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HELPING AGRICULTURAL PRODUCERS "RE-GROW" RURAL AMERICA: PROVIDING THE TOOLS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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HELPING AGRICULTURAL PRODUCERS "REGROW" RURAL AMERICA: PROVIDING THE TOOLS

WEDNESDAY, MARCH 15, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 2:20 p.m., in room 2360, Rayburn House Office Building, Hon. Jim Talent [chair of the Committee] presiding.

Chairman TALENT. Well, I want to open the hearing and apologize to everybody for the delay. I was over in the House handling a bill, and then we had this vote. The Ranking Member told me that she needed to stop at her office very briefly, and then she would be here. I am going to go ahead and open up the hearing.

I want to welcome the participants here today for the House Committee on Small Business hearing on helping agricultural producers regrow rural America, providing the tools.

Last September, the Small Business Committee held the first "helping agricultural producers regrow rural America" hearing which focused on the current crisis in the agricultural community, what could be done to lift rural America out of recession, and how agriculture could prepare itself to weather any future downturn in prices and production and conditions. The agricultural leaders at that hearing painted a clear picture of the need and desire of producers to become the vertical integrators, capturing more of the consumer dollar by adding value to their commodities.

I continue to be impressed by those in the agricultural community who during these darker times for producers are still optimistic for the future. I am pleased their entrepreneurial fire continues to burn.

Agricultural leaders at September's hearing described the current value added movement in agriculture and described various policy recommendations to the committee that could be accomplished to help the hardworking visionary producers in their efforts to build a stronger agricultural economy as well as a stronger rural economic base.

Charlie Kruse who is back with us today suggested one-stop shops be established to provide the necessary business, marketing, engineering, and legal expertise to assist producers as they move to establish their own processing and manufacturing facilities. Every agricultural organization presented at the hearing echoed

Charlie's recommendations. I assure you, Charlie, your voice was heard.

Mr. Thune and I with the help and expertise of the agricultural community introduced the Value Added Agriculture Development Act for American agriculture. This legislation would create agriculture innovation centers that would provide the business, marketing, engineering, and legal assistance needed to begin a producer-driven value added revolution in agriculture.

The Committee heard additional recommendations for specific policy tools that could be provided to assist this movement. Dale Ludwig, the executive director of the Missouri Soybean Association, which Brooks Hurst is representing today—well, we have a lot of great agricultural leaders from Missouri. Have you ever noticed that coincidence, how many we have here. Mr. Hurst advocated the creation of a producer-investment tax credit for up to 50 percent of the producer investment. The tax credit would help level the playing field for producers as they compete in markets that have been traditionally consolidated into a handful of multinational corporations. In my meetings with agricultural leaders, I have shared this concept and the idea has been received with great interest and support. Of course, any attempt to work with tax code is always a complicated process, and understanding on the ground effectiveness of any tax incentive is crucial as legislation is developed.

I encourage the witnesses to provide the committee with their views on these and other legislative initiatives.

Over the last few months, I have had the opportunity to see firsthand the innovative entrepreneurial spirit that America's farmers and ranchers share. Their enthusiasm about the concept of value-added agriculture is overwhelming. I have become more convinced than ever that the future of rural America in our agricultural system is bright.

Missouri Soybean Merchandising Council research committee and soybean utilization researchers at the University of Missouri at Rolla, the MSMC, the sister organization to Brooks' group is the soybean checkoff board in Missouri. On behalf of soybean producers, the MSMC has made a major commitment to developing soy-based products to help increase the demand for soybeans. The researchers at UMR demonstrated numerous innovative technologies from which such products as plastics, composites, lubricants, and solvents have been synthesized from raw soybean materials.

Tom Green explained the vision of Missouri soybean farmers and the MSMC and how these new technologies could be best utilized by the producers of Missouri. You know, we are living through a crisis right now which could have been substantially alleviated had we been further along with these value-added soybean products because we have the opportunity through that kind of research, if applied properly, to create new kinds of products that will enable us to move away from our dependence on petroleum, which of course is hurting the country right now.

The opportunity I have had to work with the agricultural community on this issue of value-added agriculture has reaffirmed a core observation I made many years ago as I began working with farm organizations at the State level. There is great sense of pride

and satisfaction shared by the hardworking men and women who have chosen to provide the food and fiber for our Nation. Often, especially in years such as the past 2, these men and women work for the equivalent of less than $3 per hour in wages. Yet they remain engaged by the fact that they produce the safest, most abundant, and cheapest food supply our world has ever known.

I am glad the group such as the Farm Bureau who have been gracious enough to attend this hearing as part of the annual president's D.C. Trip take the time to come to Washington to remind me and my colleagues that the future of agriculture in rural America is safely in the hands of the family farmers who shed their blood, sweat, and tears in the pursuit of feeding the world. I believe these family farmers who are often second, third, fourth and even fifth generation on their farms deserve the opportunity to build a stronger tomorrow for themselves.

These tools for the future of value-added agriculture I am convinced are a positive step towards helping the family farmer regrow rural America.

When the Ranking Member comes, we will defer to her for any comments she may wish to put in the record, and I will without objection keep the record open for any opening statements that other Members may wish to submit. We will, however, go right to the witness panel and Members will be coming in as you all are testifying.

First, I would like to recognize for his testimony Charles Kruse, the President of the Missouri Farm Bureau Federation, and I am grateful to all the witnesses for being here today. Charlie, please give us your testimony.

STATEMENT OF CHARLES KRUSE, PRESIDENT, MISSOURI FARM BUREAU FEDERATION

Mr. KRUSE. Thank you, Mr. Chairman. As you mentioned in your comments, we have a large number of Missouri Farm Bureau people here this week, about 115, and several of them are here for the hearing today; and on behalf of all our Missouri Farm Bureau people, I want to thank you for having this hearing. And I also want to thank you for the emphasis you have placed as chairman of the Small Business Committee on agriculture.

My name is Charles Kruse, and I am a fourth generation farmer from Stoddard County. My wife Pam and I raise corn, soybeans, and cotton on our farm. I also serve as President of Missouri Farm Bureau, the State's largest general farm organization.

It is indeed a pleasure to appear before this committee and share the views of Missouri Farm Bureau members on opportunities for adding value to U.S. agricultural products. I commend you, Mr. Chairman, for your continued interest in this issue and determination to address the hurdles farmers face as they attempt to capture a larger percentage of the consumer's food dollar. We appreciate your leadership and stand ready to assist this committee in whatever way possible.

Last September, as you mentioned, I was invited to share some general thoughts relative to value-added agriculture and the outlook for new generation cooperatives. Today almost 6 months later, I am pleased to report both growing interest and knowledge in

value-added opportunities. Yet the problems plaguing U.S. farmers and ranchers have changed very little.

In Missouri, spring crops have not even been planted, but many economists project another year of commodity prices that are far below the cost of production. Agricultural exports are expected to grow only marginally this year, and now farmers have to deal with skyrocketing fuel costs and rising interest rates. These factors coupled with the growing regulatory burden and continued consolidation pose serious threats to the future of many family farms. According to the U.S. Department of Agriculture, 14 percent of our Nation's farmers are expected to experience debt repayment problems this year.

Enhanced demand for agricultural products is the key to our future success. Overseas, it is important that Congress approve permanent normal trade relations status for China and pave the way for implementation of the U.S.-China bilateral trade agreement. Also, we remain hopeful that agricultural negotiations within the World Trade Organization will move forward in upcoming months.

Domestically, while rising fuel costs are a tremendous problem, they have also generated renewed interest in alternative fuel sources. We welcome the interest in renewable fuels such as ethanol and bio-diesel. Farmers and consumers alike will benefit from a national commitment to expand the research of development of bio-based fuel technologies. We are pleased that the administration recognized the potential benefits of bio-based fuels in its proposed FY 2001 budget. Many farmers believe strongly in the concept of value-added products but are unsure how to turn their interest into action. The learning curve is steep but climbable.

It is the financial requirements that can be insurmountable. For this reason, we support legislation developed by Chairman Talent and Congressman Thune that would authorize a Federal tax credit for producers investing in value-added endeavors. A Federal tax credit would be an important tool for farmers and their lenders. Given the weakness of the U.S. farm economy, we have heard all too often that a producer lacks the capital to join a cooperative and the family's lender is wary of additional exposure. State and/or Federal tax credits can help bridge this gap.

In addition, we support legislation introduced by you, Mr. Chairman and Congressman Thune, that authorizes centers to provide producers with much needed technical assistance related to value-added ventures. Access to information relative to engineering, legal services, business planning, and market development via these one-stop shops is absolutely critical if these cooperative ventures are to succeed. We applaud the bill's focus on competitively awarded State projects and believe the grants could be extremely helpful to farmers throughout the United States.

Finally, we commend the sponsors for including a provision authorizing $300,000 per year to develop the quantitative tools necessary to evaluate the impact of these centers on local economies.

Last year, Missouri Farm Bureau conducted a series of regional meetings to ask our members what we should be doing to help restore long-term profitability. More farm program assistance was not the sole answer. We learned that farmers want to learn more about forming cooperatives, becoming price makers rather than

price takers. Today, farmers are looking beyond market trends and focusing instead on the creation of entirely new markets for their processed products.

During the meetings, we surfaced a number of ideas that warrant further consideration, including: The development of educational programs for producers interested in forming new generation cooperatives and directors of new generation cooperatives; the ability for new generation cooperatives to solicit outside equity from investors who are not required to commit agricultural products and do not have voting privileges; and also access to additional State or Federal funds for initial marketing assistance; and finally reducing the regulatory burden and expense associated with forming new generation cooperatives, especially those that include more than one State. For example, and Mr. Chairman, I think you are aware of this, a newly formed pork processing cooperative in Missouri has already spent $15,000 to comply with Securities and Exchange Commission requirements.

In closing, let me just say it is important that you know that Farm Bureau does not blame the woes of the U.S. farm economy on the 1996 farm bill or any other single factor. Likewise there is no simple solution to our problems. We now have freedom to farm. We must focus on improving our ability to have freedom to market.

Thank you, Mr. Chairman. I appreciate the opportunity to testify.

Chairman TALENT. Thank you, Charlie. I have a list of value-added start-ups in Missouri, some of which have already broken ground, others of which are in the exploratory stage, and without objection I will have that put into the record.

