

Cashing In: Corporations, The Ultimate Farmer Collective?

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I have enjoyed listening to the previous speakers. They have made my own presentation somewhat easier—particularly Dr. Merritt's talk on the new cooperatives. Much of what he has proposed is mirrored in my own recommendations—albeit reduced somewhat as to dimension. Here, we are talking about 20 people as opposed to 500 people, and while I propose looking at many of the same issues, my recommendation comes from a somewhat different angle.

My task today is to stir the waters a bit—present some interesting ideas and hopefully persuade you (the audience) to give them some serious thought. I have been doing precisely that, here in Eastern North Carolina for the last three years—both with kenaf and with duckweed. I don't know whether many of you have heard of duckweed. In addition to the new crop, kenaf, I am also promoting the general cause of duckweed—also as a new agricultural crop. It takes a very patient approach to get a new crop—basically a brand new concept—on the ground, working and accepted. Once you have finally succeeded in gaining local acceptance—inducing local farmers to adopt a new product and the new processes that go along with it—you must then deal with the peculiarities of state and local bureaucracies, and the various rules they enforce. So, I now find myself a Greene County resident working on these two new 'things' and I am very pleased to be doing so. Indeed, from the kenaf side of the equation, we have a number of people at this conference. Mr. Larry Moye, at the back of this

hall, is one of the great local sponsors of kenaf, and we are very pleased to have him with us. Larry is a farmer from Greene County who has dared to think outside the envelope. What I am proposing today is to do precisely that—to have the daring to think outside the envelope—to examine carefully who you are and to ask the question: what advantage do I have in life and how should I take that advantage and move forward? I am asking farmers to think somewhat beyond the cooperative framework when considering what can be achieved at the farm level and how to do it. Perhaps, just perhaps, the tried and true corporation provides the answer as the ultimate farmer collective.

During my three-year tenure with the

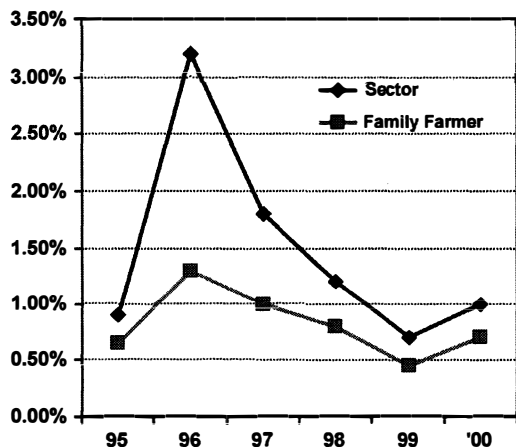


Figure 1. US Farm Sector & Family Farmer Return on Equity (1995 Through 2000)

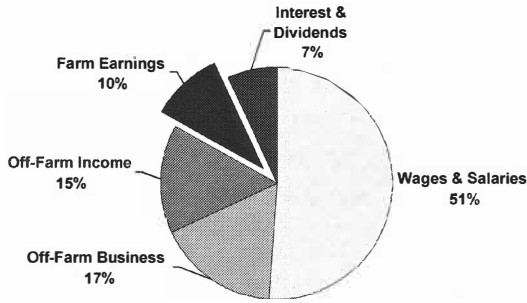


Figure 2. Sources Of Income for the 'Average' US Farm Family (2000)

Carolina Kenaf Farmers Foundation, and more recently with Greene Natural Fibers, it has been my privilege to talk and work with a large number of local farmers. While this has been an education in itself, I was particularly shocked to discover the true level farmers are producing at relative to their invested equity (see Figure 1). The bottom line in Figure 1 is particularly important. Since 1996, the average family farm in the United States has earned a net return on equity of less than 1%. This is shocking, astonishing, and certainly very sad. At another level, however, it demonstrates an incredible opportunity—and, it is the nature of that opportunity that is the focus of my presentation today. Certainly, at a very simplistic level, even a farmer, if he thinks outside the box, must be able to do better than a 1% return on his equity. It is instructive to note that only 10% of the 'statistical' family farmer's net earnings come from his farm (see Figure 2). Wages and salaries comprise 51% of earnings. In Greene County where I now live, every farmer's wife seems to work in the school system. That's the diad, the farmer and the teacher—not just here, but across the country you have exactly the same thing. This statistical farmer has half a million dollars in equity and he is making only 4,250 net dollars on that not inconsiderable wealth—most of it land. It is noteworthy that, at \$10,000, the capi-

tal gains on the simple appreciation of the farmer's land assets is more than 2.5 times his direct farm income. Indeed, while the gradual appreciation of his land asset is his principal strength, it does not give him cash in his pocket. As we move along with this presentation, I would like to talk about the possibility of using that wealth a little more efficiently.

