on the premise that they will be lucky, so we will not focus on the luck component any more.

The second way to make money is to offer a product or service that returns more from the marketplace than it costs to produce it. This means either duplicating current production and marketing efforts that are making somebody else money or finding a new product or market where profits can be made. Of course the duplication of profitable efforts is why success at developing new profitable niches is difficult to maintain for a long period of time unless there is some feature of the product that cannot be duplicated.

And, of course, the third way of making money is to produce a commodity at a lower unit cost than anybody else. This striving to make money by being the low-cost producer is what drives the market price of commodities downward.

Farmers investing in ethanol plants and most efforts at investments in meat-packing plants attempt to make money by being the low-cost producers of a commodity product. That is, this type of value-added investment moves farmers from producers of one commodity to producers of two commodities. Experience over the last 20 years with farmer-owned enterprises suggests that a group of farmers can become the low-cost provider of a value-added commodity if it hires high-quality external management talent and relinquishes day-to-day and some strategic control of the enterprise over to the professional management. A good example of this type of structure is American Crystal sugar cooperative in North Dakota.

Farmers face a different set of challenges when they want to produce a differentiated product. One of the members of the Resource Center's advisory council said that the three biggest challenges are marketing, marketing, and marketing. By this, the member meant that most good ideas about alternative production fail because farmers do not realize how difficult it is to create a market for a new product. The mentality of "I will produce it and the market will be created" just does not work. Just think of the million-dollar test marketing and advertising campaigns that food companies undertake when they offer a new product. Furthermore the ability to find shelf space in today's supermarkets is both difficult and expensive.

Of course, farmers could concentrate on what they do best—production—and leave the marketing to others. This strategy can work if farmers are supplying a product that is difficult to procure elsewhere. For example, more than 75 pork producers in Iowa sell their pasture-raised hogs to Niman Ranch for a premium over the commodity market and leave the marketing to Niman Ranch. These producers earn money because they are offering their buyer a unique ingredient—natural pork—while leaving the development of the market to others. Other example of differentiated products are organic food grade soybeans, identity preserved corn, free-range meats and eggs. Perhaps if consumers continue to demand more information and accountability in the way that their food is produced, then this type of value-added enterprise might soon become a major influence in rural America as it has become in Europe.

Will Increased in Value-Added Agriculture Increase Rural Vitality?

Many in Congress justify government farm program spending in terms of propping up rural America. But clearly the *prima facie* evidence suggests that it has not worked. The December 15th issue of *The Economist* showed that the counties who received the most farm subsidies were the counties that

suffered the greatest decrease in population. While I do not suggest that the subsidies necessarily caused the population decrease, it is clear that encouraging commodity production with price subsidies has not kept people in rural areas. Our experience with commodity production also suggests that large-scale, capital intensive value-added enterprises like ethanol plants will not slow down the migration from rural areas. After all the viability of ethanol depends on lots of inexpensive, commodity corn.

How can rural areas reverse the population loss? First it must be recognized that people are more mobile today than ever before. People will choose to live where they think they can have the best life. This involves judgment about types of jobs, associated income, recreational amenities, and other family considerations. All things being equal, businesses will locate in areas where they can find workers or where their existing workers will want to live. So the question becomes, what amenity advantages do agriculturally dependent regions have that no other regions have? That is, what kind of worker or business would want to live in an agriculturally dependent region? One of the first issues that we want to address with regards to this center is to determine the types of jobs that different value-added agriculture investments will make available and whether they will enhance rural vitality. A related issue is to identify those value-added endeavors that increase the demand for labor and those that are dependent on capital. To me at least, it is not obvious that an increase in value-added agriculture necessarily increases rural vitality. It depends on the type of products produced, where they are produced, and what types of jobs are created.

I would like to review a few of the other research questions that we have begun addressing to give you some idea of what issues we feel are important.

How Can Controlled Origin Denomination Work to the Farmer's Advantage?

Wisconsin cheese, Vermont cheddar, Idaho potatoes, Bordeaux wine, Tuscan wine, New Zealand lamb, and Parmesan cheese are examples of attempts to brand a product by identifying it with a specific geographic region. Two ISU economists, Sergio Lence and Dermot Hayes, are looking at how these brands were created and how they were defended and exploited. A key question that they will attempt to answer is whether the costs of verification of geographic source and quality has decreased with the availability of new information technology tools. For example, a verification system named KAT in use in Europe makes the process of tracing production back to the farm level transparent and affordable. It helps producers of free-range eggs keep non-free-range eggs out of its supply chain.

Who Captures the Value in Value-Added Investments?

Many farm and rural advocates for value-added agriculture see it as a way to increase net farm income. Of course net farm income will increase if a farmer receives a higher price for exactly what was produced in the past at the same cost of production. Some soybean producers who received a premium for their non-GMO soybeans, and some "old-fashioned" hog producers who sell their hogs to a Niman Ranch buyer for a premium fall into this category. But, typically, farmers will have to change their production practices to capture a higher price. After all, it is difficult to add value without also incurring costs. For farm income to rise, farmers need to sell their product for a price increment that is greater than the cost increment. But this goes against the interests of the buyer who wants to buy the product at the lowest price possible. Two other ISU economists, Philippe Marcoul and Brent Hueth, will be studying the factors that influence the ability of producer bargaining groups to capture a portion of the

value-added in terms of a higher price. Bargaining power increases with the uniqueness of the services or product being offered by a farmer or a group of farmers because the buyer has fewer alternative suppliers. Also, bargaining power will tend to increase the greater the number of potential buyers there are. Thus, farmers should focus on offering the market something unique with many buyers. This is the opposite of the position farmers increasingly face: that of offering a commodity product with relatively few buyers.

Dual Role of Farmers as Investors and Input Suppliers

Are returns to capital investment an increase in net farm income or an increase in off-farm income? This question is important to consider because as Iowa corn farmers and North Dakota wheat farmers invest in new processing facilities such as pasta and ethanol plants, they need to consider that their interests as producers and sellers of an input into a processing plant is in conflict with their interests as an investor in the plant. Profits from corn production move opposite the profits from ethanol production. Through a series of case studies the Center will explore the implications of this dual role on the ability to raise capital to support ongoing investments and to manage a farmer-owned investment.

My colleagues at the University of California, Kansas State University, and Oklahoma State University in the Agricultural Marketing Resource Center look forward to working together to provide producers and producer groups with the resources they need to guide profitable investment decisions and to provide answers to the many policy questions raised by the opportunities and challenges of value-added agriculture.

References

Hodgson, James D. "The Midwest Small Town – A Struggling Past and an Unpromising Future." Unpublished mimeo, 2001.