[Mr. Kruse's statement may be found in appendix:]

Chairman TALENT. Our next witness is J. Gary McDavid, and Gary McDavid joins us today representing the National Council of Farmer Cooperatives. Gary is the chair of the legal, tax and accounting subcommittee on tax legislation of the NCFC.

STATEMENT OF J. GARY McDAVID, ESQ., CHAIR, LEGAL, TAX & ACCOUNTING SUBCOMMITTEE ON TAX LEGISLATION, NATIONAL COUNCIL OF FARMER COOPERATIVES

Mr. MCDAVID. Thank you, Mr. Chairman, other Members of the Committee. On behalf of America's farmer cooperatives and their nearly two million farmer owners, we want to take this opportunity to express our appreciation for the steps you are taking in bringing to the forefront the needs of rural America, especially with regard to the availability of technical assistance and tax incentives that will help farmers help themselves and the communities in which they live.

Additionally, we recognize and appreciate the efforts over the past 2 years by this Congress in approving much needed economic and disaster assistance in response to low commodity prices and adverse weather conditions in many parts of the country. For many farmers and ranchers, the emergency assistance has been the difference between survival and going out of business. However, it appears that given the current economic outlook, similar assistance may again be needed this year. Accordingly, we strongly support such action as may be necessary.

At the same time, we believe that it is critical that action be taken that will lead to a sustained long term economic recovery, improved farm income and risk management, increased market opportunities and growth in exports for U.S. agriculture. It is within this framework that current farm policies and related programs should be reviewed and evaluated, as well as strengthened.

Furthermore, we strongly recommend a number of additional actions that can and should be taken to address not only the near-term challenges facing U.S. agriculture, but also to achieve the long-term objectives outlined above. Critically important is strengthening the ability of farmers to join together in cooperative self-help efforts to improve their income, manage their risk, and compete more effectively in a rapidly changing global economy. A high priority should be given to ensuring that public policies and programs relating to agriculture are directed toward achieving this goal.

Federal programs relating to farmer cooperatives should be revitalized and funding for research, education, and technical assistance similar to the legislation resubmitted yesterday by Chairman Talent and Congressman John Thune from South Dakota. Other actions are needed to help farmers through cooperative efforts become more involved in value-added production, processing and marketing activities beyond the farm gate and to capitalize on new market opportunities. Not only would this help farmers capture a larger share of the consumer dollar, thereby strengthening their income and providing greater economic stability in the communities in which the farmers and cooperatives are located, it would also promote needed competition.

To achieve this, farmers and their cooperatives must have in place policies and programs, including adequate tax incentives, to help attract needed capital and investment. Equally important is the need to maintain access to a strong and competitive cooperative farm credit system. Current loan guarantee programs should be expanded to provide financing for both new as well as existing farmer cooperatives seeking to become more involved in value-added activities. Other initiatives also should be considered to further meet capital requirements.

On the issue of tax incentives that are very important to us, the National Council of Farmer Cooperatives supports and is working for the inclusion of H.R. 1914 into an upcoming tax bill. H.R. 1914 was included last year in the Tax Refund and Relief Act of 1999 that was vetoed by the President. H.R. 1914 would allow farmer cooperatives to bypass the dividend allocation rule, a regulatory rule which negatively impacts the amount of the patronage dividend deduction taken by a cooperative.

As cooperatives look to the 21st century, it is important for the industry to have the appropriate tools so it can continue to give value to its farmer owners. In today's world, businesses need to be adequately capitalized if they hope to remain competitive. Farmer cooperatives have a difficult time raising capital. The reason is that they generally only have two sources of capital, their farmer owners and borrowing from a lending institution. Farmer cooperatives do not raise capital from financial markets by issuing voting common stock because their members hold this stock.

However, farmer cooperatives are allowed to issue a class of nonvoting preferred stock that can be used to raise equity from sources other than farmer owners. When issuing a dividend-bearing class of nonvoting preferred stock on which dividends payment is made, a cooperative must now comply with the dividend allocation rule which has adverse tax effects on the cooperative and has been one reason why cooperatives today rely heavily on debt financing.

The effect of the dividend allocation rule is a third tax on this portion of the cooperative's income. The dividend allocation rule is technical in nature and is explained in our written testimony. NCFC has been working with Representative Bill Thomas in attempting to change this regulation. Congressman Thomas has introduced H.R. 1914 that, if enacted, would modify the dividend allocation rule.

The benefits of this legislation for cooperatives could be substantial. Among other things they could more easily raise capital from outside investors without giving up any ownership or control by the farmers who own the cooperative, could increase the amount of patronage earnings paid to farmer owners, create a class of nonvoting preferred stock that could be traded on capital markets thereby providing liquidity to cooperative interests, create a preferred-stock program for management and employees that would improve incentive programs, allow a cooperative to repurchase a departing member's interest for dividend paying stock rather than through debt. In a nutshell, this proposal would give farmers a useful tool when attempting to raise capital for their cooperatives.

For this reason, the National Council of Farmer Cooperatives supports and is working for the inclusion of H.R. 1914 into an upcoming tax bill, and we look forward to working with this Subcommittee and the Ways and Means Committee on this issue.

Mr. Chairman, we appreciate this opportunity to testify and look forward to taking your questions. Thank you very much.

Chairman TALENT. Thank you, Mr. McDavid. I guess that dividend allocation rule is a kind of triple taxation; isn't it when you work it all out?

Mr. MCDAVID. Yes, it is. It is very unfortunate.

[Mr. McDavid's statement may be found in appendix:]

Chairman TALENT. I will recognize the gentleman from South Dakota for the next introduction.

Mr. THUNE. Thank you, Mr. Chairman, for holding the hearing in the first place because I think this is a very timely hearing and for giving voice to this issue and shining a light on this issue because this is something that I believe really is about the future of agriculture, and we have had a good amount of success already in our State in the area of value-added enterprises. The legislation which you have taken leadership on and helped move forward here is critical in terms of what it can do to further bolster those efforts.

I am honored today to have a couple of gentlemen from my home State, first of which I will introduce right now, to testify on this issue. Rick Vallery is here today on behalf of South Dakota Wheat, Inc. He has also formerly farmed with his family in western South Dakota raising cattle and irrigated corn and alfalfa and wheat. In 1984 he went to work for the South Dakota Farm Bureau; and 3 years ago left the Farm Bureau to go to work for South Dakota Inc.

Rick is very knowledgeable regarding value-added agriculture, and I believe his testimony will be a great asset to the Committee as we begin to consider how we might expand opportunities for value-added endeavors.

So, Rick, thanks for coming; and with that we are happy to listen to what you have to say to us.

STATEMENT OF RICK VALLERY, EXECUTIVE DIRECTOR, SOUTH DAKOTA WHEAT, INC.

Mr. VALLERY. Thank you, Mr. Chairman and members of the Committee. My name is Rick Vallery. I am the executive director of the South Dakota Wheat, Incorporated which is a producer group located in Pierre, South Dakota. Currently, South Dakota, Incorporated is working on two valued-added projects, and we have two value-added projects that are kind of waiting in the wings. One project is a proposed flour mill that has a niche market. It is a very specialty-type flour, and so we are working on that.

Another project that we are just putting together and we are not sure how far we are going to get with it, but it is a Web site where you buy and sell commodities. We think we have some potential for that, and we are very interested in seeing how that may work out.

A year ago, the South Dakota legislature through the work of us and some others established a value-added subfund account of $3.4 million. This is a one-time fund. We only get it once. This account is designed to handle feasibility studies and/or marketing plans for value added, and that is all that it is to do. To date, there have been five projects that have been funded and approved for these moneys. Two of those studies are nearing completion. If either one of these studies become feasible or are proven to be feasible, then this legislation that Congressman Talent and Congressman Thune have proposed becomes very important.

Also around a year ago, South Dakota commodity organizations and interested businesses such as the association of co-ops and rural electric and rural water systems established a nonprofit organization with a board of directors, and this is their mission statement verbatim: To foster creation of producer-owned, value-added agriculture by offering technical and staff support and championing value-added agriculture publicly by educating producers, lenders and the public on value-added concepts.

So for the last couple of years, we have become very serious about value-added agriculture in South Dakota. There are two keys to a successful value-added project. One is organizational and the second is financial, but the key that brings it together, it is the finances during the organizational phase of start up that is needed most, and that is what the Talent-Thune bill does. It provides that organizational assistance in the legal, in the research, in the consulting, in the engineering, all areas that are extremely important once the feasibility marketing plan has been proven successful. It is the next step. It is a perfect fit.

During that organizational phase, you will have questions or producers will have questions that are asked and answered concerning about the legal structure of which entity should we be making, should it be an association, should it be a corporation, should it be a cooperative. If it is a cooperative, what kind of cooperative?

Should it be open, should it be closed, should it be a 521? All those decisions need to be done, and this allows for some financial assistance in the legal side of that.

Another scenario is if it is a cooperative, is it going to be in one more than one State. If it is in more than one State, then we have the securities we need to go through which is additional legal entity work which is important. It is very, very important.

Questions will be asked concerning the markets. Questions will be asked concerning the by-products of the entity that is being focused or the value-added product. Questions will be asked concerning real estate or building procedures or building structures. Location, all those things are handled through the engineering, through the infrastructure that is available in whatever State, and those are things that are covered in the proposed legislation.

The Talent-Thune bill offers you a niche in starting and organizing value-added agriculture. It is an extremely important opportunity to provide assistance in legal engineering and consulting aspects of value-added projects wherever they may be.

The second part of that, which is the tax credit portion, is a concept that is needed in the agricultural industry and would be welcome. We just view that from a producer's standpoint as just a wonderful opportunity to take advantage to provide that incentive to be a part of a value-added agriculture, and so we think both bills have tremendous value.

With that, that closes my testimony. Thank you for the opportunity and the time for allowing me to share my beliefs.

Chairman TALENT. Thank you, Rick. When we complete the testimony, we will have an opportunity for questions. I don't want our witnesses to think we don't have questions, but by and large, I restrain myself and wait until all the witnesses are done.

[Mr. Vallery's statement may be found in appendix:]

Chairman TALENT. Our next witness is Brooks Hurst. Brooks farms with his father and brothers in Missouri, in the far northwest corner of Missouri. So we have the southeast and the northwest of Missouri represented today. Brooks is vice president of the Missouri Soybean Association which has taken a strong lead in value-added agricultural development; and I should state, particularly given my comment before, that one of the reasons Mr. Thune and I got into this is that our two States, South Dakota and Missouri, while certainly not the only States to be active in value added, are two of the leaders and the ag leaders from our States really have probably as much experience that exists in the country in applying this concept. Mr. Hurst, please go ahead.