Figure 3 shows that all the farm support and farm service industries are making a reasonable return (10% or better) on equity, while the farmer down here at the left, gets a pathetic 0.9%. Next up from the bottom are farm product distribution services, which is a function often served by farm cooperatives. At a return of around 1%, these institutions do not fare much better than the farmer himself. Now, take a look at all the other industries that surround the farm and, in fact, use what the farmer is producing (perhaps exploit is a more appropriate term): farm supply, milling companies, bakeries, dairy products, meat products, cereal companies (which are immensely profitable at an average annual return of 70%), farm machinery, trucking, warehousing, agriculture services, grocery stores, other food stores, restaurants, grocery stores, other food stores, restaur-

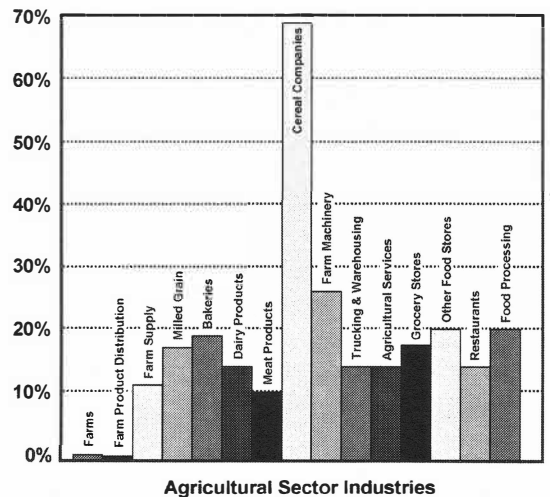


Figure 3. Farm Return on Equity (ROE) Compared to Other Ag-Related Industries

rants and food processing. Beyond cereals, I think 'other food stores' is going to be a category worth keeping a close eye on. We have gone through a stage where the Food Lion, or its equivalent large grocery store, is increasingly providing a very mundane service. There is clearly a growing opportunity to get into specialty marketing of foodstuff. The green grocer from fifty years ago is going to come back as a better, and ironically less expensive, way to retail fresh produce. Farmers, as the growers of food—the original suppliers—have the opportunity to take these businesses for themselves. They can, selectively, participate in any or all of these value-added business. The big advantage they have is that ultimately it all comes from 'down on the farm.' If farmers just stop producing food or fiber, all these farm-dependent value-added industries would simply die. The control ultimately rests with the farmer—if he chooses to exercise it. There is no logical reason why farmers should earn 1% on their investment while everyone else is netting 10 to 20 percent, or even above. That they are not doing so was for me a truly shocking revelation.

It is instructive to look at the leverage from farm to retail for a number of specific products (see Figure 4). If we look at pork, for instance—noting that the leverage on pork from farm to retail is not as great as with many other products—we still see that there is a 405% increase from the farmer to the retail level. Only recently, when Mr. Joe Luter of Smithfield Foods was doing his magic in this state, it was much, much more than that. Lettuce, with 500% increases from farm to retail, achieves similar results to pork. Shortening and oils occupy the next rung on the ladder, with farm-to-retail leverage of between 500% and 800%. Canola, a high-end oil, occupies the upper end of that spectrum, with generic, mixed oil shortening at the bottom. Higher still, we see corn—that is corn on the cob, not processed or processing corn—at 800%. What is startling about that increase in price is that almost nothing is actually done to corn to get it to the grocery store shelf. French-fried potatoes are higher still at 1,000%. Again, not much goes into making a French-fried potato and freezing it. The equipment necessary to achieve this, and the expertise required to run it, is trivial. As Bobby Ham, the previous speaker noted, "it's all in the mar-

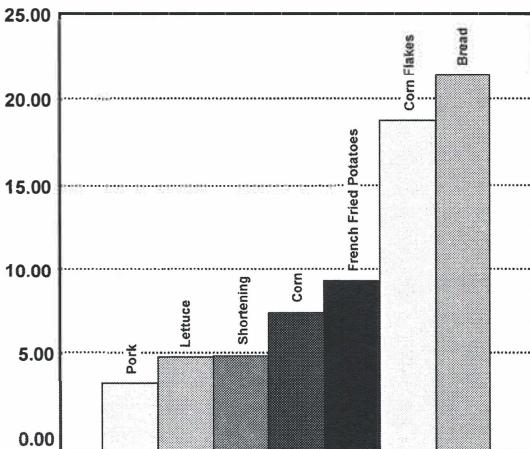


Figure 4. US Retail to Farm Value Ratios for Selected Agricultural Value-Added Products

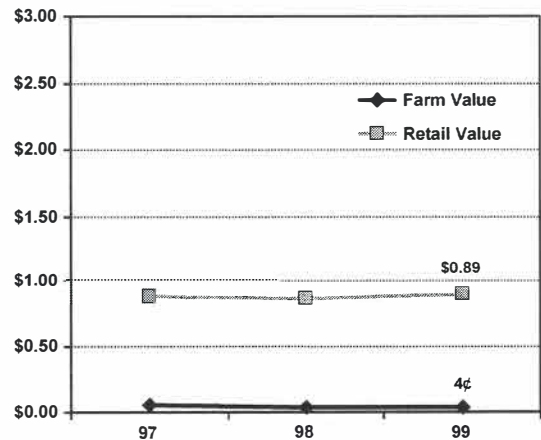


Figure 5. Retail To Farm Price Spread For 1 lb. of Bread (1997 - 1999)

keting.” Corn flakes is a classic—that old line of “2 cents worth of corn flakes in the box”—is a fact, with 9 cents paid to the farmer for a pound of corn flakes that retail for \$1.76. Finally, bread ‘takes the cake’ with a farm to retail leverage of around 2400%—and there are other examples that go even higher still.

