OUT-MIGRATION OF AMERICA'S HEARTLAND
CAN MACHINERY COOPERATIVES HELP STOP THE EXODUS?
WRITTEN TESTIMONEY FOR THE UNITED STATES SENATE FINANCE COMMITTEE

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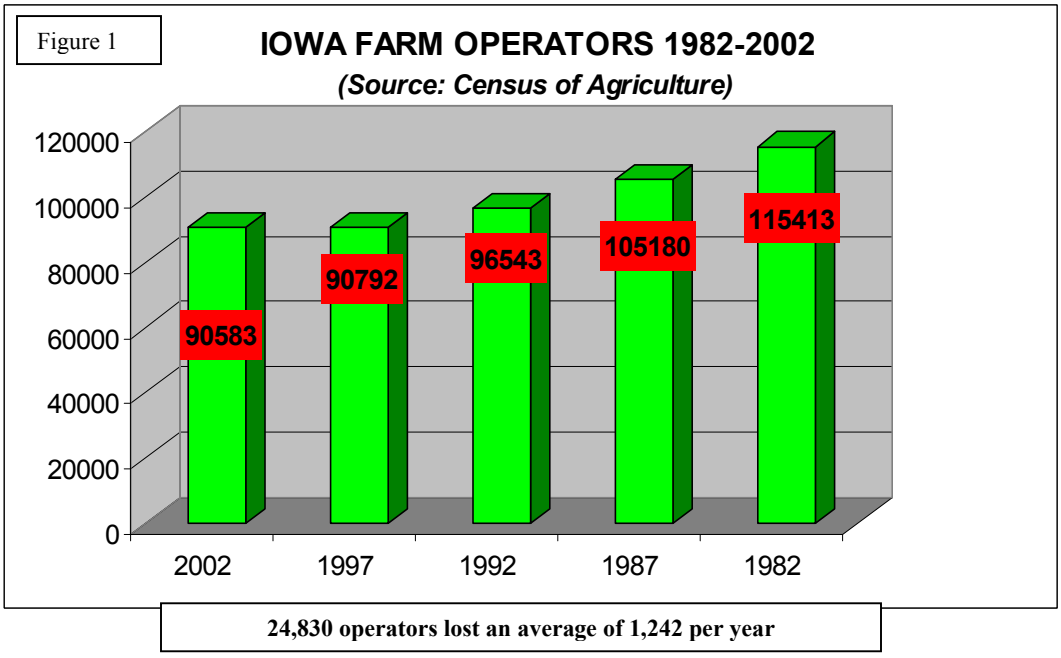
Rural regions across America have long been suffering with how to address the out-migration of our rural communities and farms, but have yet to come up with viable solutions that have stopped or even substantially slowed the exodus of young men, women and families from these rural areas.

Regions primarily dependent upon agriculture have been particularly hard hit. Since 1982 Iowa alone has witnessed a loss of 24,758 farm operators (Figure 1) an average loss of 1,238 per year. [1] Seventy-six percent of these losses have come from farmers age less than 25 to 34 years old. As of 2002 Iowa only had an average of 62 farm producers per county in this age category.

Figure 1



While there is no doubt the "Ag Crisis" of the mid 1980's took a large toll on farm producers across all age categories the loss of young producers was especially high. Since the "Ag Crisis" rural regions across rural America have not been able to recover from these losses. The ripple effect of these losses has had and will continue to have major economic implications and at some point, if not stopped could jeopardize the foundation of rural Agriculture which has always been family owned and operated farm operations.

Many questions have been raised about how to address this issue without any substantial success. The current cost of entry into production Agriculture as well as the cost of being able to stay in business will continue to force the exodus of our young farm producers. Congress has recently enacted some legislation that attempts to address some of the problems out-migration has caused. The HIRE and the New Homestead Acts do provide relief in certain areas, but do not presently specifically address production agriculture.