STATEMENT OF BROOKS HURST, VICE-PRESIDENT, MISSOURI SOYBEAN ASSOCIATION

Mr. HURST. Thank you, Chairman Talent. I would like to thank you and your fellow Committee Members for the opportunity to testify before you today. I would also like to thank you, Mr. Talent and Mr. Thune, for the introduction of the Value-Added Development Act.

My name is Brooks Hurst. I serve as vice president for the Missouri Soybean Association and farm with my two brothers and father in northwest Missouri raising soybeans and corn. Mr. Chair-

man, I have written testimony; but for the sake of time, I would just submit it for the official record.

You are all familiar with the tough times in the farm economy today; but as a farmer, I am inherently optimistic as I believe all farmers are. I believe the future of farming holds great opportunities and the technical assistance provided for in this act will allow farmers to capture these opportunities.

Some of the things, biotechnology will bring such as nutraceuticals are truly exciting. Currently, Monsanto has beta-carotene they can put into rice to provide vitamin A for third-world countries, and this is just the first of many new technologies that are going to allow niche marketing, and I believe that farmers will be able to capture some of these markets.

One of the future trends is identity preservation, and a system is needed to keep track of these different technologies and keep them in a separate pipeline. Northwest Missouri is starting a soybean processing plant right now, and we have got a farmer board that is just entering into discovery of business plans, and a technical assistance center such as proposed in this act would be very beneficial to building marketing plans, help with legal assistance, an engineering assistance.

Soybeans are processed into meal and oil. Soybean meal is primarily used for feed. The oil has many uses, such as bio-diesel that has been mentioned several times here today. We believe we have found a more efficient, smaller-scale process for separating the meal from oil in this small added-value processing plant that we are working on in northwest Missouri. If we can find an efficient, environmentally-friendly way that is just as cheap as the mass production processing plants that the current processing corporations use, then we have an opportunity to gain a huge market in identity-preserved soybeans. We can clean out this plant in less than a day and switch to a different variety of soybeans with different traits for different customers.

AGP has talked about identity-preserved soybeans and they said it would take them 2 days to shut down the plant and totally clean it out to run a different type of soybeans through. So we would have a great advantage as a small processing plant in this market. If we had one place to go for all the technical assistance, we would have an advantage in marketing these soybeans and getting the production process started.

We also need all kinds of technical assistance. For instance, we can also make plastic out of soybeans and if we can find a way to harden plastic in 2 hours instead of 3 days, it makes it a lot more viable opportunity for us.

Continuing on in the identity-preserved focus of things, there are several businesses in Missouri that sell directly to Japan. One of the things that Japan is really interested in is knowledge of where their food products come from. They like to know where it was raised and who raised it, and if we have a system set up providing information for these consumers, that will be a great benefit to Missouri and American farmers.

You know, I feel I am an expert in farming, and I know how to raise soybeans and corn, but I don't know how to set up a business structure. I don't know how to engineer a soybean processing plant,

and this act would lend great benefit to myself and fellow farmers when we start these value-added businesses. My father was on the founding board of an ethanol plant in northwest Missouri. He came home late many nights frustrated because he didn't have the expertise to start a business plan, and he didn't know where to go.

I don't know how many oil wells there are in Missouri, but I don't think there are a whole lot. Processing corn into ethanol is one way to get energy from a renewable, environmentally-friendly source. Soy-diesel is another, and I feel farmers will benefit greatly from these opportunities.

Touching on the tax credits, I think that that is a vital instrument. Other businesses have received them, and it is a vital interest and levels the playing field with large corporations so the small farmer can capture these added values and maintain a viable business.

I would like to thank you for the opportunity to testify once again, and if there are any questions afterwards, I would be happy to answer them.

Chairman TALENT. Thank you, Brooks.

[Mr. Hurst's statement may be found in appendix:]

Chairman TALENT. I will recognize again the gentleman from South Dakota for another introduction.

Mr. THUNE. Thank you, Mr. Chairman. The other witness from South Dakota, another friend of mine, is John Haverhals; and I want to thank him for appearing before the committee today as well. John is the past-president of the South Dakota Cattlemen's Association and is currently a director on the South Dakota Beef Industry Council's board. John and his family also run a cattle feedlot there in Hudson, South Dakota; and as a cattle producer and partner in a value-added agricultural business, John knows his subject inside and out. I very much look forward to his testimony here today. So John please share with us your thoughts on value-added agriculture.

STATEMENT OF JOHN HAVERHALS, FORMER PRESIDENT, SOUTH DAKOTA CATTLEMEN'S ASSOCIATION

Mr. HAVERHALS. Thank you, Mr. Chairman, and thanks to the Members of the Committee for the opportunity to testify.

My name is John Haverhals. I am from Hudson, South Dakota, and we do have a cattle feedlot. So the entire time that I have been in beef production, I guess I have always been involved with value added as we took feed stuffs and processed them through the live animals and created protein meats. So from the day I started as a young child feeding cattle, I think I have always been involved.

I want to relate a story that I have with starting our business that we started 7 months ago. It is in Overland Park, Kansas. It is a gourmet meat store where we sell some of our meat through that process. The biggest opportunity that comes along with that, instead of receiving a dollar eight or a dollar fourteen that I would receive from a traditional harvesting facility, I am now selling product at $19 a pound. With that dramatizes the value that can be captured by creating these entities. That also is a stimulus for others to want to enter into these things.

As the testimony that was given prior to me, many things have been said of what helps and doesn't and what is needed so I am not going to reiterate that; but I can truly say as a person who has just started this process 7 months ago, there isn't a single item in your legislation that I couldn't have used dramatically. And when it comes to the tax credit, that is also a major part of not entering into these things. We had several people that did not enter into our joint agreement because of the capital outlay. Right now, the capital outlay I have in our store, it is on our balance sheet; but it is a nonrenewable asset because we won't receive a return on our investment for 3 or 4 years. I can't use it as a tax break, and it is not being used in my general business. So I have taken capital from my general business and moved it over into this new venture, which actually is a deterrent to my income in the short term. Long term it will be of benefit.

In summary, these pieces of legislation are a win-win for those involved. Farmers and ranchers will have the opportunity to become more profitable through the development of new and existing products. The communities in which they live will benefit from their success. The economy will see enhanced competition; and in the end, the consumer will enjoy a larger variety of products from which to choose. For these reasons, I ask you to continue to work on the legislation, and I thank you for the opportunity to testify.

Chairman TALENT. Thank you, John.

[Mr. Haverhals' statement may be found in appendix:]

Chairman TALENT. It is a pleasure now to introduce Gerald Tumbleson, who is the past president of the Minnesota Corn Growers. And let me just say that I think we have on this panel three States' representatives who have been the lead in value-added enterprises. And not to spark a competition, but Minnesota may be at the forefront. And I am a big believer that when you have a working model some place you try and duplicate it rather than reinvent the wheel. So Gerald, please tell us how you are doing it in Minnesota and thank you for coming.

STATEMENT OF GERALD TUMBLESON, PAST-PRESIDENT, MINNESOTA CORN GROWERS ASSOCIATION

Mr. TUMBLESON. Thank you, Mr. Talent and also Mr. Thune for inviting us here. It is quite an honor for us to come off the farm out there and come in here and speak with you today. Not only being with the Minnesota Corn Growers, I am on the board of the National Corn Growers. And Minnesota does have a lot of ethanol plants as we go through this; but as we see it happening, you sometimes think of it as a farmer-owned thing and farmer controlled.

I am going to not follow my script—you will be able to read that—because some of the things have been repeated, and we don't have to go through those again. But first of all, I want to thank you for the foresight of coming along with this bill and the bill for the tax credit at this time. It is so amazing that it happens to be surfacing now.

I remember great grandfather who was a farmer, what he did is he took horsepower which was four legged at that time. He put a seed in the ground; he let it grow; he nourished it. And he har-

vested it, and he sold it. You know what I am doing today? I am putting a seed in the ground with horsepower. It might be on rubber tires or something. I nourish it, and I sell it.

And as I look across the United States and in the world, I see every business has made a drastic change. And here I am farming similar to what my great grandfather did. And I am thinking, why are we doing that? Why hasn't agriculture today taken the technology and the things and moved into a different direction? If you think about the technology in agriculture over the last 10 years, starting 10 years ago and where it is today, we have started that. There is IP grains, the identity-preserved grains. There is other forms of things that we are putting together.

And as we do that in Minnesota, we have some 30 farmer-owned cooperatives or venture-together cooperatives up there, and we are working very hard on that. But it is amazing as you get farmers together the way you have to do it; you need to join in an alliance. Now there is a 21st century alliance that many of you are familiar with from down in Kansas. There is an alliance in Illinois. Minnesota has not had an organized alliance in the past. We had farmers get together. Now we are organizing an alliance called Farm Connect in Minnesota. We are going in there where farmers can put in $500 to join this alliance, and every year they add another hundred dollars for membership.

What it does, it puts farmers together. If you get 1,000 farmers together and now you want to do some processing or something, or value-added thing, you send a letter out to all of them and say would you like to invest into this or would you like to get more information. The ones that want it write back. Now, you might only have a hundred of them or 200 of them, but you have the organization that puts it together.

From then on what your bill does—and I commend you wholeheartedly for this bill, like I say it is prime time, it is perfect. What we can do is now we can get money to go out and find out where we have to go. The feasibility studies, as farmers, as was mentioned before, we don't have the expertise. So why do we have to be stubborn farmers like we have been all our life? Why can't we say let us hire that expertise? Let us join together and do this, and that we can do in these organizations that get together.

We have corn-processing plants in Minnesota. Somebody said, well, why do you need more if you have the processing plant. The processing plants today are basically working with starch. We have protein; we have oil; we have fiber. We are going to take that all out of the kernel before it goes into the starch processing. Okay. Now, look at where we can go, where we can go with those processing plants in the next step if we have the Farm Connect working together so that we can go out and do that.

And what happened is agriculture is really in a pretty tough time. As you know, the prices are down; and we don't have a lot of money. But there is other things going on here in Congress, and I appreciate what you are doing. And like crop insurance, income protection, it is not a profit thing out there, but it is a protection. What that does is frees up a little money. I don't have a reserve in a back pocket in a savings account in case I have a bad year to keep farming. That frees that up. Now, look at what the farmer

can do with that money. Now it opens up. He has a little cash. He joins—if he has 50,000 or a hundred thousand, joins with a hundred other farmers, then you are talking millions. Then you go to the banker with three or four million and you leverage that three to one, you are six to eight. Now we can move and with your bill so that we can get the expertise and work in that direction—besides your tax bill, that is gravy on top of this. If you can get that done, invite me back; I will fight for you on that one, too.