Looking at the specific farm to retail price spread graph for bread, it is sobering to see the farmer stuck down there at four cents per pound for the wheat he delivers, while the bread made from it is selling for an average of 89 cents per pound. Many arguments have been made as to why this is the case. The issue is not to dwell on those arguments but to look at what farmers can do to begin moving up the chain. This is the same message echoed by all of the speakers who have gone before me. How can we take the farmer from his 1% return and bring him in line with everybody else at 10% or greater? Figure 6 shows the potential income accruing to a farmer earning a 10% return on equity. If, for instance, a farmer earned at 10%, which is the low end of a normal return, we would see farm family income going from around \$40,000 to over \$100,000—a massive increase in earnings—and, frankly, there’s no reason why the farmer can’t achieve that. Why must we believe that farmers have to be stuck down there at the bottom—always being ground into the dirt?

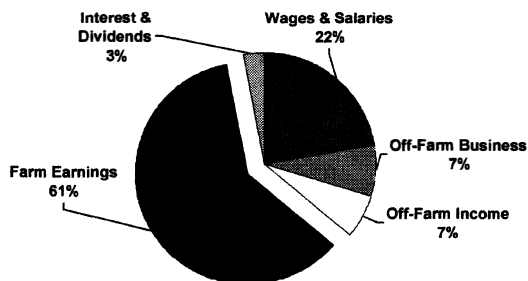


Figure 6. Farm Operator Potential Sources Of Income Assuming Farm Earnings ROE of 10%

Let us look at what real value farmers actually control. The US Department of Agriculture estimates that farmers control approximately one trillion dollars in assets (see Figure 7), most of which is land. The top portion of the bar to the left represents non-real estate assets, including machinery and equipment. The incredible statistic here is the value of the land asset—eight hundred billion dollars in land holdings. Notice from the earlier income graphic (Figure 2) that the statistically average farmer is getting up to ten thousand dollars a year in capital gains on his assets. Unlike many industries, his primary asset, therefore, continues inexorably to gain strength through time. If you take a hard look at the US economy, you will find that there are really only two significant chunks of capital—two ‘pots of value’ sitting out there—that are really not performing (namely, generating reasonable income on value). One is this trillion dollars in farm real estate. The other is the American investment in houses and homes. It has always bothered me that we are sitting on an incredible amount of wealth in this country—houses—that are not performing. That, of course, is the subject of another essay at another time—and, frankly, there is not much that can be done about it. Farmer equity, on the other hand, is another issue—and, something can indeed be done about it. At one percent return on value, it is clearly not performing. It has got to be able to perform above that and I think much can be done to achieve that.

I think it is a useful exercise at this point to apply this redemptive thinking to a fairly typical US agricultural scenario—any scenario. My partners and I are, as Mr. Nimmo has already presented to you, engaged in a new crop development effort in neighboring Greene County. This is a reasonably modest effort, and approximately the right size for such a project—around twenty or so partners. Note that we are talking about twenty participants and not a thousand. Its important that you have around twenty, or maybe less than twenty, because

above that number institutional dissonance increases exponentially. People, as individuals, cease to exist. The dynamic of twenty people together is a very positive, powerful dynamic. Five hundred together is sheer dissonance. At that point you simply have a lot of people making a lot of noise—and that is when the ‘outside’ managers take over. With the small group, each partner has a voice, and farmers unambiguously retain control over their own enterprise. Individual partners feel sufficiently incentivized and empowered to exercise the collective will necessary to ‘make it happen.’ They are both able and willing to put in that extra energy—that each of us knows we’ve got—to make something work. At the level of twenty or less we have an entrepreneurial dynamic. Above that it simply doesn’t work.

The other important parameter is the size of the project. Kenaf in Greene County is a five million dollar project. That is an interesting number. At one level it is small enough to be doable. Five million dollars is not an impos-

sible amount to raise. At another level, it is sufficient to cover around 90% of all agricultural value-added projects that farmers may elect to pursue. There is not all that much out there in the agricultural value added domain with a base ‘entry fee’ greater than five million dollars. There is no clear advantage obtained, for instance, in building a hundred million dollar tomato processing plant. In fact, if you go to California today you will find that all the big tomato processing plants are either bankrupt or perilously close to being so—and if that is not enough, with few exceptions they also have huge, seemingly intractable problems maintaining compliance with environmental regulations. They are ponderous and inflexible. Most are run by MBA’s who do not, in any real sense, understand agriculture. Consequently, they tend to be weak, poorly performing institutions. Increasingly in this economy, the spoils go to the small, flexible, quick, and nimble. The inherent advantage that farmers have over companies like ADM, Cargill, and Kellogg is that they can elect to operate in such a nimble manner, while the big oligopolies now find themselves hopeless burdened with the massive weight of poorly performing equipment and machinery, and people who don’t really know the business. They are weighed down by yesterday’s paradigm.

