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Focus on the Farm Economy: A View From the Barnyard

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Chairman Rouzer, Ranking Member Costa and Members of the Subcommittee, thank you for the opportunity to testify on behalf of the Agricultural and Food Policy Center (AFPC) at Texas A&M University as you focus on the situation in the livestock sector of agriculture. While a member of the AFPC, I am also a professor and livestock economist with the Texas A&M AgriLife Extension Service. As many of you know, our primary focus as been on analyzing the likely consequences of policy changes at the farm level with our one-of-a-kind dataset of information that we collect from commercial farmers and ranchers located across the United States.

Our Center was formed by our Dean of Agriculture at the request of Congressman Charlie Stenholm to provide Congress with objective research regarding the financial health of agriculture operations across the United States. For over 30 years we have worked with the Agricultural Committees in both the U.S. Senate and House of Representatives providing Members and committee staff objective research regarding the potential farm level effects of agricultural policy changes.

In 1983 we began collecting information from panels of 4 to 6 farmers or ranchers that make up what we call representative farms located in the primary production regions of the United States for most of the major agricultural commodities (feedgrain, oilseed, wheat, cotton, rice, cow-calf and dairy). Often, two farms are developed in each region using separate panels of producers: one is representative of moderate size full-time farm operations, and the second panel usually represents farms two to three times larger.

Currently we maintain the information to describe and simulate 20 representative dairy farms in 10 states and 11 beef cattle ranches in 9 states. We update the data to describe each representative farm relying on a face-to-face meeting with the panels every two years. We partner with FAPRI at the University of Missouri who provides projected prices, policy variables, and input inflation rates. The producer panels are provided pro-forma financial statements for their representative farm and are asked to verify the accuracy of our simulated results for the past year and the reasonableness of a six-year projection. Each panel must approve the model's ability to reasonably reflect the economic activity on their representative farm prior to using the farm for policy analyses.

The results I am going to discuss today were developed utilizing FAPRI's January 2016 baseline price projections over the 2014-2020 period and will focus on the outlook for these representative livestock operations. We have developed a color coding system to provide a quick way of showing how the farms are doing. Each farm is evaluated based on two criteria – their ability to cash flow and maintain real net worth. If a farm has less a 25% chance of not cash flowing or losing equity then it is coded green. Yellow farms have between a 25% and 50% chance of not cash flowing and losing equity. Red farms have greater than a 50% chance of not cash flowing and losing equity.

The results indicate:

- 55 percent of the 20 dairy farms are projected to end the baseline period in marginal or poor condition.
- Nine of the 11 cattle ranches are projected to end the period in marginal condition.
- While pressured by falling milk prices, the dairies are aided by low feed costs. Milk prices have declined further since the baseline was developed.
- Record calf prices boosted returns early in the baseline period, but falling prices as national herd expansion occurs quickly pressures their financial position using up any cash balances. The ranches relying on public grazing face increasing pressure from lost grazing access.

An Overall View of the Livestock Industry

- Cattle prices remain historically high, but well below the record high levels of a year ago. For example, 500-600 pound steer calves at Oklahoma City have averaged $188 per cwt to date this year compared to $277 over the same period a year ago (a decline of 32%). Fed cattle have averaged $134 per cwt this year compared to $162 per cwt last year (down 18%).
- Farrow to Finish hog operation returns have remained largely profitable over the last year following unprecedented returns in 2014 (based on the data published by Iowa State University). Barrow and gilt slaughter and pork production have remained close to year ago levels so far through 2016.
- Chicken producers have been buoyed by recent increases in wholesale cut prices, even though prices remain below a year ago and the five year average. Even with less expensive feed, low meat prices will likely constrain production growth.
- Dairy profitability continues to be pressured by falling prices as production has not yet declined significantly as a response to lower returns.
- The lamb market remains under pressure from record levels of imports.
- Across the livestock sector of agriculture, producer returns have been aided by dramatically lower feed costs. Even with lower feed costs, producer margins will likely remain lower in the next few years when compared to the rather good year of 2014.

The Farm Bill and Livestock

While often focusing on Title I commodities, the farm bill has direct impacts on the livestock industry as well. In particular the Livestock Indemnity Program (LIP), Livestock Forage Disaster Program (LFP), and the Emergency Assistance for Livestock, Honeybees and Farm Raised Fish program (ELAP) have been important programs for livestock producers. These programs have been successful and popular with producers. These have provided financial assistance to producers trying to survive unique, catastrophic weather events like the 2010-2013 Southern Plains Drought and winter storm "Goliath." The drought's impact on Texas livestock producers was an estimated $3 billion in 2011 alone.