As you do this, think of where we can go out there. This is not just farmers. I have implement dealers, I have hardware store owners, I have grain builders in my area that are really hurting because we don't make enough money. This opens it up and makes rural United States prosperous. Now we are not here just as farmers. I am not here just as farmers because those friends go to church with me. They have kids in school with my kids. That is very important, and what you are doing under this thing is you are opening up rural development even though it looks like it is farmer-owned value added. It is rural development when you think about what it does, and I am going to quit now because I think we have everything wide open for us, but I am so excited that you have come with these pills at this time. If you need help, call.

Thank you for this opportunity.

[Mr. Tumbleson's statement may be found in appendix:]

Chairman TALENT. I appreciate that, Mr. Tumbleson, and you said, I think, better than John and I have said it so far. And I am grateful for your passion on behalf of this.

In fact, it leads into my first question because I was going to ask Charlie, you were talking about the impact even beyond producers. Charlie, I know that there are three value-added enterprises under consideration just in southeast Missouri, and maybe you would talk a little bit about them. And I wanted to ask you the impact they would have on the economy in general, in Stoddard County and in southeast Missouri if we can get these up and running. Maybe you can follow up on what Mr. Tumbleson was saying.

Mr. KRUSE. Yes, sir. I think Brooks Hurst made a good point a while ago when he said we know how to farm, but we don't necessarily know all the things we need to know in order to get involved in some of these value-added enterprises. I think one of the most exciting things we have going on in southeast Missouri is we have a group of rice farmers that have joined together and they have found that there is a real demand from the country of Turkey for a medium-grained rice.

We had never grown this rice. In fact, it has never been grown anywhere in the United States until this past year. And they sold every bit of the rice they produced, and the government or the company in Turkey that they worked with has come back to them and told them that they want to buy a whole lot more rice next year than they had this year. And I think this is exactly the kind of thing we are talking about. Farmers coming together, finding a new market or finding a new niche, if you will, for something that we produce, adding value to it, and whether we are talking about livestock, whether we are talking about any of the other issues that have been talked about here today, I think it is absolutely essential that we do this.

And then I think, Mr. Chairman, as you pointed out, not only are we going to help farmers, we are going to help the agricultural economy and we are going to help everybody from implement dealers to automobile dealers to everybody on main street in all the communities in rural America. When agriculture is thriving, our economy thrives in rural America.

Chairman TALENT. Thank you, Charlie. You talked about niche marketing, and one of the reasons I wanted to do this and do this in this committee is we have seen in this committee in other contexts how this kind of technical assistance helps people, entrepreneurs in particular get going. And for a very, very small amount of money up front, you produce an awful lot of economic activity.

Now you mentioned niche marketing, we have something in the St. Louis area called produce row, which is a row of fruit distributors, and I go down and talk to them. They are very in touch with where consumers are coming from. People in terms of the domestic market are more and more interested in certain kinds, I don't want to call them exotics, but food-specialty items; and it is the small producers who are in a position to understand that market and react quickly to it and get way out ahead.

John, you were mentioning the beef, what you are doing in terms of gourmet beef, and you get $19 a pound for that as opposed to a dollar a pound, right? It is really out there to do and it is the small value-added enterprises who can react quickly and create IPB products. It is a classic example of that.

Let me see if I had any other questions. Okay. Rick, you mentioned a $3 million program that South Dakota has for feasibility studies. Is that a grant program?

Mr. VALLERY. It can be a grant, or it can be a loan program. It is based on the profitability of the project. If the project goes through, it can be called in as a loan. If the project does not go through, then it will be considered a grant.

Chairman TALENT. We may want to talk with you more about that because we are pushing this tax credit legislation, and the problem is complicated when you create tax credits. I mean, can they be sold? Who exactly can qualify for them? You know, all that sort of stuff and I think we will figure all that out, but we have to be open to all different kinds of ways of getting extra financing because the tax credit is complicated. And believe me the Ways and Means people can come up with all kinds of questions when you take a bill over to them.

Here is another example, if any of you want to comment on this, in terms of applied research, as we develop for example new value-added soybean products. I saw at University of Missouri at Rolla, the kinds of products that are being developed and a small-value added enterprise can take that and market it much more quickly than a larger, huge corporate outfit can.

Any of you want to comment on that? Brooks, you want to make a comment on that?

Mr. HURST. Sure. Yes, they can move into the market a lot quicker; and I would just like to go back and address the economic impact on the communities a little bit, too. The town that the ethanol plant is going into is small. The plant is going to hire 22 people and that is a 15 percent increase in the population of the town,

which is a big impact on the economy. And the surrounding communities will be greatly impacted, too; and so any of these small value-added processing plants increase the tax base and the population—around the turn of the century the population in our county was about twice what it is now which is 7,000 people. So we need jobs in rural America. The farm economy is the only economy in our county, and so any value-added processing plant that we can bring into that town would be a great benefit.

Dr. Virgil Flanagan in the University of Missouri at Rolla has done a tremendous amount of work with soybean products and processes. And the possibilities are limitless. Some of them are, as you mentioned getting brought to market quicker, and some of them are going to be very hot commodities and will be produced rapidly and have a huge market in a short time.

Chairman TALENT. The only other comment I want to make before I recognize Mr. Thune is dealing with the issue of costs, and we are talking about legislation which will cost in the millions of dollars. Certainly our VETA bill costs that much. We are fixing out the tax credit right now.

Well this year, we are considering another safety net bill which I will fully support on the order of six or seven billion dollars or more. When you consider that for an up-front investment in the order of tens of millions of dollars, we may empower producers to diversify and get into value added so the next cycle of low-commodity prices—I mean if that cuts in half, which is probably conservative, the amount of the safety net bills we are going to have to pass then, you see the difference in terms of savings for the tax payers. You all can comment on this if you want to, but not doing this now would be a classic case of being pennywise and pound foolish and we are emphasizing that. And I would encourage you all and the other commodity groups to emphasize that as you talk to your congressmen about the bill.

I am happy now to recognize my friend and cosponsor of the legislation Mr. Thune.

Mr. THUNE. Thank you, Mr. Chairman. And if I might just note a couple of observations. One being which I think some of the panelists noted and that is a—I have a tendency and this is kind of the crossroads of agriculture and small business, and I appreciate again the leadership that you have taken. I hope we can generate interest on the ag committee in this because I have a tendency to look at a lot of these issues in terms of the impact it will have on individual producers and what a great benefit that will be. But the bigger picture is as well is how do we preserve the rural economy.

In my State we are talking about a lot of small businesses, a lot of small main streets and downtown areas that are dying slowly and don't know what to do. And this is a perfect opportunity not only to improve the bottom line for our producers but also to provide some improvements in downtown main streets, and like all the ancillary businesses that you mentioned that also benefit from this. And I think that is really important when we talk about it, that is—you know, I think that is an aspect we need to keep in mind.

And the second observation would be as you just noted, it is really important, I think, for the producer organizations who are represented here today as well as others to get out and do the grass-

roots and start, I think, raising this issue, raising the awareness level, the education level that is out there because it is going to be critical for us to move this forward.

The Chairman mentioned, we are dealing with Ways and Means on tax issues. There is no easy feat. We have got our work cut out for us. I think this is the right approach in my opinion, and I credit everybody at the table today for efforts that have already been made that are underway and want to encourage you to continue that, but I think we need to be looking at ways we can partner and provide the incentives to take this further down the track.

It seems to me that the operative state of agriculture today, if you look at it at least in the last couple of years is we lose a little bit on each sale, but we make up for it in volume. You can only do that for so long before you end up in the red, and part of the problem is—is again we have become very efficient on the production side of it. We are producing wonderfully. We have got great efficiencies and great technology that is serving us extremely well, but the other side of the issue is we have got to open markets.

I think part of the solution to the whole crisis we are facing in agriculture today is markets, and it is trade. It is risk management. It is crop insurance, and other things that we are working on here. And as you mentioned, Mr. Chairman, the House budget which we will adopt, hopefully, sometime next week will include emergency provisions to provide again assistance this year to address the ongoing cycle of low prices.

But this is such an important, I think, component part of the solution; and I appreciate again those who have testified today and think that it is important that we continue to highlight not just the impact on individual producers as important as that is but also how important this is to rural economies. And our State is a perfect case in point.

A couple of questions I might ask, I guess; and Rick, you had mentioned that South Dakota Wheat is working on two value-added projects today and has two more in the wings. Could you elaborate a little bit briefly on what those projects entail?

Mr. VALLERY. Certainly. Project one is a $50,000 feasibility study for a specialty flour mill. We are also—I call it specialty. Identity-preserved, it is the same type of thing. Major problems that we are facing are infrastructure, transportation to the markets. When you are working with value added from South Dakota—and this is a South Dakota issue, we know that, it has usually been told to the producers that it is cheaper to ship the commodity than to ship the finished product.

Well, how do we know that? We are being told that. How do we know that? Part of the $50,000 was a $10,000 transportation study which has not been completed but has found a couple of switches, which is railway terms, where we basically can ship the finished product cheaper than the raw product. But without the $10,000, we would have never known that; and we still might not be successful. But at least we have an opportunity to continue to look into that area and maybe be successful.

The second project we have is an interesting concept. It is basically putting together the commodity groups and selling commodities via the Web site. The idea is to post on a Web site a com-

modity that a farmer-producer has tested. For the soybeans, it will be tested for certain oil; or for wheat, it will be tested for protein or test weight of the wheat or possibly flour millability characteristics or dough characteristics for the bakers or ash content. For sunflower, it will be oil. For corn, it will be starch or whatever. Those will be tested—and might be a white corn let us put that in there. Those will be tested by the producer themselves and then will be put on a Web site for purchasers to surf.

If they find something they like, they can then go to that purchaser. It is simply a clearinghouse idea. It is in the very conceptional stages. We are not exactly sure where this is going to go, but it is a good idea. It is something that has not been done. I shouldn't say has not been done. I just read just the other day there is a Web site that is trying to do very similar to us called CyberCrop, but this is going to be tried to be producer owned and producer driven.