Five million dollars can get you into practically anything. If you want to make bread you can make bread. If you want to make pasta you can make pasta. If you want to grow and process fish you can do so. It is my contention that five million dollars can get you into practically every aspect of farm value-added processing. Within that context, it is worth considering an approach specifically crafted by the SEC as a mechanism for capitalizing small businesses—known affectionately in the securities industry as “Reg D.” (SEC Regulation D, Rule 504). There have been some shenanigans associated with Reg. D—particularly by people artificially pumping stock values in the OTC (over the counter)

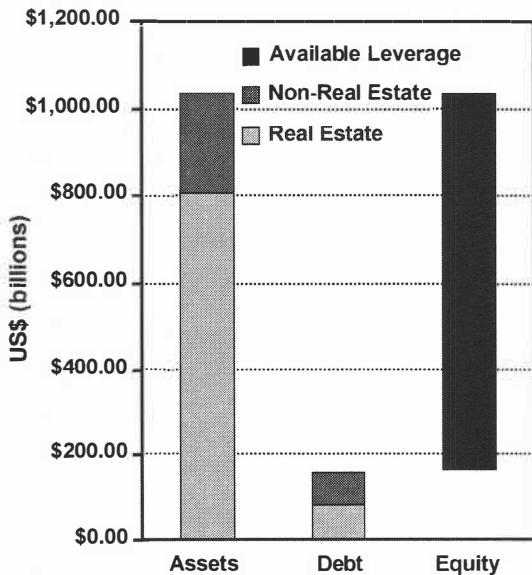


Figure 7. Farm Assets, Debt and Equity (1997)

market. It remains, nevertheless, a very useful mechanism for taking a new company public at minimal cost. Under Reg. D, 504 all the underwriting costs and much of the paperwork overhead of taking a company public are waived. The catch is that you can only raise a million dollars in that first year, and you cannot raise more than that with respect to direct equity investment during startup. If you are able to maintain that cap then you can go public. After the fact, you still have to go through the motions of filing with the SEC, but quite frankly once you simply make up your mind to do it, the paperwork is really not that intimidating. The added incentive here, is that once you have completed all the SEC requirements, you can again begin raising capital—through the magic of the stock market this time.

I propose the Reg. D, Rule 504 approach for consideration as an attractive, alternate mechanism because it can serve, quickly, to bring farmers into the mainstream of the US economy. Today, everybody is participating in the market. Everybody, that is, except US farmers. There is almost no market participation by farmers. I asked Bobby Ham (previous speaker) yesterday: “Bobby, have you thought about going public?” His story is incredible. We are talking about 40% annual growth rates. His is a fantastic business by any criterion, and he is driving it with all the zeal and verve of the very best entrepreneur. This is the kind of thing the markets love. It is simply a great story. That said, Bobby is not in the market. The question we have to ask is what does that mean for him, both in the short and long run?

An average scenario in which a group of farmers grow Durham wheat might be expected to have the following key characteristics:

- 20 Partners
- \$5 million Project: \$50,000+ Investment
\$200,000 in Guarantees for each Partner
- Regulation D, Rule 504 Public Offering

- Farmers Grow Durham Wheat
- Company Produces ‘Specialty’ Pastas
- \$1 million net earnings after year three

The farmers would like to benefit by adding value to their wheat. Having researched the market, they realize that the specialty pasta business is huge—certainly big enough to accommodate another small market entrant. I have picked pasta as an example here—almost at random. We could have picked something else. It might, for instance, have been corn and grits. Indeed, it could have been almost anything. The agricultural market is extremely broad and very, very deep. The prevalence of generic labels has also served, significantly, to open up the market. Increasingly, grocery stores are going to generic labels. In fact if you look at the food industry as a whole—not just food but other products as well—consumers are abandoning major brand names and settling instead for more cost-effective generic labels. Personally, I find the quality of generics, with minor exceptions, to be just as good as the major branded products. I never, for instance, buy anything but generic brand aspirin. When I buy pasta I buy the generic label, and I notice that people around me are also increasingly doing the same thing. The impact on advertising firms in this economy is huge. They are being abandoned. Clearly, the specific benefits of advertising today are diminishing very rapidly. Farmers have the opportunity to come in and supply generic labels very quickly. It is my opinion that they are truly missing the boat if they do not do so. You can expect to create a company such as this with an investment of around one million dollars supported with another four million in guaranteed debt.

