Prairie Agriculture at Crossroads: Specialize or Perish

Over the last three decades the Prairie grain-economy has undergone a fundamental transformation with noteworthy gains. Grain output increased by 50% and export volumes by 60%, even more in value by diversifying to higher value crops. There is a tendency to attribute all these achievements to market-liberalization, through deregulation and privatization. These policy reforms made the Prairie grain-economy highly market-driven, but much more of the credit must go to producers.

By embracing latest advances in agronomy and technology, producers increased their crop-yields and diversified their crop-mixes -- first to canola in a big way, and later pulses, at a smaller scale but higher value. Farms have become much larger through persistent consolidation, with advanced farm-machines in the fields and larger storage facilities, using much improved seeds, fertilizers and pesticides, while refining farming-methods and embracing new farm-management systems.

All these advances and achievements have given producers a sense of comfort and security, which is justifiable but should not mask the looming risks on the horizon. Despite all the diversification, Prairies are still too dependent on staple-crops that in turn are captive to bulk-trades. Wheat-exports are down from 85% to 50% of the total but only to be substituted by another bulk-crop, canola. These two crops now account for 75%, while 85% of crop-exports though the West Coast are still in bulk.

These bulk-trades are exposed to increasing competition from emerging-producers. Moreover, China has been the main driving force behind global demand for grain-exports, with its share of global trades reaching 20%. Now China is trying to become more self-sufficient and increasingly turning to emerging-producers to its west to meet its import-needs. These trends are likely to dampen demand for our bulk exports, pushing prices down and in turn squeezing producer-margins further.

This comes at a time when producers are already under pressure to increase their margins to pay-back the debt-overhang from years of investment, be it for land acquisitions or equipment purchases. Their only salvation is diversification to higher-value crops that can yield higher margins outside the web of grain-companies and their bulk-trades. In this vein, however, they face a dual-challenge -- lack of direct-sales and containerization channels, which is our mission to help them overcome.

While a sense of unbridled optimism still prevails, particularly among politicians and vested grain-industry interests, the time has come to interject a sense of realism over our export prospects through traditional bulk-channels. The Prairie grain-economy is stuck in a bulk-trap, with low-margins which are likely to get squeezed even further. The time has come for producers to think about alternative sales-channels to increase their margins -- future prospects in bulk-trades are grim.

Export growth and diversification

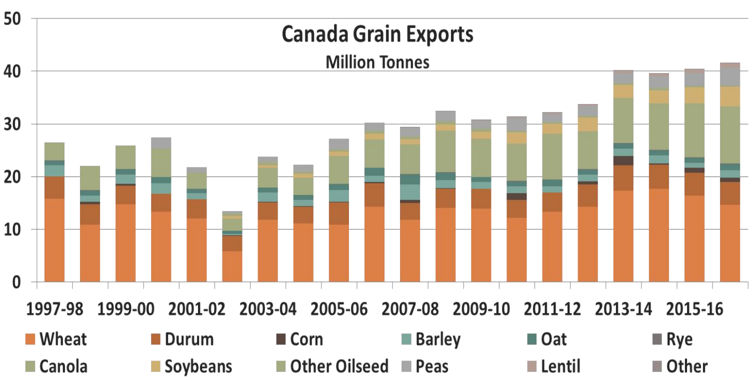
Our largest grain export is wheat, 20 MT 25 years ago and still about the same, but down from 75% to 50% of the total. Total exports increased significantly over this period, by close to 60%, with a fairly wide range of crops in the mix -- soybean, pea, lentil, barley, corn and oat. But the most significant growth was in canola, exports reaching 10 MT. Now two staple-crops in our grain export basket, wheat and canola, represent a 75% share -- next largest shares, soybean and peas, less than 10% each.