Those are the two we are working on right now. We have had some discussions about wheat straw boards. That has been ongoing. We have had some things that haven't quite worked, and so those are kind of waiting in the wings.

I would like to add one thing that is so important with the assistance that this bill provides. For every co-op or project—value-added project that fails, whether it is because of funding or legal or market or whatever, you create yourself a higher hill to sell the next project. And it is so important to keep that hill low so that the next project has a good opportunity as well, no matter what the commodity or what the crop.

Mr. THUNE. I guess I think the thing—you do have to keep in mind is we are not going to hit pay dirt on every one of these deals, but to me this is sort of—the legislation that we have proposed in many respects is like a kind of R&D fund. You know, if you don't do research and development you are not going to find those little gems out there that are really going to make it big, and I think that providing the technical assistance and expertise that is necessary to at least get this process underway and develop a system where you can gauge and measure whether or not a project is going to be successful is really important. And so I think this again is the right approach.

I also believe that, you know, ultimately long term some things that we did last week on the bill that we passed, the tax relief deductibility of health insurance premiums, relief on the death tax, expensing provisions increased. Farmers and ranchers are small businesses. Those are things that are going to be critical, I think, in terms of lessening the load that you all carry; but I am delighted that we were able to at least begin the process here in hopefully filling in the blanks in terms of the value-added concept because the concept is one that needs to be fleshed out. I think the timing is right.

And one of the other issues that I would say I know is a concern in our State has to deal with the whole issue of concentration. In fact, we are going to be introducing legislation here soon. We are in the process of drafting a bill which will address concentration in the ag industry, and I would just direct this question to John—Mr. Haverhals.

You indicated at the end of your testimony that value-added projects can enhance competition. And with the, you know, stepped up level of concentration mergers and large agri-business firms within the ag sector being a serious concern to producers, do you think that development of value-added endeavors can aid producers as they try to compete in what has become an increasingly vertically-integrated industry?

Mr. HAVERHALS. Absolutely. As you have the more opportunities to select where you are going to sell your products, you can move away from your traditional three or four markets as we have in beef today. So as I produce animals, whether I buy them in South Dakota or Missouri, as I buy those animals and feed them, I can target them to the different markets. Some of them are now targeted to go to our own store. But with that comes great rewards, and I wholeheartedly think it would defer concentration.

One comment I would like to make, if I may, Congressman, is as we go and build all these value-added processing for corn and soybeans and wheat, and et cetera, never forget to create co-companion products. And at our feedyard today, we feed—60 percent of our ration is coproducts for food processing, ethanol plants, et cetera. One of the greatest harvesters of those co-products is the ruminate animal which is a beef animal or a sheep. So never forget about the beef animal and its integral part of completing the cycle as we reprocess and recycle those products back.

Mr. THUNE. I have a feeling if I ever forget you will let me know about it, John. So, Mr. Chairman, I can keep asking questions but I yield back.

Chairman TALENT. Your addressing the concentration issue which was the only other point that I wanted to make; that this was a way of dealing with the concentration of mergers of large agri-business firms that I think concern all of us in the agricultural sector and allows producers to participate and concentrate upwards instead of having it always come back down to them.

Mr. Tumbleson, I thought your comments were maybe an appropriate way to conclude about how everything has changed and agriculture needs to change as well. It isn't good enough anymore just to be a better and better producer. You have to be a better and better businessperson at the same time. Do you want to comment on that?

Mr. TUMBLESON. That is very true. Thank you, Chairman. The thing I want to stress as we look into that is many people don't realize that if you have to have vision, and farmers sometimes get caught without vision because they aren't making enough money, but we know the carbohydrate ion is going to overtake the hydrocarbon ion in the future. The hydrocarbon ion being the petroleum ion and the carbohydrate ion being the renewable ion that is degradable. We know it is going to happen, and with your concentration issue here, if we can get ahead of that step in farmer owned, not totally owned, maybe assisted owned into part of this, do you realize what—I am going to die. You are going to die. Everybody is going to die, but my love for agriculture is too great to have agriculture die.

If we can get this value added bringing some of that profit back to our future generations through that carbohydrate ion which we

can through value added, we will be in a position in time, as it replaces the hydrocarbon ion, to have a solid footing. And I am really excited that we can do it, and these bills you have are going to push us toward that. And we in Minnesota are working very hard at that, and there are other States, you talk about Missourians and South Dakota. I have a State right south of me in Iowa going strong at it, and we will move across the country with this concept with your help. And I want to thank you very much.

Mr. THUNE. Would you move across the country and move to South Dakota? We would like that, too.

Chairman TALENT. I want to thank all the witnesses. Let me close by saying that there is something here which I have heard described as the 7-year rule which means that once a good idea is introduced and floated, it takes 7 years for it to sink into the consciousness of Congress enough to pass. And John and I are hoping to shorten that to 1 year and get it done this year; and in order to do that, we really need the help of producer groups.

We have had very good conversations with some of John's colleagues on the agriculture Committee, and we can catalyze this whole process if when there are hearings there on the general situation, make sure that your witnesses testify in favor of these kinds of value-added ag innovation centers and the tax credit and be sure and talk to your Members of Congress about it. We are really counting on you. We will do our share up here, but we need your help.

With that without objection I will leave the records open for 5 days for any further questions that Members may wish to submit; and with that, adjourn the hearing. Thank you all.

[Whereupon, at 3:25 p.m., the committee was adjourned.]

JAMES M. TALENT, MISSOURI
CHAIRMAN

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"Helping Agricultural Producers "Re-Grow" Rural America Providing the Tools"

March 15, 2000

Opening Statement of Chairman Jim Talent

I would like to welcome the participants here today for the House Committee on Small Business hearing titled: Helping Agricultural Producers "Re-Grow" Rural America: Providing the Tools. Last September the Small Business Committee held the first "Helping Agriculture Producers Re-Grow Rural America" hearing which focused on the current crisis in the agricultural community, what could be done to lift rural America out of recession, and how agriculture could prepare itself to weather any future down turn in prices and production conditions. The agricultural leaders at that hearing painted a clear picture of the need and desire of producers to become the vertical integrators—capturing more of the consumer dollar by adding value to their commodities. I continue to be impressed by those in the agriculture community who during these darker times for producers, are still optimistic for the future. I am pleased their entrepreneurial fire continues to burn.

Agricultural leaders at September's hearing described the current value-added movement in agriculture, and prescribed various policy recommendations to the Committee that could be accomplished to help the hard working, visionary producers in their efforts to build a stronger agricultural economy as well as a stronger rural economic base. Charlie Kruse suggested "one-stop-shops" be established to provide the necessary business, marketing, engineering, and legal expertise to assist producers as they move to establish their own processing and manufacturing facilities. Every agricultural organization represented at the hearing echoed Charlie's recommendations. Charlie, I assure you that your voice was heard. John Thune and I, with the help and expertise of the agriculture community, introduced the Value-added Agriculture Development Act for American Agriculture. This legislation would create "Agriculture Innovation Centers," that would provide the business, marketing, engineering, and legal assistance needed to begin a producer driven value-added revolution in agriculture.

The Committee heard additional recommendations for specific policy "tools" that could be provided to assist this movement. Dale Ludwig, the Executive Director of the Missouri Soybean Association, which Brooks Hurst is representing today, advocated the creation of a producer investment tax credit for up to 50% of the producer investment. The tax credit would help "level the playing field" for producers as they compete in markets that have been traditionally consolidated into a handful of multi-national corporations. In my meetings with agricultural leaders, I have shared this concept, and the idea has been received with great interest and support. Of course, any attempt to work with the tax code is always a complicated process, and understanding the "on the ground" effectiveness of any tax incentive is crucial as legislation is developed. Each of these witnesses and their organizations has played an integral role in the development of the "Value-Added Agriculture Development Act for American Agriculture" and research is underway to develop an effective tax credit to compliment this legislation and create a comprehensive value-added package for producers. I encourage the witnesses to provide the Committee with their views on these and other legislative initiatives.

Over the last few months I have had the opportunity to see first hand the innovative entrepreneurial spirit that America's farmers and ranchers share. Their enthusiasm about the concept of value-added agriculture is overwhelming. I have become more convinced that the future of rural America and our agricultural system is bright. Recently, I had the opportunity to join Tom Green, Chair of the Missouri Soybean Merchandising Council (MSMC), Research Committee, and soybean utilization researchers at the University of Missouri-Rolla (UMR). The MSMC—the sister organization to Brooks' group—is the soybean check-off board in Missouri. On behalf of soybean producers, the MSMC has made a major commitment to developing soy-based products to help increase the demand for soybeans. The researchers at UMR demonstrated numerous innovative technologies from which such products as plastics, composites, lubricants, and solvents have been synthesized from raw soybean materials. Tom Green explained the vision of Missouri soybean farmers and the MSMC, and how these new technologies could be best utilized by the producers of Missouri. Tom emphasized that these technologies represented significant opportunity as the next generation of value-added agriculture—where producers would have access to cutting edge processing and manufacturing technologies and put them to use in their own plants to manufacture high value products. Clearly, the opportunity for economic development and job creation, in our largely agricultural based rural economy is eminent as long as producers have the tools they need to allow their vision to become reality.

The opportunity that I have had to work with the agriculture community on this issue of value-added agriculture has reaffirmed a core observation I made many years ago when I began working with farm organizations at the state level—there is a great sense of pride and satisfaction shared by the hard working men and

women who have chosen to provide the food and fiber for our nation. Often, especially in years such as the past two, these men and women work for the equivalent of less than $3.00 per hour in wages, yet they remain engaged by the fact that they produce the safest, most abundant, and cheapest food supply our world has ever known. I am glad that groups such as the Missouri Farm Bureau, who have been gracious enough to attend this hearing as part of the annual Presidents DC Trip, take the time to come to Washington to remind me and my colleagues that the land, the future of agriculture, and rural America is safely in the hands of the family farmers who have shed blood, sweat, and tears in the pursuit of feeding our world. I believe that these family farmers, which are often second, third, fourth, and even fifth generation on their farms, deserve the opportunity to build a stronger tomorrow for themselves.

These "tools" for the future of value-added agriculture, I am convinced are a positive step towards helping the family farmer "Re-Grow Rural America.

Remarks of Missouri Farm Bureau President Charles E. Kruse
Before the US House of Representatives Committee on Small Business
March 15, 2000

My name is Charles E, Kruse and I am a fourth-generation farmer from Stoddard County, Missouri. My family and I raise corn, soybeans and cotton. I also serve as President of Missouri Farm Bureau, the state's largest general farm organization.