The farmers who own this company can predictably expect to be netting a million dollars a year in their third year of operations. What does that mean? Take a look at Figure 8. With either an S Corp or an LLC, both of which serve as useful ‘dividend machines,’ each of the twenty partners would be putting \$50,000

a year in his pocket from his pasta operation. I think we can all agree that most farmers would be very happy with such a return, which comes on top of their direct earnings on Durham wheat. Co-ops of the traditional type would be expected to yield a somewhat lower return because they typically have less efficient management, and, therefore, higher overhead costs. While proponents of co-ops may argue to the contrary, evidence suggests—and it is overwhelming—that a co-op will generate significantly lower dividends than a comparable company—all things being equal. If the farmers elect to do a Reg. D 504 it would be managed to maximize growth—not just dividends. You are obliged to set the company up, and to run it in such a manner as to demonstrate what the market—what investors—want. That is growth, and it dictates reinvestment. A farmer/partner subscribing to a Reg. D 504 approach must typically reinvest at least half of the company’s profits to drive that growth. The result is a capital gain. The farmer is not putting the money in his pocket now, but he is generating increased real wealth that far exceeds the value of the dividend he has withheld—and, it is taxed at half the rate.

What does all this mean? Let us assume that our pasta company has been quite successful. The twenty partners are collectively making a million dollars a year. They have worked very hard for three straight years. They have been putting in overtime. They have been working nights. Their wives are disaffected. What point have they arrived at? What have they achieved for all the pain they have experienced... and inflicted? Looking at Figure 9, the left-hand bars, we see that the S Corp (or LLC), co-op and Reg. D approaches will generate similar book values—in the \$70,000 to \$150,000 range. The Reg. D company value is approximately double that of the other two because it has adopted a growth as opposed to dividend approach. Each farmer will have put around \$70,000 less into his pocket during those three years than would the S Corp farmers.

Now, let us also look at the relative stock values. The differences are astonishing. The S Corp farmer will typically achieve a multiple of around two over appraised value and around 3 over earnings, while the poor co-op farmer gets no value premium at all. For him it is book value all the way. The Reg D farmer, on the other hand is sitting on a stock value of a mil-

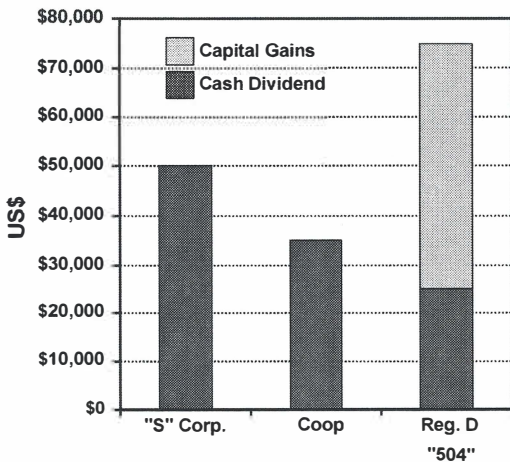


Figure 8. Three Cash Income Scenarios for Hypothetical Pasta Company in Year Three

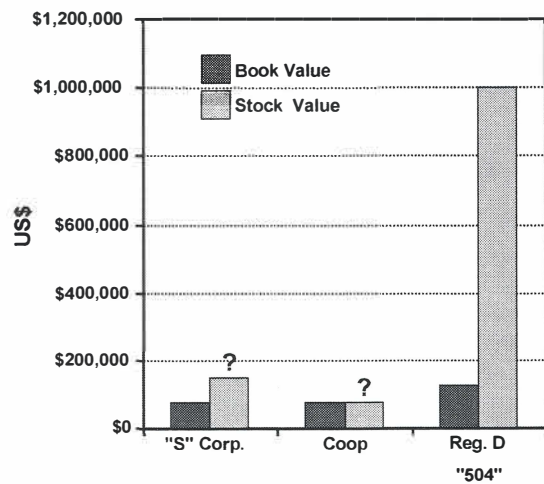


Figure 9. Three Valuation Scenarios for Hypothetical Pasta Company in Year Four

lion dollars. He has taken \$75,000 less in dividends than his S Corp counterpart during these three years, and he has put in the same long hours and earned the same disaffection from his wife and kids—but he has also made a million dollars in the process. Should he choose to do so, he can now cash in on his hard work. The co-op farmer cannot, and the S Corp farmer probably cannot sell his shares. An S. Corp will typically have a shareholders' agreement that ties partners up in knots and prohibits easy sale of stock. The new cooperatives described by Dr. Merritt (previous speaker) do allow some sale of stock, but there being no market for such shares, I would venture to say obtaining anything more than book value would represent a small miracle. If you have got a freely tradable, open company that has not yet gone public, about the best one can hope for is three times earnings. If, for instance, you are "pulling in fifty thousand," and the company is healthy, you might reasonably project your shares to be worth around one hundred and fifty thousand. You may not get that—indeed, you probably will not get that, but it is a good point of departure.

Look again at what you can do through a publicly traded company—how the stock market ascribes value to shares of stock. It is this phenomenon that I believe farmers would do well to ponder. A farmer and his partners can spend three years, or perhaps four years, really busting themselves to make their pasta company work. They are listed on the Over The Counter Exchange (OTC). They are getting good reviews—good market play. Suddenly, each is worth a million dollars. Now, that is taking an optimistic twenty times earnings—maybe the eventual multiple is only fifteen. Regardless, the return is impressive.