One concept that has had success in lowering the costs of entry and the costs of staying in production agriculture is the establishment of machinery cooperatives. Machinery cooperatives actually have their roots in France. After WW II machinery was scarce and farmers in France were forced to come up with a plan where they could share common ownership of machinery and equipment which in turn lowered their production costs and

[1] Census of Agriculture 2002-1982

helped them to become more economically viable. By the end of 2000 it was estimated that France had 13,400 machinery co-ops employing some 4,550 people. [2]

The machinery cooperative concept has since made its way to Canada which saw its first machinery co-op established in 1991. Co-ops in Canada have basically taken three forms:

1. CUMA's Coopérative d'Utilisation de Matériel Agricole—loosely translated as "co-operative for the use of farm implements," and modeled after the French co-ops these enterprises are established by their farmer owners and are structured to allow the sharing of individual machines among sub-sets of members. The sharing of individual machines is facilitated through the use of activity branches and member contracts.
2. Sharing of complete farm machinery sets[3]. These cooperative arrangements being used primarily in Saskatchewan involve common ownership of entire machinery lines and the specialization of labor contributions where member owners have the most expertise. For instance one member may be in charge of all machinery repairs. Another may be responsible for maintaining financial records. Under these arrangements production may or may not be pooled by the membership.
3. Pooled Production. This is a system where the cooperatives members assign their entire land base to the cooperative management team who makes all production decisions. Members retain ownership and control of their land, but all production is pooled to the cooperative.

Much can be learned from the experiences of Canadian producers to fashion a cooperative arrangement that would work in the U.S. According to data available from the Center for the Study of Cooperatives at the University of Saskatchewan producers participating in these cooperative arrangements are seeing machinery cost savings of up to 35%. The additional benefits of sharing labor and talents helps encourage the producers to also become more efficient in other areas of management of their farm operations.

Machinery sharing arrangements are not uncommon in the Midwest, but there are no known formal cooperative arrangements such as are seen in Canada. A recent unpublished paper from Iowa State University Economists[4] provides a summary of the Canadian cooperatives as well as examples of formal and less formal machinery sharing arrangements in the Midwest.

On August 5, 2004 Grundy National Bank, Grundy Center Iowa represented by myself facilitated a discussion regarding the feasibility of a machinery cooperative in north central Iowa. Also participating in the discussion were a group of farm producers, representatives from USDA Rural Development, Farm Service Agency, Iowa State University Extension, Iowa State University department of Economics, three implement dealers, a representative from the Iowa Agricultural Innovation Center, one state legislator and representatives from the state senate and the U.S. Senate. Grundy National Bank as do all rural community banks, has a significant vested interest in helping production agriculture find ways in which family owned operations can remain viable. The other driving forces behind this discussion are:

1. All farm production costs continue to increase, especially the cost of machinery upkeep and replacement. Many efforts are being made to try to increase revenue, but few programs are available that actually help farmers reduce their overall costs especially fixed costs of machinery and equipment.
2. The loss of farm producers in a six county region serviced by Grundy National Bank has seen substantial losses in farm producers in the past twenty years (Figure 2). In 1982 operators age less than 25 to 34 years old made up nearly twenty-one percent of total operators. As of 2002 that number has shrunk to less than eight percent (Figure 3)

[2] Harris, Andrea & Murray Fulton. *The CUMA Farm Machinery Cooperatives*, Canada: Centre for the Study of Co-operatives, University of Saskatchewan. 2000.
[3] Ford, Catherine & Dr. Robert Cropp. "*An Analysis of Machinery Cooperatives for Dairy Farms in the Upper Midwest"* University of Wisconsin Center for Cooperatives., September 2002
[4] Ginder, Roger, Georgeanne Artz and Greg Colson. "*Alternative Approaches for Sharing Machinery, Labor and Other Resources Among Small and Medium Sized Producers"*, Iowa State University, August 4, 2004