It is a pleasure to appear before this Committee and share the views of Missouri Farm Bureau members on opportunities for adding-value to US agricultural products. I commend Chairman Talent for his continued interest in this issue and determination to address the hurdles farmers face as they attempt to capture a larger percentage of the consumer food dollar. We appreciate your leadership and stand ready to assist this Committee in whatever way possible.

Last September, I was invited to share some general thoughts relative to value-added agriculture and the outlook for new generation cooperatives. Today, almost six months later, I am pleased to report both growing interest and knowledge in value-added opportunities. Yet, the problems plaguing US farmers and ranchers have changed little.

In Missouri, spring crops have not even been planted but many economists project another year of commodity prices that are far below the cost of production. Agricultural exports are expected to grow only marginally this year and now farmers have to deal with skyrocketing fuel costs and rising interest rates. These factors, coupled with a growing regulatory burden and continued consolidation, pose serious threats to the future of many family farms. According to the US Department of Agriculture, 14 percent of our nation's farmers are expected to experience debt repayment problems this year.

Enhanced demand for agricultural products is a key to our future success. Overseas, it is important Congress approve permanent Normal Trade Relations status for China and pave the way for implementation of the US-China bilateral trade agreement. Also, we remain hopeful that agricultural negotiations within the World Trade Organization will move forward in upcoming months.

Domestically, while rising fuel costs are a tremendous problem they have also generated renewed interest in alternative fuel sources. We welcome the interest in renewable fuels such as ethanol and bio-diesel. Farmers and consumers alike will benefit from a national commitment to expand the research of development of bio-based fuel technologies. We are pleased the Administration recognized the potential benefits of bio-based fuels in its proposed FY 2001 budget.

Many farmers believe strongly in the concept of value-added products but are unsure how to turn their interest to action. The learning curve is steep but climbable. It is the financial requirements that can be insurmountable. For this reason, we support legislation developed by Chairman Talent and Congressman Thune that would authorize a federal tax credit for producers investing in value-added endeavors. A federal tax credit would be an important tool for farmers and their lenders. Given the weakness of the US farm economy, we have heard all too often that a producer lacks the capital to join a cooperative and the family's lender is wary of additional exposure. State and/or federal tax credits can help bridge this gap.

In addition, we support legislation introduced by Chairman Talent and Congressman Thune that authorizes Centers to provide producers with much-needed technical assistance related to value-added ventures. Access to information relative to engineering, legal services, business planning and market development via these "one-stop shops" is absolutely critical if these cooperative ventures are to succeed. We applaud the bill's focus on competitively awarded state projects and believe the grants could be extremely helpful to farmers throughout the US. Finally, we commend the sponsors for including a provision authorizing $300,000 per year to develop the quantitative tools necessary to evaluate the impacts of these centers on local economies.

Last year, Missouri Farm Bureau conducted a series of regional meetings to ask our members what we should be doing to help restore long-term profitability. More farm program assistance was not the answer. We learned that farmers want to learn more about forming cooperatives, becoming price makers rather than price takers. Today, farmers are looking beyond market trends and focusing instead on the creation of entirely new markets for their processed products.

During the meetings we surfaced a number of ideas that warrant further consideration, including:

- The development of educational programs for: 1) producers interested in forming new generation cooperatives and 2) directors of new generation cooperatives.

- The ability for new generation cooperatives to solicit "outside" equity from investors who are not required to commit agricultural products and do not have voting privileges.

- Access to additional state or federal funds for initial marketing assistance.

- Reducing the regulatory burden and expense associated with forming new generation cooperatives, especially those that include more than one state. For example, a newly formed pork-processing cooperative in Missouri has already

spent $15,000 to comply with Securities and Exchange Commission requirements.

In closing, it is important you know that Farm Bureau does not blame the woes of the US farm economy on the 1996 farm bill or any other single factor. Likewise, there is no simple solution to our problems. We now have freedom to farm. We must focus on improving our ability to market.

Statement of the National Council of Farmer Cooperatives

Testimony Submitted to the U.S. House of Representatives Small Business Committee

"Helping Agricultural Producers 'Re-Grow' Rural America":
Providing the Tools

Wednesday, March 15, 2000

On behalf of America's farmer cooperatives and their nearly 2 million farmer owners, we want to take this opportunity to express our appreciation for the steps this Committee is taking in bringing to the forefront the discussion on the needs of rural America, especially with regard to the availability of technical assistance and tax incentives that will help farmers help themselves and the communities in which they live.

Additionally, we recognize and appreciate the efforts over the past two years by this Congress in approving much needed economic and disaster assistance in response to low commodity prices and adverse weather conditions in many parts of the country. For many farmers and ranchers, the emergency assistance has been the difference between survival and going out of business. However, it appears that given the current economic outlook, similar assistance may again be needed this year. Accordingly, we strongly support such action as may be necessary.

At the same time, we believe it is critical that action be taken that will lead to long-term sustained economic recovery, improved farm income and risk management, increased market opportunities, and growth in exports for U.S. agriculture. It is within this framework that current farm policies and related programs should be reviewed and evaluated, as well as strengthened.

We also strongly recommend a number of additional actions that can and should be taken to address not only the near-term challenges facing U.S. agriculture, but also to help achieve the long term objectives outlined above. Critically important is strengthening the ability of farmers to join together in cooperative self-help efforts to improve their income, manage their risk, and compete more effectively in a rapidly changing global economy. A high priority should be given to ensuring that public policies and programs relating to agriculture are directed toward achieving this goal.

Federal programs relating to farmer cooperatives should be revitalized, and funding increased for research, education and technical assistance, similar to the legislation resubmitted yesterday by Chairman Talent and Congressman John Thune from South Dakota. Other actions are needed to help farmers, through cooperative efforts, become more involved in value-added production, processing and marketing activities beyond the farm gate, and to capitalize on new market opportunities. Not only would this help farmers capture a larger share of the consumer dollar, thereby strengthening their income and providing greater economic stability in the communities in which the farmers and cooperatives are located, it would promote needed competition.

To achieve this, farmers and their cooperatives must have in place policies and programs, including adequate tax incentives, to help attract needed capital and investment. Equally important is the need to maintain access to a strong and competitive cooperative farm credit system. Current loan guarantee programs should be expanded to provide financing for both new as well as existing farmer cooperatives seeking to become more involved in value-added activities. Other initiatives also should be considered to further meet capital requirements.

On the issue of tax incentives, the National Council of Farmer Cooperatives (NCFC) supports and is working for the inclusion of H.R. 1914 into an upcoming tax bill. H.R. 1914 was included in the "Tax Refund and Relief Act of 1999" H.R. 2488 that was vetoed last year. H.R. 1914 allows a farmer cooperative to bypass the dividend allocation rule, a regulatory rule, which negatively impacts the amount of the patronage dividend deduction taken by a cooperative.

As cooperatives look to the 21st Century, it is important for the industry to have the appropriate tools so it can continue to give value to its farmer owners. In today's world, businesses need to be adequately capitalized if they hope to remain competitive. Farmer cooperatives have a difficult time raising capital. The reason is that they generally have only two sources of capital – their farmer owners and borrowing from a lending institution. Farmer cooperatives do not raise capital from financial markets by issuing voting common stock because members hold this stock.

However, farmer cooperatives are allowed to issue a class of non-voting preferred stock that can be used to raise equity from sources other than its farmer owners. When issuing a dividend bearing class of nonvoting preferred stock on which a dividend payment is made, a cooperative must comply with the "dividend allocation rule," which has an adverse tax affect on the cooperative and has been one reason why farmer cooperatives must heavily rely on debt financing.

What is the dividend allocation rule? The dividend allocation rule applies when a cooperative pays a dividend on its capital stock or other proprietary capital interests (a "Capital Stock Dividend"). The rule causes a portion of the capital stock dividend to be allocated to the patronage operation and reduces the amount of the patronage dividend deduction, thereby creating additional taxable income for the cooperative.

This rule has a long history going back to the 1920s, and currently is interpreted under Treasury Regulation § 1.1388-1(a)(1). It has evolved over the years to go beyond the particular situations in which it was developed to become a general rule that has a devastating effect on the industry's ability to raise equity capital. The prohibition established by the rule is one of the main reasons why cooperatives are heavily dependent on debt capital for their financing today.

H.R. 1914

NCFC has been working with Representative Bill Thomas in attempting to change this regulation. Congressman Thomas has introduced H.R. 1914 a bill that, if enacted, would repeal the "dividend allocation rule."

H.R. 1914, adds the following sentence to §1388, and effectively changes the regulation:

> (a) IN GENERAL- Subsection (a) of section 1388 of the Internal Revenue Code of 1986 (relating to patronage dividend defined) is amended by adding at the end the following: 'For purposes of paragraph (3), net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation or bylaws of such organization or other contract with patrons provide that such dividends are in addition to amounts otherwise payable to patrons which are derived from business done with or for patrons during the taxable year.'

The language of H.R. 1914 is straightforward. It reverses the language of the regulation if agreed to by the patrons of the farmer cooperative. The effect of the language would allow a farmer cooperative to pay a "capital stock dividend" without first reducing the patronage earnings of the cooperative's patrons.

H.R. 1914 allows cooperatives and their members to bypass the rule by agreeing in the articles, bylaws, or other contract that a Capital Stock Dividend would first be paid from nonpatronage and accumulated earnings of the cooperative before patronage dividends would be reduced. This would allow the cooperative, for example, to create a class of nonvoting preferred stock and pay dividends on this stock exclusively from nonpatronage earnings. The cooperative would not reduce the amount of its patronage dividend deduction by any portion of the Capital Stock Dividend.

The benefits of this legislation for cooperatives could be substantial. Among other things, a cooperative could more easily:

(1) raise capital from outside investors without having the farmer members who patronize the cooperative lose control;

(2) create a class of nonvoting preferred stock that could be traded on capital markets, thereby providing liquidity to the cooperative's interests;

(3) create a preferred stock program for management and employees that would improve incentive programs;

(4) repurchase a departing member's interests for dividend paying stock, rather than debt; and

(5) increase the amount of patronage earnings paid to the farmer owners.

For these reasons, NCFC supports and is working for the inclusion of H.R. 1914 into an upcoming tax bill, and we look forward to working with the House Small Business Committee and the Ways & Means Committee on this and other issues important to cooperatives.