Bobby Ham's story is a stunning one. I would venture that his company would significantly outperform the average OTC price/earnings ratio and give him a value even greater than twenty times earnings. On average, today, a boring run-of-the-mill company will get a valu-

ation of at least fifteen times earnings. Perhaps most importantly, the stock market gives the farmer a chance to cash in on all his hard work and suffering. And, better still, he can do so without having to sell his precious land—his family heritage. He may, perhaps, choose to sell only 10% of his stock—that is a hundred thousand dollars that he can put in his pocket. Most people typically have only limited 'windows' in their lives when they can invest large amounts of energy and suffer major deprivation—these windows can last for four, five, or even six years, but not much longer. It is important that they maximize extraction of value from these bursts of energy. Everybody deserves the opportunity to cash in at the apex of that investment of time and effort. Under the present paradigm, however, farmers cannot do so. Tragically, short of selling out—giving up their precious land—farmers almost never cash in. Co-ops certainly never cash in; ultimately all co-ops die, and with them all the value invested in them by their attendant farmers.

All that can change. We live in a fast changing, very different world today. The Internet and the proliferation of inexpensive, high bandwidth communication systems have made things very different. It has evened the playing field and given everyone access—given everyone potential exposure. Bobby Ham's company, were it out there, trading on the OTC market, would be noticed and perused by a surprisingly large, diverse group of people—people from across this country, indeed all over the world. Reacting to software that would automatically flag good performance as indicated in SEC filings and press releases, they would both buy and sell his company's stock. The value of that stock would react accordingly. It is a huge market out there. Institutional investors are all plugging into Over The Counter (OTC). They are watching it very closely. Every investor in America has access to a variety of stock tip sources. If you perform well you will, without question, be noticed. It does not matter that you are a small company buried in

rural Greene County. Many, many small cap stocks are performing at well over twenty (on a P/E basis). Summarizing, then, the key to 'cashing in' is for farmers to share their successes with OTC investors:

- 25 million serious PC-based private investors peruse the OTC market
- All institutional investors are 'plugged into' the OTC market.
- Performing OTC Small Cap Stock demonstrate 20+ P/E Ratios
- Regulation D, Rule 504 Public Offering costs are less than 5% of conventional IPO—and can be easily done without outside assistance.
- Cashing in on the Value-Added business precludes selling land

The good news for farmers is that not only is this magical market there, waiting for them, it is that they have a huge, natural advantage over the next guy—both in gaining access and then playing in that market. If my three years living and working in rural Greene County have taught me one thing, it is that farmers are sitting on an extraordinary amount of wealth. It does not seem like it to the farmer, because he is not making anything on it, but I assure you, the wealth is there. All these farmers lack is a clear understanding of the advantage they hold, and a willingness to exercise that advantage.

It is useful at this point to review those advantages. Farmers are literally sitting on a vast amount of wealth that is simply not performing. As we have noted, only housing is a comparable non-performer. Farmers also hold ultimate control over the agricultural production base, and therefore over the massive number of value-added industries that derive their raw materials from that base. Ultimately it remains the farmers' option to deliver their products to these industries—or, indeed, to add that value themselves. Clearly, if the farmer wishes to consider himself besieged and impotent, that is his option as well. But if he takes the time and effort to examine his options with care, he

will see a virtual smorgasbord of options arrayed before him.

By most conventional criteria, I think all would agree that the average farmer works exceedingly hard. Personally, I am even more impressed with the incredible pain threshold they have—and their ability to recover, time and again, from blows that would debilitate most families and business institutions. This is not a trivial asset. If you are out there competing in the market place and you have a high pain threshold, good recovery and persistence you will prevail. Personally, from what I have seen of farmers, if I knew they were absolutely convinced they would prevail, I would hate to compete against them. Certainly, an ADM, a Cargill or a Smithfield would hate to compete against them.

As we have already noted, consumers are moving away from brand loyalty, machinery has become less expensive and product development and design more quick and flexible. These all play to the farmers' advantage. Small, quick, nimble and flexible—this is the advantage of someone going into these areas today. Everything is changing very, very rapidly. We may think of the big companies as overwhelming, but if we carefully consider their circumstance, we will see that behind their posturing they are sitting with millstones around their necks—big, huge pieces of equipment—factories that are not nimble, and simply do not perform well. These companies are forced to contend with managers who often do not understand what they're dealing with—guys coming out of school with generic MBAs who do not understand anything about the dynamics of agriculture. They are not, and have never been, part of American agriculture, and I can assure you that they are vulnerable to sustained, persistent competition from farmers. Farmers can definitely win this particular competition.

This is an appropriate opportunity to showcase my farmer colleagues in Greene County. They provide a stellar example of what farmers can achieve if they think strategically

and out of the box, accept the need to take risks and commit to competing with all their collective might against the big companies. Fiber, the industry they have tackled, is a huge part of the US economy. Local farmers are already supplying significant amounts of cotton (a global commodity that is seriously distorted by subsidies), and they play, to some extent in the wood market. Wood, however, takes twenty-five years to grow and most farmers are therefore unable to devote significant resources to something that really only pays off once in a lifetime. The kenaf fiber grown by the Greene County farmers can produce four times the tonnage of wood on the same acreage and it delivers a better fiber and a stronger fiber than wood produces—and, as an annual crop, it allows farmers to make a conventional, annual return.