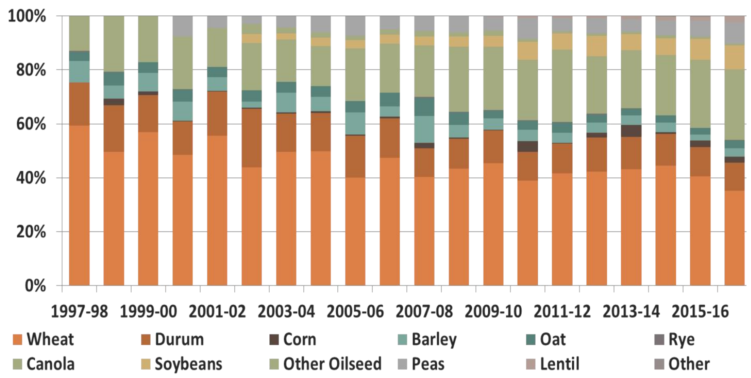
Perhaps the grain-economy is in much better shape now than 25 years ago; we are exporting 60% more and at least two crops account for 75% share instead of just one. Also, the remaining 25% is more diverse with higher value crops in the mix. Still, we cannot overlook our vulnerability in relying on just two staple-crops with such a large share, both exported through bulk-channels. Even in other crops, we rely too heavily on bulk-shipments, as much as 85% of all grain-exports through the West Coast.

We can be proud of the quality of our export-staples, but as long as we consolidate them in bulk we cannot differentiate the specialty types and grades that tend to fetch higher prices in world markets. Bulk-trades of most crops are vulnerable to increasing competition from emerging growers with a much lower cost-base than us to compensate for the lower yields they achieve. We already see China, by far the largest importer on the world scene, turning to the emerging grain-belt to its west.

We must also recognize that rapid export growth we have enjoyed was largely driven by imports from China -- more than 60% of the growth in recent years, now taking 20% of our exports, single largest destination. As China tries to become more self-sufficient, tries to limit imports to specialty grain varieties and grades, and turns to emerging-regions for most ordinary grades, our bulk-exports may be in peril, particularly in view of the fact that canola accounts for half our exports to China.

We may not own up to it, but the *bulk-trap* our grain-economy is in poses serious dangers to our export prospects. Our grain handling systems are geared to bulk-trades, while our direct-sales and containerization channels are woefully inadequate to facilitate the diversification of our export-mix to higher-value varieties or grades.





Farm consolidation and advancement

Rapid output growth the Prairies enjoyed has been due to yield increases -- driven by science-and-technology applications, more or less on the same land foot-print. Latest farm-machines equipped with positioning, guidance, spreading and sensing devices introduced increasingly AI-driven functionality, paving the way for precision-farming. Also, advances in crop-genomics improved seed-quality, coupled with applications of more effective fertilizers and pesticides, contributing to higher yields.

At the same time, the farm-economy went through massive consolidation. In the highly collectivized era farms were modest in size (typically 1,000-2,000 acres) but now mega-farms are quite common (20,000 acres or larger). Farm-size *per se* does not result in significant scale-economies, but makes technology more affordable for larger farms, where equipment can be utilized more effectively. Also, larger farms can diversify their crop-mixes more effectively by sectionalizing their lands.

Neither the farm-consolidation nor the advanced-technology adaptation we saw in recent years would have been possible without significant capital-investment on the part of farmers. In theory, the yield increases that were being achieved should have been adequate to pay for all this investment, but in practice revenues have not been commensurate with the capital outlays, be it for land-acquisitions or equipment-purchases. Farmers have been accumulating debt to stay on this advancement-path.

Contrary to common belief, we do not have sufficient data on farm-finances to pass judgement on the scale of farm-debt. Clearly, farmers still have enough equity to be able to continue to barrow from conventional sources through mortgages or leases. Lenders have not yet faced a serious default-crisis; yield increases have been steady with a long stretch of good crop years (only one poor one in 2002), but one severe draught (like the one we might be going through this year) can change all that.