NCFC is a nationwide association of cooperative businesses owned and controlled by farmers. Its membership includes nearly 70 major farmer marketing, supply and credit cooperatives, plus the state councils of cooperatives in 31 states. NCFC's members, in turn, represent nearly 4,000 local cooperatives, with a combined membership that includes approximately 1.6 million farmers in the United States. NCFC members handle almost every type of agricultural commodity produced in the United States.

Farmer cooperatives are self-help organizations that were formed, and operate today, to meet the needs of farmers for reliable and fairly-priced sources of farm supplies (fertilizer, seed, feed, petroleum products, herbicides and pesticides), services and credit, and to provide farmers assistance in effectively marketing the commodities that they produce. Some cooperatives focus on serving a single function -- providing farm supplies to members (referred to as "supply cooperatives"), or helping members market a particular kind of crop (referred to as "marketing cooperatives"). Others perform several different functions for their members. Whatever their function, farmer cooperatives are an extension of the farming operations of their members. Their importance to agriculture is demonstrated by the fact that most American farmers are affiliated with one or more cooperatives.

Value-Added Testimony
Washington, DC
March 15, 2000

Good afternoon. Mr. Chairman and members of the committee. My name is Rick Vallery and I am the executive director of South Dakota Wheat Inc. a producer group located in Pierre, SD.

As a backgrounder, I was born and raised on a farm/ranch in western SD near the Wyoming border. I farmed with my father and brother and we raised cattle, irrigated corn, alfalfa and wheat. In 1984 I left the ranch to work for the SD Farm Bureau and I have been with SD Wheat Inc for the last three years.

Currently, South Dakota Wheat Inc is working on two value-added projects, with two more value-added projects waiting in the wings.

A year ago, the South Dakota Legislature, realizing the need for ag processing in SD, established the Value-Added Sub Fund Account. This account has approximately $3.4 million in it and is designed to handle feasibility studies/market plans. To date there have been five projects approved for feasibility studies/market plans.

Two of those five studies are nearing completion.

If either one of the studies are found to be feasible then this proposed legislation becomes extremely important.

Also around a year ago South Dakota commodity organizations and interested business's such as Association of Co-op's, Rural Electric's and Rural Water Systems established a non-profit organization with a Board of Directors **to foster creation of producer-owned, value-added agriculture by offering technical and staff support and championing value-added agriculture publicly by educating producers, lenders, and the public on value-added concepts.**

So we are serious about value-added agriculture in South Dakota.

There are two keys to a successful value-added project. One is organizational. The second is financial. **But it is the finances during the organizational phase that are needed most.** That's what this legislation does and is about.

During the organizational phase, questions will be asked and answered concerning the legal structure of the entity. Should the entity be organized as an association, a corporation, a cooperative, if a cooperative what kind????(open closed 521 etc.) Should the entity be able to operate in more than one state?? If operating as a cooperative and in more than one state security agreements must be put in place that are acceptable in the state in which the securities are being offered. Questions will be asked and answered concerning markets and the use of byproducts that may be produced. Questions will be asked and answered concerning real estate, building procedures, building structure, location of the plant, and transportation.

The legislation you have in front of you fills a niche in the process of establishing successful value-added projects. The opportunity for assistance in the legal, engineering, and consulting aspects of value-added projects will allow for additional success for upcoming projects.

I urge you to strongly support this legislation and thank you for the time allowed for sharing my beliefs.

Testimony before the U.S. House of Representatives
Washington, D.C.
March 15, 2000

Testimony of
Brooks Hurst
Missouri Soybean Association Vice President

Good morning. My name is Brooks Hurst. I'm a soybean and corn farmer from Northwest Missouri. I farm more than 3,000 acres with my brothers and father.

Today I'm representing the Missouri Soybean Association. I'm vice president of that organization. We are a membership organization made up of nearly 2,000 soybean farmers from across the state. Our goal is to communicate issues facing soybean farmers and rural America to legislators at the state and national levels.

Congressman Talent, I would like to thank you and the committee for the opportunity to testify today.

Back home on my farm in Missouri, we're seeing the lowest soybean prices in more than 40 years. Although our product price has gone down, our production prices, like land, seed and fertilizers, have stayed at nearly their same levels. It's simple economics that when input prices don't change but the price for your product lowers, your profit margin disappears.

That's the situation we're in as farmers. Because we take the commodity price we're given off the Chicago Board of Trade, we're dependent on that price for our well being.

However, there are some of us that would like to move ourselves from price takers to price makers. By being able to set our own price, we can have better control of our future. But, to make that switch from taking prices to making prices, we must sell specific products, not the commodity prices we're currently producing.

One way we can move ourselves up the value chain is by identity-preserving our crops. You're probably familiar with organic foods. That's one method of keeping the identity of our crop separate and getting paid a premium for that product. There are many more examples out there.

Farmers are finding that as their marketplace becomes global, they must look to new solutions to remain competitive.

Just as corporations have found that they can join forces to increase economies of scale and remain profitable, farmers are discovering the same thing. Farmers are also uncovering that they can enhance their bottom line by extracting value from their products at more than one point in the delivery chain.

Farmers are adding value to their products. It started when poultry production companies like Tyson began vertically integrating their operation to receive profits at different points along the chain. The idea has spread to more segments of agriculture.

Farmers are innovative. A group of producers in Northwest Missouri is in the planning stages for a soybean processing plant. It will give them another market to sell their soybeans. They will also profit as the soybeans are processed into soybean oil and soybean meal.

Other success stories are out there. There's a Michigan soybean processing plant owned by farmers that makes and sells its own motor oil. Two ethanol plants, owned by corn growers, are being built in Missouri. There are also groups of cattlemen, pork producers and rice producers in Missouri that are all trying to join forces to move their operations further up the marketing chain.

The catch as a farmer, I'm an expert. But, only an expert in my field, literally. I know how to raise soybeans and grow corn. Other farmers are experts at raising cattle and

producing beef. However, even with all our innovations on the farm, we're outside our arena when it comes to putting together processing plants. From looking at environmental site analysis, to determining the engineering components of a plant and even writing a business plan, we need expertise in technical assistance.

Along with technical assistance, we would like to see you offer tax credits for our investments in value-added enterprises. We've seen many other industries benefit from tools like tax credits and believe our industry and your food supply can benefit from this tool.

Farmers are looking for ways to reach up the agricultural marketing chain and capture some of the profits generated by processing their raw commodities. I would like to see our government assist farmers on the technical side of setting up these value-added endeavors. Helping farmers with things like business plans, engineering and site selection is the weak point in these joint business endeavors by farmers. Helping with technical assistance is a way to help rural America and farmers – America's original small business owners.

I would like to thank you again for this opportunity. I would be happy to answer any questions at this time.

NATIONAL CATTLEMEN'S BEEF ASSOCIATION
1301 Pennsylvania Ave., NW, Suite #300 • Washington, DC 20004 • 202-347-0228 • Fax 202-638-0607

Testimony submitted to:
The U.S. House Committee on Small Business

Submitted by:
John Haverhals
On behalf of:
The South Dakota Cattlemen's Association

My name is John Haverhals. As a cattle producer and partner in a value-added agriculture business, I am pleased to have the opportunity to testify in support of these companion pieces of legislation under consideration by your committee.

My family and I run a cattle feedlot outside of Hudson, South Dakota. I am past president of the South Dakota Cattlemen's Association, and a current director on the South Dakota Beef Industry Council's board. One of my driving interests has been to find creative and efficient ways to bring additional economic return to those farmers and ranchers raising cattle. Today's farmer produces great commodities, but in order to retain more of the profits, we must become more involved in developing products from those commodities and marketing them to the consumer. Both of these bills would work to encourage the development of value-added agricultural enterprises.

Let me begin by stressing the vital role value-added agriculture can play in the economic well being of not only those involved in agriculture today, but society as a whole. Value-added agriculture is based on the premise that farmers and ranchers can work together effectively to own and control processing and marketing entities for their agricultural commodities, consequently returning more value or financial rewards to the producers who own and control them. Value-added agriculture is a means for farmers and ranchers to improve their profitability and sustainability. It's common knowledge that agriculture is currently in a depressed economic business cycle that has been devastating to farmers and their rural communities. It is important to provide viable options for producers so they can become involved in the development and marketing of products that the consumer wants, retaining additional financial rewards for their work. Subsequently, those profits can be invested back into their local communities.

No where could encouragement of value-added agriculture be more welcome than in my state of South Dakota. Agriculture, the state's number one industry, has a substantial impact on South Dakota's

economy, with an estimated $15 billion of economic value created in 1998, according to statistics provided by South Dakota State University, our land-grant institution. The next largest segment, the computer industry, provides just $9.6 billion of economic value. With that much dependence on agriculture, it is essential to maintain a vibrant agriculture economy in the state. Creation of value-added agricultural projects is a key component in helping build a healthy agricultural economy.

And yet, South Dakota has been lagging behind its neighboring states in the creation of value-added agricultural businesses. There are many examples of successful value-added agricultural cooperatives throughout the midwest that have been established by producers working together for the purpose of helping themselves and their communities. In Minnesota, approximately 30 value-added producer-owned projects have been created, while North Dakota has an estimated 25 value-added projects. South Dakota, on the other hand, has only one value-added processing facility in operation and the equity capital raised to start construction in the spring of this year for another.

Our state took a progressive step in 1999, however, with the formation of the Value-Added Agriculture Development Center. This center was developed by 13 producer-based, farmer-owned cooperatives and other entities that saw a need to assist in the creation of value-added agriculture businesses in South Dakota. The center will undertake the critical project of helping small and emerging businesses that add value to agriculture to start or expand by providing direct technical assistance to the business or its potential owners. South Dakota agricultural producers want to help themselves, and with the financial assistance and incentives provided by these two bills under consideration, we can spur the growth of value-added agricultural businesses.

Let me speak first to the bill that would provide grants to assist such businesses. In the past year, I have personally become involved in a small value-added agricultural venture. Having spent my entire life in the cattle feeding business, I grew up with the concept of value-added agriculture. In the cattle feeding business, instead of selling the crops we grew on our southeastern South Dakota farm, we fed the grains to cattle, adding value to those crops in the form of live animals. While feeding out cattle is a value-added enterprise, it became evident that in order to retain even more of the profit, cattle producers would need to become more involved in producing a finished product to sell to the consumer.