Greene County kenaf farmers will be supplying a small, but quickly growing market for kenaf-based automotive paneling. Ultimately, most of their product will be supplied to mainline applications in the engineered lumber and paper industries. Kenaf's superior strength-for-weight allows it to be engineered as almost any type of dimensional lumber. Creating the perfect 2 by 4—one with superior strength, lower weight and better dimensional stability—remains their ultimate objective. With respect to paper, kenaf also holds significant advantages over wood. It mimics both hardwood and softwood with its core and bast fractions, respectively, and, having a much lower lignin content, can be rendered to pulp with a significantly lower expenditure of both energy and chemicals. While the major paper companies do not now have equipment optimized for these fibers, technologies that can achieve this are now in the prototyping stage. In the not too distant future, an investment of \$10 million at the county level should allow production of price-competitive kenaf-based paper that does not exact an environmental cost from the local community. This new paradigm should set the trend for the paper industry into the future.

Summarizing, then, we note that, in the context of a corporation, farmers have the following notable advantages over their competition:

- Other than housing, farmers are sitting on the largest non-performing capital base in America.
- Farmers control the land production base for a vast number of value added and higher value added industries. It remains their option to use what they produce or to hand it over to other processors and manufacturers.
- Discipline, patience, high pain threshold and a strong work ethic give farmers a very basic market place competitive advantage.
- Consumers are moving away from brand loyalty; machinery has become much less expensive; and product development/design more quick and flexible. These factors open the door for small-scale efficient, just-in-time production of tailored products that are not 'burdened' by the weight of huge infrastructure costs and massive advertising budgets.
- Farmers can now also choose to move into new fields such as non-cotton fiber and aquaculture—seizing early control over the production base for the next generation of paper, engineered lumber technologies and fisheries. This can double, or even triple the market for farm produce.

What do these developments mean for the absolute size of the farmers' market? As things now stand, that market is variously valued at between \$100 and \$120 billion. If farmers get into paper, that market increases to between \$200 and \$240 billion. Add lumber, and it increases to between \$300 and \$330 billion. Finally, farmers can also opt for aquaculture—in particular, growing produce of various kinds in land-based aquatic systems. Inland fisheries are one thing, but aquaculture is also going to grow in other directions as well. I am now

working with a product that can produce 30 times the protein equivalent of soybeans on the same acreage—thirty times! That is a true paradigm shift in the production of protein. The technology is already here. It can be done with relative ease, and I assure you that it will happen. Aquaculture is, for farmers, an exciting new area in which to get involved. As a general rule of thumb, if you can flood a unit of land and grow something on it you're at least 300% better off in terms of productivity—no matter what the product. With something like protein production, aquaculture can deliver 30 times that produced by soybeans.

In conclusion, I would like to propose some specific policy recommendations—both to the US Government and to farmers. Summarized, these are as follows:

To the US Government —

- *Phase Out Farm Subsidies:* While agricultural subsidies, at the margin, maintain some farmers' noses above the water line in crisis circumstances, they also serve, in general, to cement farmers' noses at that level. The primary effect of agricultural subsidies is to maintain the strength of quasi monopolies such as ADM, Cargill, General Mills, Smithfields and the like. Their market power allows them to extract all the value of the subsidies. This is disastrous for farmers. Ultimately, it is these monopolies that farmers must escape from under—and eventually compete against.
- *Help Organize and Capitalize Farmer-Owned Value-added Corporations:* USDA should hand the farm emergency and relief

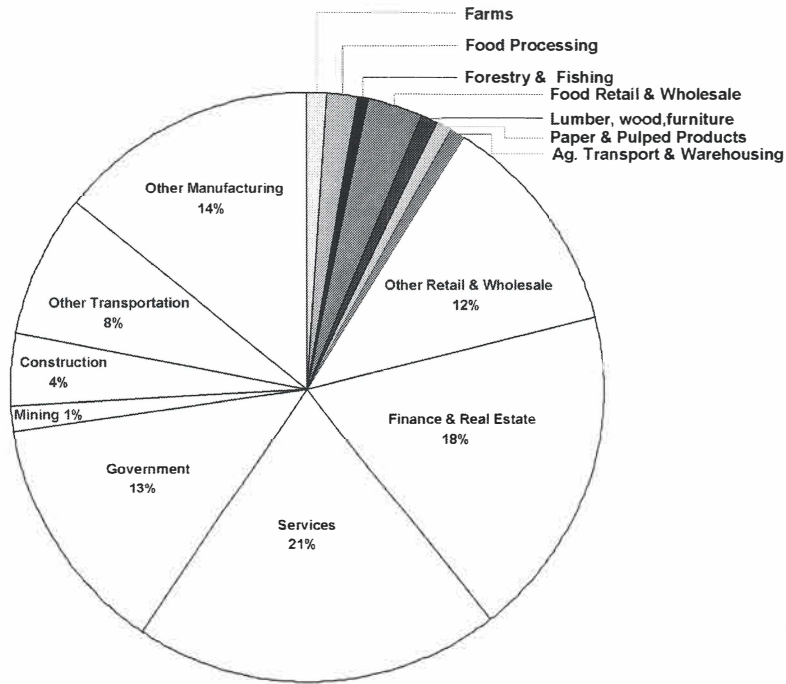


Figure 10. US Agriculture & Timber Sectors

business over to FEMA and gradually convert its budgets to the task of capitalizing (initially) farmer controlled corporations that add value to farm-grown crops. The task, simply put, is to get existing farmer equity performing, like everything else in the agriculture sector, at between 10% and 20% ROE.