Figure 2

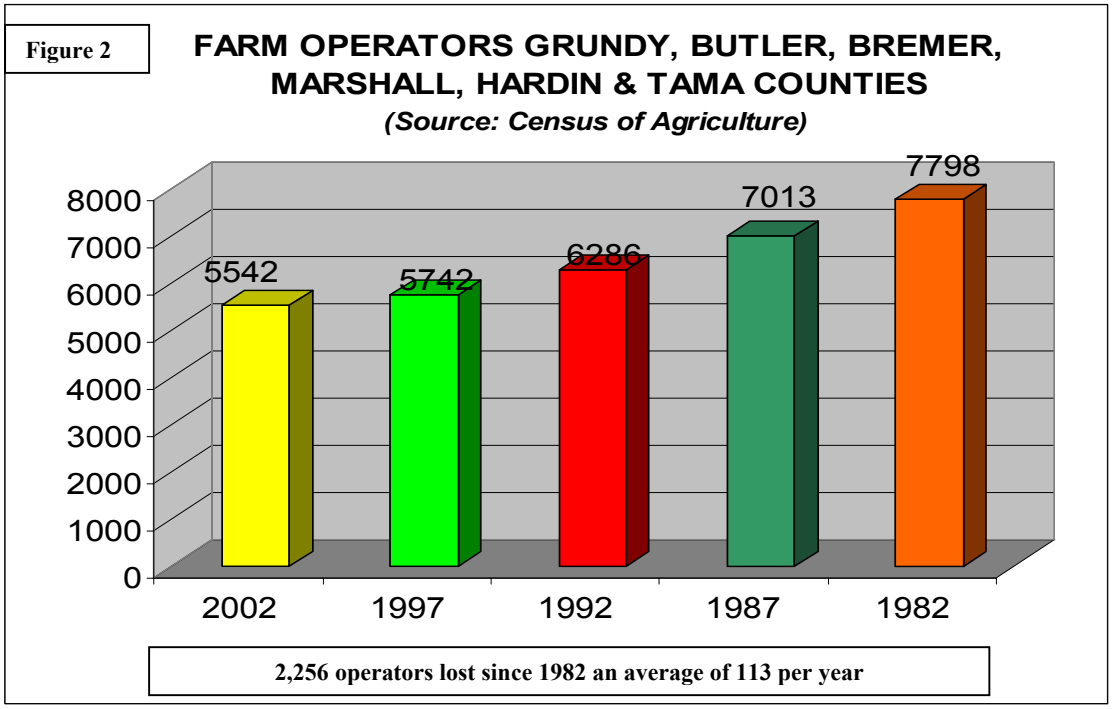
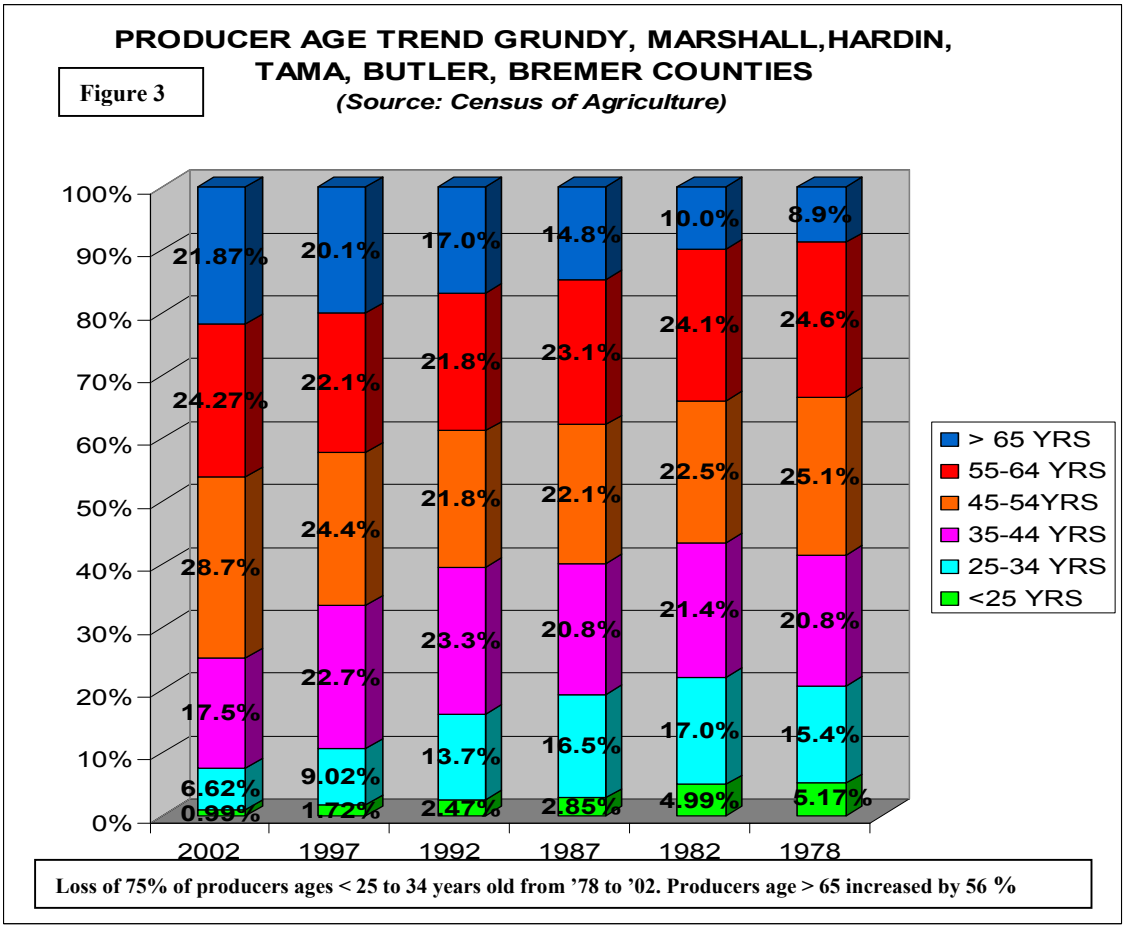