This past year, I, along with 16 other cattle feeders and ranchers, formed Ranchers Gourmet Meats, Inc. The gourmet meat store operates in Overland Park, Kansas, selling high-quality beef products to consumers in an up-scale section of that city. The high-income shoppers at our store enjoy – and are willing to pay for -- the quality of product and the service Ranchers Gourmet Meats provides. What does it mean to me? When I sell a live animal to IBP for processing, I am currently receiving approximately $1.08 per pound. When I sell a steak through Ranchers Gourmet Meats, Inc., I am receiving approximately $19 per pound. As cattle producers involved in selling directly to the consumers, we have a greater opportunity to make a profit, even taking into account the added expenses of running a retail business. If Ranchers Gourmet Meats, Inc., can survive the hurdles that face new start-up businesses and turn a profit, it will mean a more livable income to my family and the families of the other 16 producers. That in turn creates jobs and money available to invest in the businesses and tax base of our local communities. In fact, the business is currently successful enough to have initiated interest from other cattle producers. Our goal eventually is to have 25 to 30 franchises. Financially, we are not yet in a position to move into that next level of the business.

How can this bill make a difference to a value-added agriculture project such as Ranchers Gourmet Meats? While there are grants currently available to conduct feasibility studies for value-added agricultural businesses, this particular legislation would funnel grant funds into areas including technical assistance, marketing, organizational and legal needs. One of the primary challenges we faced in starting this business was simply coordinating the schedules of 17 different individuals from various locations in order to organize meetings and planning sessions. All of us had separate farm businesses that demanded our attention while attempting to get Ranchers Gourmet Meats off the ground. Two of our members ended up volunteering much of their time to those organizational efforts – time they had to take away from their own ranching businesses. We also faced limitations in our expertise in areas other than raising and feeding cattle. None of us had the technical experience necessary in developing a web site to market our store, for example. This bill could help provide the funds necessary to help farmers and ranchers overcome those hurdles which often discourage many farmers and ranchers from pursuing ventures into value-added agriculture.

The second bill, which would amend the Internal Revenue Code to allow a business tax credit for investment by farmers in agricultural product development facilities, could also play a key role in helping farmers help themselves. With today's depressed agricultural economy, many farmers and ranchers are experiencing a lack of equity. This legislation will encourage producers to invest in, and become a part of, business structures beyond their farm or ranch. It will give us the tax incentive to invest in those assets or facilities and be able to participate in the management and ownership decisions of businesses that take our commodities to the product development and marketing stage.

This is a law that is very similar to the investment credit laws from the 1960s, which induced the farmer to buy new equipment. We invested millions of dollars in farm machinery and helped stimulate a stagnate economy and greatly increase our production capabilities. I am convinced that this type of legislation today can be successful in encouraging a likewise boon to our agricultural economy and rural communities. The incubator-type programs have worked well in the manufacturing sector, where tax credits were used to induct risk or venture capital individuals to help grow or develop products. The Small Business Administration programs have been very successful in my state in providing the structure and capital or incentives to induce business to further process and add value to raw materials as they find their way into product development and eventually to the consumer. There is no reason it will not work in production agriculture. We simply need the incentives, the structural guidance and the opportunity to invest in the stages beyond simply producing the raw commodities.

In summary, these pieces of legislation are a win-win for all those involved. Farmers and ranchers will have the opportunity to become more profitable through the development of new and exciting products. The communities in which they live will benefit from their success. The economy will see enhanced competition. And, in the end, the consumer will enjoy a larger variety of products from which to choose. For these reasons, I ask you to pass the two pieces of legislation before you today. Thank you.

TESTIMONY OF GERALD TUMBLESON
BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES

Washington, D.C.
March 15, 2000

Good morning. My name is Gerald Tumbleson. I am a grain and livestock producer and I live and farm in Minnesota. I am also a past president of the Minnesota Corn Growers and currently participate as a member of the Board of Directors of the National Corn Growers Association.

Today, I bring a message to you about farming. It is a message of hope for an industry vital to our national interest, and it's a message of hope to an industry that has lost its hope.

There is a role for government in my message. It's a good role. It's the role of a helping hand, and not of a hand-out. It's a role that leads farmers to self-sufficiency.

This Committee is well aware of the dramatic changes in agriculture. Increases in world income and economic growth are helping to spur foreign demand for American agricultural products.

Agricultural trade agreements over the past few years have provided access to foreign markets by lowering tariffs. And, in spite of the

controversy about genetically-modified foods, American agriculture exports are increasing dramatically.

In 1999, exports accounted for almost one-quarter of all farm income. This year, 30 cents of each dollar of farm income will come from the export markets.

Yet, at the same time there are historic lows in prices for commodities. Soybeans are at their lowest price in 40 years.

In some economic circumstances in 1999, a farmer would lose less money destroying pigs than preparing them for market. If it weren't for record harvests in 1999, more farmers would have gone out of business than predicted, and even then Minnesota lost more than 1,000 farms in 1999.

Both domestically and internationally, there is a growing demand to provide specialized products to serve specialized food markets. Even in the worst markets for pigs some producers serving Japanese markets were reaping a premium price for hogs produced to specifications required by the Japanese manufacturer.

These specialized product exports are of vital importance to rural America. Fully one third of agriculture industry jobs associated with

exports are in rural areas. In the year 2000 agriculture exports will approach $100 billion.

The U.S. food system, like many other key sectors in the world economy, is undergoing fundamental, far-reaching change. Driving this change are new mechanical, biological, and information technologies, new institutions and business arrangements, as well as new national and international policies.

These changes are the basis for new products, new ways of doing business, and new competitors in once stable industries. In summary, there is a redefinition of horizontal and vertical boundaries in all parts of the agriculture sector.

In the midst of this change, farmers must make efforts to understand and analyze the economy's transformation. One important aspect of the transformation of the American food system is the shift away from broadly defined commodities to products with differentiated characteristics that add value when commodity product identity can be preserved.

The shift to mass production and mass distribution at the end of the nineteenth century made identity preservation a defining feature of post-processing in the food supply chain.

Processing, packaging, and brand marketing have turned commodities into differentiated food products, but have not required identity preservation at the primary end of the production chain. In fact, you are familiar with dozens of products that were just as familiar to your grandparents: Pillsbury flour, Uncle Ben's converted rice, Wheaties cereal and others.

Now this identity preservation is moving upstream in the food system. Low saturate soybeans, non-genetically modified soybeans, and organic soybeans are all examples of identity preserved agricultural products.

Each has added value for some end-users if--and only if--it reaches them without having been blended with other soybeans. However, the current commodity production and marketing system was not designed for identity preservation.

Food supply chain participants must view the chain as a unified system, focusing first on improving system-wide performance and then on the distribution of gains from improvements. Farmers can participate, and farmers must participate..

In Minnesota, we are beginning to understand these changes better. Farmers have developed a state-wide entity called FarmConnect. It is one of the reasons I come to you today with a message of hope for agriculture.

Let me add briefly an observation on technology that will be useful to your discussion here today.

Sixty years of government support and protection of agriculture has given way to the ruthless efficiency of free market economics in which those with concentrated economic power are emerging as winners.

Changes in government policy toward agriculture, have combined with a swift and unprecedented growth in technological advancement in communication and commerce. The result greatly impacts the independent producer.

What was unthinkable technologically only a few years ago is now well within the province of savvy entrepreneurs who will capitalize on the new technology.

Soon hand-held Internet devices will allow farmers to market their grains, buy their inputs for farming and household use, provide

complete banking relationships (from farm operating loans to mortgages to retirement plans) and be the primary form of communications for the farm community. Farmers must participate in the development, ownership and use of this technology.

FarmConnect is a new farmer-owned enterprise in Minnesota. It's goal is to make agriculture profitable for the independent producer. The strategy is simple. Determine the markets that benefit from specialized grains and livestock, and then provide them. Make contracts directly with food processors and manufacturers.

These products are more and more in demand in global markets, especially in Asia and Western Europe where specialized agricultural products earn premium prices for producers.

In one sense, this enables the farmer to sell to a market further along the food supply chain. In a second sense, it adds value to agriculture products the farmer sells, so the he receives a higher price for his commodities.

At some point along the value-added chain of distribution, the farmer can provide a product that is ready for sale to the retail market of consumers. Currently, the most recognizable retail area is certified organic products.

Whether as aggregate sellers to the wholesale market or to the retail market, the goal is a mechanism whereby there is a constant evaluation and re-evaluation of farmers' business operations to move the farmer continuously along the "value-added" chain of distribution for products which he produces.

In its ultimate--and quite theoretical--end point, farmers produce as an aggregate group only products that serve the final retail consumer. While it may be impractical to reach the ultimate end point, this philosophical approach will generate the mind-set to strive for higher value and thereby more profitable farming.

Farmers can negotiate contracts with producers for specialized commodity products to serve particular needs. At the same time, they can look for opportunities in which the farmer can exploit the consumer market directly with products designed for sale and consumption on the retail level.

Moving in this direction requires the farmer to contemplate entering into innovative and non-traditional food processing. Farmers must go beyond just providing specialized agricultural products.

To this end, investment alliances provide an opportunity to provide a mechanism to move the farmers' products along the continuum to a higher-value consumer product.

Investment alliances, such as the 21st Century Alliance located in Kansas and others provide excellent models. Farmers come together on a project-by-project basis to determine how to invest in food processing and other facilities that add to price they get for their commodities. The 21st Century Alliance in the four years since it was organized has invested in five successful ventures.

Rather than just selling a specialized wheat to a cereal company, an alliance can partner with an existing company to manufacture cereal, or can own the plant itself. For example, the 21st Century Alliance supplies specialized wheat to a Mexican manufacturer of bake goods, cooperating in a way that its identity-preserved wheat products sell at a price higher than what the farmer would get in the United States.

In summary, farmers must change their thinking. Farmers are no longer in the commodity business. Farmers are in the consumer products business with our commodities.

What is the role of government in all this? Government can provide a small amount of initial funding to help launch enterprises like FarmConnect. These funds provide an "incubation" period to allow farmers to explore, develop and operate in these new agriculture markets. I would like see dozens of 21st Century Alliances and FarmConnects throughout the United States. Mr. Chairman and the Committee. This is what we need. And we need you to act now.

The result will be a stronger farm community, stronger and premium-priced exports for the world market and the continuation of an abundant, safe and affordable food supply for everyone.

Thank you.

(Approximately 1, 450 words
Approximately 9 minutes reading time)