Crop Insurance is not just a crop product. There are livestock related products like Livestock Risk Protection (LRP) for feeder and fed cattle, hogs, and lamb. Livestock Gross Margin - Dairy (LGM) has also been available for dairy producers. Pasture, Rangeland, and Forage insurance products have been available for consideration in risk management for livestock producers. In many cases, these products use has been limited in part due to limited funding for the products, but also due to some lack of opportunity or practicality.

Many of these farm bill and other policy issues are related. Insurance products often rely on futures market prices, for example LGM –Dairy and LRP for cattle and hogs. Questions about the efficacy of the futures market may have important impacts on other mainstays of the producer safety net.

Price reporting and information is related, as well. Mandatory price reporting has gone a long way to maintain publicly reported prices aiding the function of competitive markets. The absence of reported prices can affect settlement of futures contracts and reduce information available to aid participants of futures markets. Interpretation and implementation of prices reporting has become a critical issue in some markets. Defining producer or packer ownership in the case of cooperatives may likely become a more important problem. Markets and products do change over time making flexibility in implementation on important consideration, including evaluating confidentiality rules.

Other Issues

Futures Market and Price Reporting

The operation of the live cattle and feeder cattle futures contracts has been the subject of much concern in the cattle industry. Areas of concern include volatility, the speed of transactions, the role of high frequency trading, outright cheating, and whether or not the futures market is broken and no longer works as an effective price risk management tool. There is some needed research on these issues. In addition, some deferred futures contracts suffer from a lack of liquidity limiting their use.

Declining Cattle Prices

Cattle prices have certainly declined from their record peak in late 2014 and early 2015. It's worth remembering that markets and incentives work. Record high prices (and drought recovery) have provided the profit incentive to increase production; of cows, calves, and beef. Increased production leads to lower prices. Fed cattle prices broke lower late in 2015 with falling fed cattle prices. Several important factors contributed to lower prices. Beef production increased, year over year, largely due to record high cattle weights. Increasing beef imports and reduced exports had the net effect of adding about 750 million pounds of beef to our market. Large financial losses by cattle feeders forced them to finally bid lower prices for feeder cattle.

The decline in cattle numbers to multi-decade lows by 2014 (due to poor financial conditions and drought) meant that the industry had an over capacity problem in cattle feeding and meat packing. Packers and feeders bid higher prices to try to keep their operations running at their most efficient levels, but eventually the financial losses led to closing packing plants and feedlots. Beyond just closing packing plants the transition to more closely align capacity with cattle numbers led to changing shifts, changing employee hours, and fitting operations to fewer numbers. As cattle numbers increase there are more cattle chasing a smaller capacity and that also pressures cattle prices lower.

Importance of Trade

Trade is of more importance to all of our livestock, poultry, and dairy sectors than ever. The beef, pork, poultry, and dairy industries export anywhere from about 10 percent of our domestic production (beef) to over 20 percent of our domestic production (pork, chicken). Events that reduce exports, often out of the control of producers, like economic slowdowns in major markets, drought in our competitor countries, a strong dollar, and policy changes in other countries reduce our exports leaving us with lower prices. Imports are also important. The lamb industry is dealing with record imports of lamb from Australia and New Zealand. Australian beef played a major role in larger U.S. beef imports in 2015.

Opening new markets and re-opening old markets are critically important to our livestock and dairy industries.

Livestock-Crop Interactions

Our domestic livestock sector is the main customer for most of our crops. Difficult times in the crop side due to low prices means that livestock producers are paying low prices for feed. As meat production surges due to lower production costs (lower feed costs) meat and livestock prices are going to decline.

The farm bill safety net that aids crop farmers is also aiding the suppliers of feed for all of our livestock. It was not long ago that record high feed costs created huge financial losses across livestock agriculture forcing bankruptcies and many to go out of business. The health of crop and livestock producers are intertwined. Low and falling prices for meat and dairy products have been cushioned by low feed costs. Many livestock producers are also crop farmers, whether it's a dairy producing feed for their herd or a farmer with cows on pastureland as part of the total farm operation. Many contract poultry producers also have a cow herd on pastures surrounding the farm buildings. The farm bill safety net also applies to those livestock producers.

Future Challenges

Future challenges will surely abound in the livestock industry. Whether its trade related, animal diseases, low prices, or regulatory in nature. All of those mentioned above will be in play.

I would echo past participants in this series of hearings by saying that some criticism of farm policies is often by parties with little idea and/or care about conditions in agriculture. Regardless of these challenges, even though some of the farm policies may differ for the livestock industry, these programs do matter for livestock producers.

Mr. Chairman, that completes my statement.