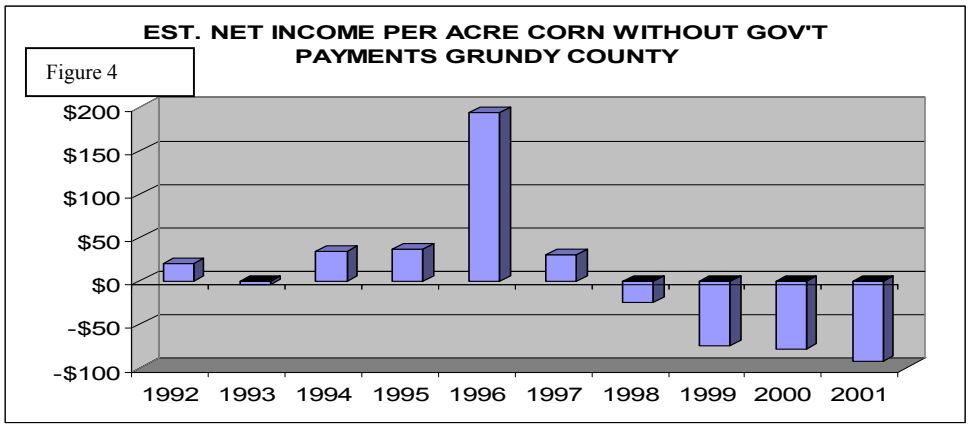
Figure 3

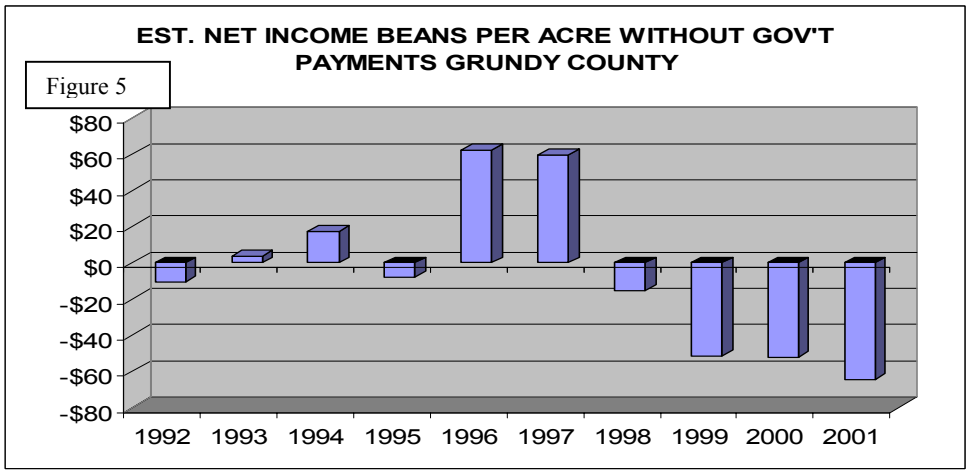


3. There are many smaller to mid-sized farm operations that cannot afford to upgrade their machinery and equipment. Consequently, they are forced to either work with older inefficient equipment, which is constantly in a state of repair, leave the industry because they do not have sufficient cash flow to replace their equipment, or as many have done, seek off farm employment in order to subsidize the costs of running their farm operation. Many of these operations cannot provide sufficient collateral or

repayment margins to be able to secure loans to replace their equipment because the cost of new and used equipment has grown beyond the scope and scale of their operation.

4. If we do not find an economical means to reduce producer costs, we will see continued increases in contract farming arrangements that are already starting to appear in the Midwest. Large grain processors need to assure steady and reliable flows of product into their plants. In some areas larger processors are initiating vertically integrated contracts with producers to provide land, labor and machinery in exchange for a flat fee per acre. We do not see these arrangements as being beneficial to our rural regions as producers move from owner/operators to no more than contract laborers for large corporations who have the benefit of participating in the value chain all the way to the consumer. Aside from these arrangements we will also continue to see large blocks of land being controlled by a handful of very large producers. While government program payments have artificially supported many farm operations (Figures 4 and 5)[5], we need to find ways in which family owned and operated farm operations remain viable in a mature industry and deal with global competition. Frankly, historical government farm programs, while providing obvious benefits have encouraged large producers to become larger. Production agriculture is not much different than many industries in that as fixed costs increase businesses must look for ways to expand their base of operations spreading their fixed costs over a larger area.





These trends will continue to accelerate the erosion of our rural community fabric which, in turn will result in the continued reduction of school districts, rural businesses and communities who are not fortunate enough to be located on the edges of recreational or metropolitan areas.

Our questions as a rural owned community bank are; in another ten to fifteen years: (1) who will be our customer, (2) who will be farming the land and how, and (3) how do we help create an environment where young men and women see a profitable future in production agriculture?