And to farmers —

- *Get into Value-added Production/Processing:* You, and your fellow farmers control the agricultural production base—Maximize that huge advantage by taking your agricultural products ‘to the next level.’
- *Seriously Consider Incorporating as a ‘C’ Corporation and going public under Regulation D, Rule 504:* Going public is relatively simple and quite inexpensive. It provides you with two advantages: (1) It will value your enterprise according to the same rules that now apply to the rest of industrial America (i.e., 15 to 20 times earnings); and (2) by allowing you to ‘share your success’ with Americans everywhere, it will also enable you, unlike most farmers, to ‘cash in’ on your hard work, high pain threshold and entrepreneurial spirit.
- *Think seriously about moving into non-cotton fiber production and/or aquaculture and their value-added processing.* These three areas will drive most of the growth in agriculture over the next several decades.

Farm subsidies are like a drug. All farmers depend on them to some extent, particularly at the margin, to mitigate effects of price fluctuations and unfavorable weather events. That said, one cannot just blindly say “get rid of them.” They are, nevertheless, ultimately very damaging to farmers. What farm subsidies achieve in the long run is to cement farmer’s noses to the water line. Almost all the true value inherent in farm subsidies is ‘sucked out’ by the companies that surround farmers. It is comparable to being hooked on a drug like heroin—one that

“you’ve gotta have,” but that you know will eventually kill you. Farm subsidies are, in fact killing the American farmer. The ADMs, Cargills and Smithfields all subsist off the subsidies—pushing, in the process, farmers’ noses to the water line. Somehow, the American farmer must escape this trap.

While this is a facile recommendation to make, it requires careful consideration at the strategic level to implement. USDA, in my opinion, should focus strictly on the business of bringing farmers up to that 10% or higher level with respect to return on equity. There are many ways to achieve such a result. The cooperatives, the new generation cooperatives that other speakers have talked about—they can do it. What I have spoken of can, on a selective basis, do it. USDA simply must start thinking along these lines. If one can identify one specific point of focus, it would be issuing capital guarantees. Financing a new corporation is a tough thing to do when you do not have a history, and you’re dealing with a new product. Banks, in particular, have no mercy. The Greene County kenaf farmers have just gone through this with kenaf. It was a tough, tough thing to achieve, even with substantial participation by non-agricultural investors with very healthy bottom lines. Ultimately, USDA feels perfectly justified in throwing billions in subsidies at ADM, Cargill and the like, while providing absolutely no assistance to this group—a group that is breaking important new ground in American agriculture.

What USDA must do is improve its analytical capabilities and work to increase delivery of loan guarantees to farmers who are engaged in intelligent, well-conceived enterprises. The true cost to USDA of providing loan guarantees is not all that great—perhaps around 5% of the principal amount they are guaranteeing. Instead of squandering money on farm subsidies that support ADM and the like, USDA should focus on promoting businesses that will bring farmers up above 10% return on equity. With such a program in place, a billion dollars

budgeted to the task at hand could support around 20 billion dollars in loan guarantees. That's where USDA should be focused. The emergency functions now performed by USDA might more appropriately be handled by FEMA (Federal Emergency Management Agency).

My recommendation to farmers is that they get into value-added processing of their farm-grown products. They should also give serious consideration to adopting the Reg. D Rule 504 approach to going public. Nothing would please me more than to see farmers out there participating in the stock market with the rest of America. The SEC small business capitalization exemption allows them to do this with relative ease. A number of companies sell software packages that facilitate this process by helping farmers with the various arcane bits of paper work that must be submitted to get the job done. With such assistance, the entire process is rendered quite painless for the average farmer. Repeating an earlier recommendation,

I also suggest that farmers consider moving into fiber and aquaculture. Bringing these two areas into the farmers' domain will serve effectively to at least double—even triple, the total market for farmers. It is noteworthy, looking at Figure 10, that the US farm sector now occupies only 1% of the US economy. Sectors such as food processing and retail, both of which depend entirely on the farms for inputs, each occupy a significantly larger percentage of the US economy than do the farmers themselves. There is no reason why farmers cannot keep this market for themselves. If one also adds forestry, paper, aquaculture, agricultural transport, the farmers' market grows to around 10% of the US economy. This is a number that will get respect from even the most cynical politician and/or investment banker. In closing I would like to thank each of you for giving me the opportunity to speak to you—and, having done so, taking the time to pay careful attention to what I have had to say.