At the root of the mounting *debt-load* is the margin-squeeze producers are under within the confines of today's grain industry structure -- captive to bulk-trades in the hands of grain-companies. Only if producers had the channels to diversify to higher-value crops, they could increase their margins, thereby pay down the debt they owe.

Industry structure and market-power

In the regulated era CWB had a monopoly on wheat and barley exports, and owned the terminal-assets (inland and coastal) to facilitate those exports. The farm-collection system (mainly country-elevators) was in the hands of provincial wheat-pools, collectively owned by producers. Into the reform era the primary policy goal was to liberalize the grain economy, by not only abolishing the CWB but also privatizing all the industry's assets, whether owned by CWB or the wheat-pools.

The faith in unfettered market-forces ran so strong that consequences of wholesale privatization was given hardly any thought, in the belief that no evil could come from a fully liberalized, market-driven grain-economy. However, these efforts resulted in a highly concentrated industry structure with a handful of grain companies holding considerable market-power, which they could exercise through the control they had over the bulk-system -- handling most exports, as much as 85% from the West Coast.

The faith in market-forces was not misguided when looked at from a broader global perspective. There were multiple sources of grain-production around the world, virtually across all continents, albeit with varying climatic-and-soil conditions, as well as agricultural knowhow and access to technology. But there was enough scope for intense competition in global grain markets to set prices in accordance to market demand -- grain companies operating in Canada were price-takers in world-trades.

However, the other end of the supply-chain was overlooked, giving grain-companies considerable buying-power in purchasing from producers -- what economists call an *oligopsony*. It was unrealistic to expect more than 100,000 farm-entities to get their fair share of the surplus from grain-trades when the buyers controlled the only bulk-grain handling-system. If producers had access to alternative sales and logistics channels, the outcome would indeed be different, driven mainly by market-forces.

These are the market realities that give rise to the *margin-squeeze* producers are under. The solution is not to revert back to the old system, by re-nationalizing the bulk-system, but to facilitate alternative sales and logistics channels, whereby giving producers a chance to shift to higher value crops they can export in containers.

Our mission: new trade and logistics channels

Proponents of the *status quo* stick to a *laissez faire* position to defend the prevailing system, refusing to acknowledge its shortcomings. Their premise is that producers already have the freedom to grow whatever they want; if there was demand for different types of crops that fetched higher value, they would be growing them. But if sales-and-distribution channels do not exist to reach export markets, they would be limited to feeding their own friends-and-family, at best their local communities.

The reality is that the way the grain-economy was privatized, with no regard to industry-structure, left the producers captive to bulk-systems in the control of grain-traders, squeezing producer-margins and limiting their choices to staple-crops that trade in bulk. Our mission is to push liberalization further through new channels, for Prairie producers to connect with end-buyers thereby further diversify their crop-mix in pursuit of higher margins -- a more market-driven, competitive grain-economy.

Prairies have already gone through a wave of diversification to pulses, like peas and lentils, by becoming a prime source for these high-value crops. There are further growth opportunities in pulses as well as many other crops -- new varieties and even specific grades of our staples (wheat, barley and canola). These crops are generally sold in smaller quantities to end users, requiring pre-export preparation, shipped in containers with their identity preserved (IP) without entering the bulk-streams.

With the growth in pulse-trades, new grain companies emerged specializing in this domain; the same may happen in other crop domains as well as new direct-sales channels. We will be pursuing all these opportunities but with a different business-model than traditional grain-companies that try to purchase at farm-gates. We will function as an open-platform to facilitate direct-sales between producers and buyers, while shouldering processing and containerization as a third-party service-provider.

Our core mission is to free producers from the *bulk-trap* they are in and the *margin-squeeze* that comes with it, by creating direct-sales opportunities that can leave them with higher-margins from grain-trades, thus higher-returns on investment -- thereby elevate the Prairie grain-economy at large to a more prosperous plateau.