[5] *"Ag Decision Maker"* Iowa State University Extension. Analysis based on historical data available from reference source combined with annual average cash rent surveys available from same source and government payment information available from Farm Service Agency.

On a more macro-scale we must be able to solve two major dilemmas facing producers.

1. How can producers participate in the value chain without being taken advantage of?

2. How can we help producers find ways to drive down their fixed costs per acre so even smaller to mid-sized operations become more viable and competitive in a globally driven industry?

Throughout the Midwest some producer groups are seeing the benefit of cooperative arrangements through producer owned or partially owned ethanol plants and farmer owned livestock cooperatives. However, even these initiatives are extremely capital intensive and often times incur substantial start-up costs before becoming viable. Many of these ventures have failed digging deeper into the already thin pockets of many farm producers. Creating and sustaining farmer owned production and machinery cooperatives creates some unique challenges that ethanol and livestock cooperatives do not encounter.

Two of these unique challenges have to do with what appear to be major economic barriers to forming a machinery cooperative that would require changes in Federal Legislation:

1. Under current tax law if a producer were to sell his/her machinery and equipment to join a cooperative they likely could incur a significant capital gains tax from the sale of this equipment. If the equipment is depreciated out the cost would be even higher as this would all be ordinary income. Given the current tax rules that govern the sale of fixed assets the consequences of selling the machinery would out weigh any benefits to be gained by joining the cooperative. Can 1031 exchange rules be adapted to machinery sales similar to the application of land sales and purchases? We think this represents a viable answer to this barrier and would provide a significant incentive for producers to join a machinery cooperative.
2. It is presently unclear whether or not current Farm Service Agency rules would consider each member of the cooperative as retaining their individual farm units, thereby putting these producers at risk of being disqualified for any production payment programs. It is believed that as long as each producer retains control of their land and materially participates on their farm unit they would not be at risk. This issue needs to be resolved before any producers will even consider formation of a cooperative arrangement.

Granted there are additional logistical issues that would need to be worked out as well such as defining work flow processes, completion of a financial feasibility study to determine of what scale the cooperative would need to be to be the most cost and labor efficient as well as others. However, it is felt that with the right structure and support systems a machinery cooperative may present a viable option to help make farm operations of all sizes more efficient and profitable.

One fact remains clear. If we do not find ways to keep young producers and smaller to medium size family farm operations viable we will continue to see the out-migration of these families to areas where they can sustain an affordable living for their families. The ripple effect of this trend has major economic and lifestyle implications for not only rural Iowa, but rural areas across this country. Many academics, economists, farm policy experts and legislatures have talked about this problem for years, yet we have failed to come up with or initiate any tangible and doable solutions. Interest rate buy-downs and beginning farmer programs provide some levels of assistance, but they do not lower the cost of entry into the industry nor do they provide any assistance to smaller and mid-sized established operations. Key to any farm operation is a reasonable cost of and access to machinery and equipment. A machinery cooperative may provide this alternative.

A machinery cooperative is only one small piece of the puzzle. There are many and complex issues surrounding the revitalization of rural America and in particular rural regions dependent upon production agriculture. If we are truly committed as a country to preserving our rural regions, then we must be willing to commit the human, technical and financial resources necessary to make this happen. While there needs to be guidelines and parameters, these resources need to be relatively free of bureaucratic processes and mountains of red tape that will only discourage participation.

I do not see this as a challenge only to be faced by the Federal Government. This issue cuts across all governmental bodies urban and rural alike. Local and Regional collaboration among communities, counties, farm and non-farm groups that is focused on creating and sustaining viable family owned

production agriculture **and includes** the growth and development of rural based job opportunities will bring the added value needed to convince our young men, women and families there are viable and lifelong opportunities for them in rural areas.

We must also be willing to be creative and non-traditional in developing the tools necessary to accomplish this. We also need to take a hard look at existing tax codes and FSA regulations and be willing to make special exceptions for innovative and viable processes and programs that contribute to the economic growth of rural community and agricultural enterprises.

While we recognize there are some challenges to forming machinery cooperatives in the United States maybe the benefits to be gained out-weigh these challenges. At a minimum these benefits would be:

1. Lower fixed costs per acre to member producers
2. Provides more sustainability for all sizes of operations
3. Brings neighbors together for a common concern and reinforces the rural community spirit and financial viability.
4. Provides an element of long term stability for rural communities and school districts.
5. Creates opportunities for young producers to enter the industry at a much lower cost, who may not otherwise have the opportunity.

The Canadian Centre for the Study of Cooperatives identifies the following elements necessary for the success of machinery cooperatives[6]:

1. *A commitment to helping one another*. Not only by sharing machinery, but also through a willingness to plan and organize work and to make oneself available during peak periods.
2. *Communication.* The ability to discuss issues and bring forth any behavior or concerns that could cause ill-will within an environment of mutual respect and trust.
3. *Discipline.* Respect of the rules to ensure the proper functioning of the organization.
4. *Cooperative Spirit*. Helping members adjust to the cooperative method and to reinforce solidarity. Strong individualism is a potential source of conflict.
5. *Training.* Sharing experience and skills especially with respect to new technology.
6. *Social Interaction*. Helping to carry out the full potential of the cooperative, while keeping it personable and of a manageable size.
7. *Partnership*. Supporting the growth and development of CUMA's not isolating one from another, encouraging the expansion of inter-CUMA practices to avoid over capitalization.

It would seem that this is a concept whose time has come in the United States. We have only to establish the proper framework and provide the proper incentives to encourage participation by producers. The benefits may be considerable and far reaching, but it will take time, patience and a true "cooperative spirit" among all parties to earn success.

Thank you for the opportunity to discuss this issue and I would be willing to do what I can to help further examine the feasibility of machinery cooperatives in the U.S.

Respectfully,
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[6] Morneau, Camille, Guidebook to establishing CUMA's, Quebec Ministry of Agriculture, Fisheries and Food (MAPAQ), 1996 AND, Harris, Andrea & Murray Fulton. *The CUMA Farm Machinery Cooperatives*, Canada: Centre for the Study of Co-operatives, University of Saskatchewan. 2000.